Questions for the Record
For The Honorable Jacob J. Lew
House Committee on Ways and Means
Hearing held February 11, 2016

Question from Chairman Brady

Question 1:

The President's FY 2017 budget proposal included a $10 per barrel tax on oil that would be phased in over a 6-year period. The Chief Actuary at the Social Security Administration has estimated that the tax would result in a cumulative increase of 1 percent in Social Security Cost of Living Adjustments from 2017 through 2022. The cost increase would worsen Social Security's 75-year actuarial deficit by 0.03 percent of payroll and move the date of Social Security insolvency forward by one year. Was this impact on Social Security considered when developing this tax on oil? Does the administration have a plan for addressing concerns about the long-term solvency of the Social Security Trust Fund?

Answer:

The SSA Actuary was asked to look at thisprovision from the FY 2017 Budget in isolation and estimate its indirct effect on the Social Security Trust Funds. That analysis estimates that the proposed oil fee would have the indirect effect of increasing Social Security benefits by a very small percentage (0.5 percent) over the next decade, for a total of $50 billion over 10 years. However, a full analysis of all of the provisions in our FY 2017 Budget proposal would show that it has a *positive* impact on the long term fiscal health of Social Security. That is because comprehensive immigration reform, program integrity proposals, and other revenue proposals in the Budget would improve Social Security's fiscal outlook. The Social Security Actuary previously estimated that the bipartisan Senate immigration reform bill would reduce the Social Security shortfall by $300 billion over the first 10 years and would close 8 percent of the 75-year Social Security shortfall (reduce the long range actuarial deficit by 0.21 percent of payroll). In addition, the Actuary scored the provision in the FY 2017 Budget for modifying the windfall elimination provision, and the government pension offset, which is estimated to reduce the long range social security actuarial deficit by an additional 0.08 percent of payroll. Finally, it is important to note that our Budget estimates fully account for the impact of the oil fee on all parts of government finances, including Social Security. The indirect impacts of the oil fee are reflected in the revenue estimate for the fee itself, which is the scoring convention adopted by both OMB and CBO, and in our economic assumptions, which incorporate the impact of all of the Administration's policy proposals.

Questions for the Record
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Questions from Rep. Boustany

TAX

Question 1:

According to this article (see attached), the EU is going to try and force public disclosure of country-by-country information related to earnings and taxes.

What does this mean for the Action 13 Country-by-country reports that Treasury worked so hard at the OECD to have go through information exchange to protect confidentiality?

Answer:

Implementation of Action 13 is being undertaken by many countries around the world, including the United States. As is clear pursuant to our tax treaties and tax information exchange agreements, the United States will not exchange taxpayer information, including any country-by-country reports, with any country that fails to protect the confidentiality of that information. The article you reference relates to separate legislation about which, according to the article, more information will be available in April. Once that legislation is made public we will be happy to provide to you our views on how consistent it is with the agreed G20/OECD deliverables.

Question 2:

The Administration actively participated in the BEPS project. Lew and Obama, through the G20 process, fully endorsed the output. Additionally, as Bob Stack said at the (12/1) hearing, the US has "... a stake in ensuring that companies and countries face tax rules that are clear and administrable ..." and "... failure in the BEPS project will result in countries taking unilateral, inconsistent actions, thereby increasing double taxation, the cost to the US treasury of granting foreign tax credits ..."

Don't the EU actions related to public country-by-country reporting and the use of state aid to unilaterally and retroactively tax deferred foreign earning of US multinationals undermine the BEPS multilateral efforts generally, and US interests more specifically?

Has the Treasury Department raised these concerns with the OECD?

Answer:

As noted above, we will await the public release of any EU legislation before assessing its conformity with the BEPS objectives. With respect to the state aid investigations, as Secretary Lew wrote to Commissioner Juncker in his February 11, letter:

> *"The United States shares the EC's strong interest in preventing major multinational companies from shifting income from higher-tax countries to low- or no-tax jurisdictions. President Obama has proposed a robust business tax reform plan that would address this problem, and he repeatedly has urged our Congress to enact it into law as soon as possible. Moreover, the United States has played a leading role in the G-20 and the OECD Base Erosion and Profit Shifting (BEPS) project. The BEPS project has produced a broad set of measures to prevent and deter international corporate tax avoidance. Countries and companies around the world are responding by reforming their policies and behavior.*
>
> *In this context, the United States is disappointed that DG COMP appears to be pursuing enforcement actions that are inconsistent with, and likely contrary to, the BEPS project."*

We are aware of the issues you raise and share similar concerns. Our representative to the OECD, Deputy Assistant Secretary Robert Stack, has raised concerns about the State Aid investigations at the OECD.

HEALTH CARE

Question 3:

Health Reimbursement Accounts (HR 2911) - Secretary Lew, the Administration issued guidance in 2013 penalizing employers who offer financial assistance to employees for the purchase of health care coverage and related expenses through HRAs at a rate of $100 per day, per employee, and I will note that the temporary relief from these astronomical fines provided last year through the Administration's guidance was appreciated. Unfortunately, that relief has since lapsed and fines are again accruing.

A friend and small business owner from Louisiana, Randy Noelle, recently communicated his serious concern over having been instructed to pay the entirety of the fines owed to Treasury for these accounts when he files his taxes this year; this could put him and a lot of other business owners out of business!

Mr. Lew, does the IRS plan to enforce collection of the $100 per day, per employee fines currently accruing while congress continues to pursue the legislative fix through H.R. 2911, which Treasury has reviewed and provided technical assistance on?

Answer:

The health reimbursement arrangements (or "HRAs") you refer to typically involve an employer's promise to reimburse employees' medical expenses – including premiums employees pay for health coverage not provided by the employer – but only up to a stated dollar amount. The arrangements are employer-provided health plans under the Affordable Care Act (ACA) and are therefore subject to the ACA market reforms that protect employees and consumers. Those market reforms prohibit annual dollar limits on employer-provided health plans and require these plans to pay for certain preventive services without cost to employees. Because HRAs have dollar limits on the amount they pay or reimburse, they cannot, by definition, satisfy the market reforms under the statute.

ENERGY

Question 4:

Secretary Lew, during the IMF conference in October 2015, your message was clear – urging countries to "use all available policy tools" to boost global growth. Your comments suggested that the U.S. was hoping to get more countries to implement the necessary fiscal and monetary policies that could re-energize the global economy.

Yet, when we received President Obama's FY20 17 budget yesterday, I was disappointed to see that while the Administration may talk the talk, you definitely aren't walking the walk. I would argue this budget fails to strengthen America's global energy leadership. Instead your proposal creates new, unnecessary taxes for industry and energy consumers alike.

Specifically, I'd like to talk about the new "oil fee" or as many are referring to it, the $10 per barrel tax.

So if I put all the pieces together, this new fee is aimed at an already struggling industry, one that has cut over 100,000 jobs already in the last year, over 5,000 in my hometown of Lafayette, Louisiana alone. In fact, the impact has been felt throughout the country as every lost oil and gas job leads to an additional 3.43 jobs cut in other sectors. That means the 114,000 job losses in the oil and gas sector wiped out an additional 391,000 jobs in other sectors last year and sliced economic growth to about 2.1 percent from 2.6 percent.

Last year, when you came up to discuss the Presidents FY 2016 budget, you told us that you "want to make it easier for companies to grow, invest and create good, stable, well paying jobs here in the U.S." If that statement is in fact true, can you please explain the rationale behind this tax?

Answer:

The American Society of Civil Engineers has given the country's highways, roads and bridges a failing grade year after year, and it is very clear that the nation needs hundreds of billions of dollars of increased infrastructure investment. While the FAST Act, passed in 2015, is a step in the right direction, more sustained investment is needed. Over the decades ahead, the nation's population and economy will continue to grow – we need to start making investments now to meet the growing demand. This fee provides an appropriate basis for funding these investments.

This proposal is also part of a broader Budget that makes the necessary investments to grow the economy and lift middle-class incomes while providing significant tax cuts for middle-class and working families. In addition, the U.S. oil industry competes in a global market, and will do so to an even greater degree now that the crude oil export ban has been lifted. The fee will have little effect on global oil prices and therefore it will have little impact on U.S. crude oil production or employment. Moreover, the fee would be phased in over five years, so the annual increment in the fee imposed on oil companies would be quite modest, especially when compared to the magnitude of recent oil price fluctuations.

Question 5:

To quote a resolution I introduced yesterday, "believing that oil companies will pay the fee with no effect on consumer prices requires also believing that the producers won't pass their increased cost on to refiners, who won't in turn pass their costs on to the public; in other words, requires suspending belief in basic economics."

As I'm sure you already know, API came out saying that this new tax would increase the cost of a gallon of gas by approximately 25 cents. And if we use history as a barometer, we know that this tax could also have an impact on food prices along with everything that relies on transportation to get to consumers. As IER economist Robert Murphy said, "you don't make it faster, easier, and cheaper to move products by imposing a huge tax on the thing that moves them - oil."

In fact, Congressional Research Service released a report to the Senate Energy and Natural Resources Committee yesterday shortly after the President's budget was released. To quote that report:

"Since it is likely that the oil fee would be shifted forward by the oil companies, and since petroleum products enter into many products, consumers will likely see higher prices, not only directly for gasoline and other consumer products, but, in general, for many products to varying degrees."

And maybe even more impactful:

"In general, the fee would likely result in decreased discretionary consumer purchasing power which may translate into lower expected economic growth."

I think you would agree with me that history has shown that the people most hurt by higher taxes that increase the cost of energy production are lower-income and middle class Americans.

So tell me, Mr. Lew, why does the Obama Administration want to make life more difficult for the average American ... to get to work, to be able to afford groceries?

Answer:

Over the last few decades, our infrastructure investments have fallen short by hundreds of billions of dollars. As a result, our crumbling infrastructure imposes a huge cost on American families from reduced competitiveness and its impact on wages, from the lost time and fuel costs caused by traffic congestion, and from diminished prospects for workers who are unable to access job opportunities. To give one example, Americans spend 7 billion hours a year in traffic – costing our economy $160 billion per year, or $960 per commuter. The infrastructure investments financed by the oil fee, particularly those in clean transportation, will improve the efficiency of shipping and travel, delivering cost savings and a stronger economy for American businesses and households.

Moreover, this oil fee proposal is part of a broader Budget that makes the necessary investments to grow the economy and lift middle-class incomes while providing significant tax cuts for middle-class and working families. The Budget includes tax cuts for working and middle-class families that would make paychecks go further in covering the cost of child care, college, and a secure retirement; a tax credit for two-earner couples; and an expansion of the Earned Income Tax Credit for workers without dependent children. All of these investments are paid for in the context of the Administration's Budget.

Finally, the President's plan would allocate 15 percent of revenues from the new oil fee to provide targeted assistance to households with particularly burdensome energy costs. Some of this revenue would fund the creation of a Household Clean Energy Transition Program to help American households lower their energy bills while using cleaner forms of energy. A particular focus would be on supporting households in the Northeast as they transition from fuel oil for heating to cleaner forms of energy.

Question 6:

Mr. Lew, it is no secret that the oil and gas industry are critical to the state of Louisiana's economic stability. In fact, Louisiana loses about $12 million every time the price of oil drops $1. This has been felt more so in recent months as the price for a barrel of oil fell below $27 a barrel for the first time since December 2003.

As you know, unlike other energy producing countries, the U.S. oil and gas industry is made up of thousands of individual companies that compete here against each other but, now, are in a life and death fight against other countries, like Iran, Russia and Saudi Arabia, that have government-owned energy companies.

I would argue that most countries with such rich energy resources would ensure the health of this strategic asset base. But in this country, the president's budget attacks the U.S. oil and natural gas industry, threatening our nation's rank as one of the world's energy leaders, and passes this cost and insecurity onto every American energy consumer.

A strong American oil and natural gas industry secures our place as a world leader in energy production. It provides jobs and lower transportation costs.

With this in mind, could you please elaborate on why the Administration is proposing a targeted repeal of Sec. 199 for only oil and natural gas companies? Repealing this

deduction for only the oil and gas industry places hundreds of thousands of jobs at risk and undermines efforts to reduce our dependence on foreign oil.

Answer:

This Administration has been focused on building an economy in the United States that is cleaner as well as more efficient and secure. As part of that effort, the Administration proposes to repeal a number of tax preferences available for fossil fuels. One of these tax preferences is the Domestic Production Activities Deduction which effectively provides a lower rate of tax for income from certain activities, including the production of fossil fuels. The extension of this deduction to fossil fuel production distorts markets by encouraging more investment in the oil and natural gas industry than would occur under a neutral tax system. This market distortion is detrimental to our long-term energy security and is also inconsistent with the Administration's policy of supporting a clean energy economy, reducing our reliance on oil, and cutting greenhouse gas emissions. Moreover, this market distortion leads to underinvestment in other, potentially more productive, areas of the economy.

Question 7:

Drilling for oil and natural gas involves expenses such as site preparation and labor, representing 60 to 80 percent of the cost of the well. This is particularly important to highlight right now since the number of rigs drilling for oil and gas has fallen from over 1,900 in October, 2014, to 744 at the end of November, 2015, and just 619 at the end of January, 2016, according to oilfield services firm Baker Hughes; due to the fact that the price of a barrel of oil is currently around $30, less than a third of the $90-plus it was selling for 18 months ago.

Since 1913, companies have been able to expense these costs, much like the R&D deduction enjoyed by other industries. Cost recove1y is an essential part of all business models and IDC, just like R&D, serves identical policy goals: innovation, development, and growth.

Yet, the President's FY 2016 budget proposes a full repeal of expensing intangible drilling costs (IDC). Eliminating the IDC deduction would discourage innovation in the energy sector, jeopardizing additional valuable advances in oil and gas exploration, high paying jobs, and America's energy security. Again, could you please provide an explanation on why the Administration believes this is a good idea?

Answer:

This Administration has been focused on building an economy in the United States that is cleaner as well as more efficient and secure. As part of that effort, the Administration proposes to repeal a number of tax preferences available for fossil fuels. The expensing, rather than capitalization, of IDCs provides a tax preference to the oil and natural gas industry and thus distorts markets by encouraging more investment in the oil and natural gas industry than would occur under a neutral tax system. This market distortion is detrimental to our long-term energy security. It is also inconsistent with the Administration's policy of supporting a clean energy economy, reducing our reliance on oil, and cutting carbon pollution. Moreover, this market distortion leads to underinvestment in other, potentially more productive, areas of the economy.

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Questions from Rep. Dold

Question 1:

Secretary Lew, in thinking about the recent spate of corporate inversions, it is clear that in the business world, companies are always looking for the economically sound thing to do. Businesses are driven by data, and will go where the data leads them.

When you see companies move their headquarters abroad, from an economic perspective, do you understand why companies do this?

Given the flight of American companies overseas, what are the lessons you have learned? Do you believe companies are doing this for economic reasons?

Answer:

We understand that there are several motivations for companies to move their headquarters and their corporate addresses abroad. Sometimes it is to improve production efficiencies or to better exploit growing markets. Other times, the shifting of a corporate address through an inversion transaction is done to reduce taxes. This is often accompanied by stripping earnings from the U.S. corporate tax base through the use of related-party debt and finding ways to avoid the residual U.S. tax on unrepatriated foreign earnings. So, there are a variety of reasons why U.S.-based multinational firms seek to move their corporate address (and sometimes headquarters) abroad, including both tax-related and non-tax reasons.

Regardless of what motivates inversions, however, these transactions point to a basic unfairness where corporations take advantage of the many benefits of operating in the United States—including reliable rule of law, intellectual property protection, government support for basic research, an educated workforce, and publicly-provided infrastructure—and then avoid paying their fair share of taxes. Treasury has used its existing authority under the tax laws to reduce the tax benefits of—and when possible, stop—inversions. Treasury's actions significantly diminish the ability of inverted companies to escape U.S. taxation. While these actions have helped slow the pace and reduce the tax benefits of inversions, only Congress can put a stop to inversions. Congress should enact legislative solutions immediately, such as the Administration's specific Budget proposals aimed at addressing earnings stripping and inversions. A larger positive step would be to accept the Administration's international tax reform proposal that would address the underlying distortions that erode the U.S. tax base.

Question 2:

When companies invest, the message that the public receives is that the company is simply moving its headquarters overseas. But when the company headquarters moves, it isn't just that the company's executives may switch locations. Potential job losses among the

employee base may result. Are you seeing evidence of job losses among working and middle class Americans as a result of these inversions?

Answer:

As a result of the enactment of an anti-inversion statute in 2004, inversions generally can occur only in the context of a merger with a foreign firm. In many merger situations, there is evidence of job losses due to consolidation by the merger partners. This generally reflects labor efficiency gains or productivity gains associated with mergers. Inversion transactions often go beyond the economic efficiencies associated with many merger transactions, however, in that aggressive tax reduction strategies are a driving force for the transactions themselves. While we do not observe large job losses immediately following corporate inversions, we are concerned about erosion of the corporate tax base and location decisions for corporate investments in the future.

Question 3:

Secretary Lew, we have seen a number of proposals that seek to penalize and block companies from moving. However, do you see these effm1s as something that ultimately leaves American companies vulnerable to foreign acquisition? Do you see foreign acquisitions and corporate inversions as two sides of the same problem, which is America's uncompetitive tax environment for multi-national companies?

Answer:

The Administration is strongly committed to making the United States an attractive place for companies to locate and invest, by developing workforce skills, investing in world-class infrastructure, and promoting a fair and efficient tax system. That is why we developed a Framework for Business Tax Reform, released by the White House and Treasury in February 2012 [and updated in April 2016]. That is why we also continue to call on Congress to enact legislative solutions, such as those proposals in the Administration's Budget to reform the business tax system, including specific proposals aimed at addressing earnings stripping and inversions and our international tax reform proposal that would address the underlying distortions that erode the U.S. tax base. These proposals, if enacted, would reduce the incentives for foreign takeovers and inversions.

Administration Budgets since 2003 have advocated tightening earnings stripping rules, which would discourage both inversions by, and foreign acquisitions of, U.S. companies. Congress has not acted on these particular recommendations. However, in 2004 Congress enacted an anti-inversion statute which attempts to penalize or block companies from moving abroad. The anti-inversion statute slowed inversions by generally requiring a merger with a foreign firm in order to shift a firm's corporate address from the United States to another country. However, corporate inversion activity has accelerated in recent years as corporations have adapted to the statutory constraints. Recent Administration Budget proposals have advocated strengthening the anti-inversion statute to deny inversions if the shareholders of the U.S. company maintain control of the combined entity, as well as restrict deductions for excessive interest to curb "earnings stripping."

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Hearing held February 11, 2016

Questions from Rep. Kelly

Question 1:

Mr. Secretary, the Administration's proposals would push the top capital gains rate from around 20 percent to 24.2 percent, or 28 percent if you include the net investment income tax. Of course, it could be even higher if you took the nominal rate of 24.2% and layered on the ACA 3.8% tax and the 1.2% Pease limitation.

As a small business owner, I don't support this higher rate because of the negative effects it would have on investment and jobs, but I would like to explore the Administration's policy decision on this point.

It is my understanding is that the weight of economic opinion would view that rate as the revenue maximizing rate. This economic opinion informed, in part, the 28% rate in the Tax Reform Act of 1986. Anything above the top capital gains rate would in fact yield revenue losses.

My question to you, as the top economic policy official in the Administration, is where does the Administration believe the revenue maximizing rate is on the ordinary side? In other words, at what top rate does the Administration believe revenue estimates turn negative? I ask this because there is an active debate, especially among my friends on the other side, about where that top rate ought to be.

What is the Administration's view on this matter?

Answer:

The Administration's revenue proposals would indeed restore the top rate on long-term capital gains income to the 28 percent rate set in the Tax Reform Act of 1986. However, the rate was not selected to maximize tax revenue. Instead, in conjunction with other Administration proposals that would limit opportunities for taxpayers to defer taxes on capital gains for long periods or avoid them entirely, the proposal contributes to deficit reduction, makes the tax system more progressive and economically efficient, and reduces incentives for tax planning and avoidance by treating income more similarly regardless of whether it is earned by wage earners or capital owners.

Because tax revenues depend not just on tax rates but also on breadth of the base to which the tax applies, the revenue maximizing rate is dependent on other features of the tax system and the state of the economy to which it applies. As an analytical exercise, academic researchers have estimated the revenue maximizing rate likely to have prevailed in varying circumstances, and generally have concluded that the revenue maximizing rate is well above the top rate that exists today.

Questions for the Record
For The Honorable Jacob J. Lew
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Question 2:

Mr. Secretary, as you know the Treasury Department regularly assists Congress in crafting tax legislation to maximize its efficiency and effectiveness from a technical perspective. Since Treasury Department oversees the Internal Revenue Service (IRS) which implements the law, I seek your office's technical input on H.R. 3678 to better understand how the IRS will implement proposed legislation and, accordingly, its impact on taxpayers.

Last year, I introduced bipartisan legislation, H.R. 3678, the Preserving Access to Orphan Drugs Act of 2015. The bill would exclude certain drugs that are designated for diseases affecting a limited population from the pharmaceutical fee. Under current law, the IRS is charged with collecting a certain amount of fees from the pharmaceutical industry based on market share. The exclusion of taxable drugs results in a reallocation of the fees among the remaining taxable drugs.

The legislation I introduced would correct this problem. Section 2(b) of the legislation provides that a drug manufacturer's total fees for a particular year cannot exceed the amount paid under the current law without the exemptions in H.R. 3678.

The language of this hold harmless provision is below:

> **(b) *Hold Harmless for Covered Entities With No or Limited Orphan Drug Sales-Subsection* (b) of section 9008 of the Patient Protection and Affordable Care Act (26 U.S.C. 4001 note prec.; Public Law 111-148) is amended by adding at the end the following new paragraph:**
>
> > **'(5) ADJUSTMENT FOR CERTAIN COVERED ENTITIES WITH NO OR LIMITED ORPHAN DRUG SALES - lf-**
> >
> > > **'(A) the fee under this section for a calendar year with respect to a covered entity (determined without regard to this paragraph), exceeds**
> > > **'(B) the fee that would be determined under this section for such year with respect to such entity if branded prescription drug sales of all covered entities were determined without regard to clauses (ii) and (iii) of subsection (e)(3)(A),**
> >
> > **then such entity's fee under this section for such calendar year shall be determined as described in subparagraph (B).'.**

My question is, if this language was signed into law, would the hold harmless language of Section 2(b) work as intended: (1) to reduce the overall collections of the fee in that year by the amount otherwise allocable to the drugs being excluded, and (2) to ensure that manufacturers not impacted by the new exclusion would not have to pay more in fees than they would have had the legislation not been enacted?

If the answer is in the negative, then what technical changes would be required to ensure that the IRS would implement such a proposal so that companies with products that do not

meet the criteria of the new exemption would in fact be held harmless and not experience an increase in the fee owed?

Answer:

We understand that there is interest in expanding the Orphan Drug exception to the Branded Prescription Drug Fee without increasing the fee on other fee payers. As you know, Treasury staff have provided technical assistance on this issue in the past. We are open to continued discussion on this topic, particularly with respect to the efficacy and administrability of legislative proposals, including specific provisions such as the proposed hold harmless language. We look forward to working with you and your staff on this matter.

Questions for the Record
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Question from Rep. Neal

Question 1:

Mr. Secretary, I very much appreciated your testimony at the Committee's hearing two weeks ago on the Administration's FY 2017 budget. I would like to focus more specifically on your response at the hearing to a question I asked regarding Puerto Rico's economic crisis. You may recall when I asked you to provide the Committee with your ideas for fixing Puerto Rico's economy, your response concentrated heavily on debt restructuring. I agree that providing new restructuring authority for the island's debt is the most significant and immediate action the Congress could take to alleviate Puerto Rico's current economic problems.

I also believe that the tax code should be utilized to incentivize long-term economic development on the island. Tax incentives for investment in the island's economy have worked in the past. I would like to encourage you to consider such incentives as a part of any solution you propose to the crisis – not at the expense of restructuring authority, but rather as a vitally important supplement to that authority. Would you be willing to work with me and others in the Congress to explore such proposals?

Answer:

Thank you, Representative. It is urgent that Congress act, and quickly, to provide Puerto Rico with the tools it needs to address this crisis, most urgently comprehensive restructuring and fiscal oversight. However, as you know, in the long term we must find ways to help Puerto Rico return to economic growth.

Having assessed the issue closely, it is our belief that providing Puerto Rico with access to an Earned Income Tax Credit (EITC), similar to what is already available on the mainland, is one of the single most powerful tax measures we could implement to support Puerto Rico's return to growth and reward work. The President's Budget provides $600 million per year to establish a locally-administered Earned Income Tax Credit (EITC) in Puerto Rico. An EITC administered by Puerto Rico is a well-targeted tax incentive designed to lift incomes, increase Puerto Rico's low labor force participation, encourage participation in the formal economy, and improve tax compliance.

We are open to other ways of delivering tax relief if well-targeted to Puerto Rican families or to business hiring and investment. However, we are skeptical of proposals modeled on the costly and ineffective incentives that were phased out by Congress in the past. Such proposals would risk turning Puerto Rico into a corporate tax haven, providing windfalls to corporate income earned in the mainland, but without having meaningful or sustainable impact on employment in Puerto Rico. In contrast, a well-crafted EITC is by far the single most impactful tax incentive for recovery and growth for Puerto Rico.

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Question from Rep. Noem

Question 1:

Secretary Lew, during the hearing you stated the current Affordable Care Act statute does not allow the Department of the Treasury (Treasury) to exempt tribal governments from the shared responsibility provision of the law, otherwise known as the employer mandate. As Congress considers legislative action to correct this serious oversight, it is important for us to get a sense of the extent to which the employer mandate's penalties will harm tribal members. Has Treasury worked with any tribes to estimate the penalties?

If so, could you please provide estimated penalties under the employer mandate for tribes in the state of South Dakota?

Answer:

The Treasury Department has not developed estimates of the employer responsibility payments that might be owed by particular employers, including tribes and other governmental employers. We continue to consider the concerns raised by Indian tribal stakeholders and look forward to continuing to work with you and your staff on this matter.

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Questions from Rep. Rangel

In October, the Federal Reserve Board (Fed) issued proposed rules requiring the largest U.S. banks and the U.S. subsidiaries of the largest foreign banks to maintain minimum levels of what is known as Total Loss Absorbing Capacity (TLAC) which must include a mandated amount of long-term unsecured debt. The purpose of the Fed's proposed rule is to reduce the likelihood that the "too big to fail" banks will need extraordinary government support during a major financial crisis. As proposed, the Fed's TLAC rule would require a contractual clause in the debt instruments of the U.S. subsidiaries of foreign banks providing that the Fed can convert the debt into equity of the bank or cancel the debt even if the bank is not in resolution proceedings. This contractual clause is not required in the debt instruments of the covered U.S. banks and, as such, would result in disparate and inequitable treatment of taxpayers and impose massive and I can only assume unintended tax increases on covered U.S. subsidiaries of foreign banks.

The Fed's mandate that the U.S. subsidiaries of the largest foreign banks include a contractual conversion clause in their TLAC long-term debt instruments would likely cause the long-term debt to be treated as equity (not debt) for tax purposes. As you well know, by being treated as equity instead of debt, the U.S. subsidiary of the foreign bank will be denied a deduction for its interest payments and incur massive unforeseen tax increases - potentially in the hundreds of millions or even billions of dollars.

Question 1:

Mr. Secretary, are you familiar with the TLAC tax issue and has anyone from the Federal Reserve Bank reached out to you or your Treasury Department about the potentially disparate and inequitable tax treatment of U.S. subsidiaries of large foreign banks versus U.S. banks under the Fed's Proposed TLAC rules?

Answer:

Treasury tax staff has not been asked to comment on the final TLAC proposal but had an informal discussion with Federal Reserve staff when the proposal was in its formative stages.

Question 2:

Assuming that the Fed retains the contractual conversion clause mandate on the U.S. subsidiaries of foreign banks, is the Treasury Department willing to issue guidance declaring that the long-term debt instruments issued under these circumstances shall be treated as debt for tax purposes?

Answer:

The tax characterization of instruments as debt or equity is generally governed by statute (the Internal Revenue Code) and a long case law history. Neither the Treasury Department nor the

Internal Revenue Service has been approached about the feasibility of issuing guidance on the tax treatment of the instruments to which you refer.

Questions for the Record
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Question from Rep. Roskam

Question 1:

Secretary Lew, as you are aware, there has been a significant increase of Chinese takeovers of U.S. businesses over the last few years. Last year, global cross border mergers and acquisitions (M&A) reached a six year high, with Chinese firms investing $15.7 billion in the U.S. – a new record. And, already this year, this trend (Chinese companies acquiring US businesses) is accelerating to unprecedented levels and will likely continue through 2016.

Already, we've seen several deals announced early this year, including Chinese construction company Zoomlion's $3.3 proposed acquisition of Connecticut-based Terex (announced in Jan. 2016), Chinese conglomerate Dalian Wanda Group's proposal to Hollywood's Legendary Entertainment for $3.5 billion (announced in Jan. 2016), and the sale of the Chicago Stock Exchange to an investor group led by China's Chongqing Casin Enterprise Group (announced in Feb. 2016). And, ChemChina's proposed $43 billion takeover of Switzerland's Syngenta has significant implications here, given Syngenta's major presence in the U.S. seed market.

One of Treasury's important roles is to help administer and oversee the Committee on Foreign Investment in the United States (CFIUS) process – particularly determining the effect of such foreign transactions on the national security of the United States. Could you please assure the Committee that your department is closely reviewing any transactions that involve national security implications?

Answer:

While statutory confidentiality rules limit CFIUS from disclosing publicly any information filed with the Committee, including whether or not a transaction has been filed with CFIUS, I can assure you that CFIUS, and Treasury as chair of CFIUS, share your interest in protecting the national security against threats arising from foreign investments in the United States.

CFIUS has the authority necessary to fully evaluate any foreign acquisition of a U.S. business, regardless of sector, to assess its effects on national security, and CFIUS member agencies thoroughly vet all transactions notified to the Committee to identify any such effects.

When a transaction poses a national security risk that is not adequately addressed by other provisions of law, CFIUS exercises its authority to mitigate the national security risk or, if the risk cannot be mitigated, recommends to the President that he prohibit the transaction.

Questions for the Record
For The Honorable Jacob J. Lew
House Committee on Ways and Means
Hearing held February 11, 2016

Questions from Rep. Tiberi

Question 1:

Secretary Lew, I was intrigued to read the Administration's claim that the President's FY 2017 budget and revenue proposals extend the solvency of the Medicare Hospital Insurance Trust Fund by over 15 years. As you may know, the Congressional Budget Office recently projected the HI trust fund would be exhausted in just ten short years. So, where is the money coming from to extend the solvency of the HI trust fund by fifteen years?

Answer:

The Budget proposes to broaden the tax base of Medicare's financing by reforming the Net Investment Income Tax (NIIT) to close a loophole that allows some high-income partners and S corporation shareholders to avoid the 3.8 percent Medicare tax. This proposal would ensure that high-income taxpayers pay the 3.8 tax on all their income over $200,000 (single and head of household returns) or $250,000 (joint returns), either through the NIIT or through employment taxes. All revenues from the NIIT would be directed into the Hospital Insurance Trust Fund. In addition, the Budget proposes reforms to improve the efficiency of Medicare services and reduce waste, which would generate Medicare savings of $420 billion over ten years. Together, these reforms would extend the life of the HI Trust Fund for at least 15 years.

Question 2:

On the tax side there's a $272 billion proposal to "Rationalize Net Investment Income and Self Employment Contribution Act Taxes." The Net Investment Income tax was created as one of the tax hikes included as part of the President's health care law. If the administration was concerned about HI trust fund solvency, why is this revenue being dedicated to the fund only now; why not in Obamacare?

Answer:

Directing revenues from the NIIT to the HI Trust Fund will mean that the NIIT, Medicare Tax and the Additional Medicare Tax receive the same treatment, as the revenues of the Medicare Tax and Additional Medicare Tax already go into the HI Trust Fund. The Additional Medicare Tax was passed at the same time as the NIIT and applies to high-income workers earned income at the same income thresholds—over $200,000 (single and head of household returns) or $250,000 (joint returns). Accordingly, it makes sense for these revenues to be used to support the Medicare Trust Fund.

Question 3:

In the past, this Administration supported modernizing the Medicare benefit and combining Parts A and B to extend trust fund solvency. Secretary Lew, which of these options do you think would best encourage economic growth and help put Medicare on a

sustainable path: a tax on investment income or a structural change within the Medicare program itself?

Answer:

The Administration's FY 2017 Budget includes a robust set of reforms that aim to improve the efficiency and quality of the care that Medicare provides, bolster the program's long-run sustainability, and drive reform of our health care delivery system as a whole. These proposals build on policies enacted in the Affordable Care Act (ACA), which have made substantial progress toward better aligning Medicare payments with the cost of services and moved Medicare toward payment systems that reward efficient, high-quality care, rather than a high volume of care. Thanks in part to the ACA reforms, Medicare spending per beneficiary has actually fallen in inflation-adjusted terms since 2010 and the program has seen improvements in the quality of care, such as lower hospital readmission rates.

The FY 2017 Budget includes a package of Medicare legislative proposals that will save a net $420 billion over 10 years by supporting delivery system reform to promote high-quality, efficient care, improving beneficiary access to care, addressing the rising cost of pharmaceuticals, more closely aligning payments with costs of care, and making structural changes that will reduce federal subsidies to high-income beneficiaries and create incentives for beneficiaries to seek high-value services.