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Honorable Charles Boustany
Chairman
House Ways and Means Committee, Subcommittee on Tax Policy
1431 Longworth House Office Building
Washington, DC 20515

Honorable Richard Neal
Ranking Member
House Ways and Means Committee, Subcommittee on Tax Policy
341 Cannon House Office Building
Washington, DC 20515

Dear Chairman Boustany and Ranking Member Neal:

On behalf of AdvaMed and its member companies, we thank you for the opportunity to provide comments on our membership's perspectives on the need for tax reform. We appreciate the Subcommittee's interest in this topic and its recent hearing on the issue. We agree that tax reform is vital to stimulating economic growth in the United States, supporting business expansion and job creation, and will reduce the significant financial and regulatory burdens imposed by the current system. In particular, we believe that a repeal of the medical device tax and key policy changes to support pre-revenue companies would provide a significant boost to the medical technology sector and other knowledge-based industries that are vital to sustaining the American economy.

As you know, AdvaMed is the world's largest trade association representing the makers of medical technology—medical devices and diagnostics. Our members range from the largest to the smallest companies in the industry, with 70 percent having annual revenues of less than $100 million. Collectively, our members account for 90 percent of medical technology sales in the U.S. and 40 percent of worldwide sales.

Medtech is one of the few American manufacturing industries that consistently maintain a positive balance of trade. Although the medical technology industry is global in scope, it has been a dynamic source of U.S. job creation, with employment expanding at a time when U.S. manufacturing employment generally was declining sharply. The jobs the industry creates are good jobs, with wages that are almost 40 percent higher than the average pay for the economy as a whole and 22 percent higher even than average manufacturing wages.

Medical technology is an industry in which America leads the world. That leadership, however, is challenged as never before, and tax reform is an essential ingredient in ensuring that our industry continues to be a source of good jobs, economic growth and new treatments, diagnostics and cures in this century of the life sciences. Competitor nations have made developing jobs in our industry and other high, value-added knowledge-based industries like ours a priority, both in terms of tax benefits and in terms of other targeted public investments designed to place a priority on locally sourced products and to incentivize in-country development of medical technology research and manufacturing. With rapidly aging populations in the U.S. and world-wide, the growth of large markets of middle class people demanding high quality medical care in countries like China, India and Brazil, and the potential for innovative new treatments and cures in this century of the life sciences, the future of our industry is bright. But it is an open question whether this future will be made in America or somewhere else.

There are a number of danger signs suggesting that America's leadership is declining. The new normal is for companies to conduct first clinical trials and first product introduction outside the United States. This involves a significant transfer of expertise abroad and reduces the attractiveness of locating manufacturing and R&D in the United States. Other countries are eager to share in the high wages and high value added generated by medical technology and are making significant investments in developing home grown industries and encouraging multinationals to locate manufacturing and research locally. Venture capital flowing to U.S. medical device start-ups has declined sharply—a mark of low investor confidence in the future of the U.S. industry and an indication that the pipeline for new products to fuel industry growth will be less robust in the future. A study in 2011 by Pricewaterhouse Coopers showed U.S. leadership on each of five pillars of medical device innovation is eroding.[1]

While the principles below were designed by AdvaMed based on the needs of the medical technology industry, we believe they are broadly applicable to all knowledge-based manufacturing industries—a key part of the high value added tradable sector, which is essential to America's future as a prosperous country where wages are high and prosperity is broadly shared.[2]

To create a level playing field with competitor nations and retain American leadership in medical technology, AdvaMed recommends:

- **Repealing the medical device excise tax.**
- **Lowering the overall corporate tax rate to levels comparable to or lower than other competitor nations.**

- **Establishing an "innovation box" to lower tax rates on profits earned from R&D and manufacturing based on that R&D, as well as providing general tax incentives for manufacturing.**
- **Providing research and development incentives comparable to or better than competitor nations.**
- **Enacting tax incentives to encourage investment in start-up companies that have no profits.**
- **Conforming the treatment of international earnings to that of competitor nations by adopting a territorial tax system.**

The medical device tax remains the number one threat to the long-term prospects for the industry. Imposing an excise tax on the industry is simply bad tax policy, and there is significant bipartisan support for a permanent repeal of this burdensome tax. Any conversation on tax reform for this industry has to start with leveling the playing field and eliminating this burdensome tax.

The medical device tax uniquely impacts the economic competitiveness of our industry, but it is important to note that the positive impact of medical technology on economic growth and competitiveness goes well beyond the jobs and economic activity associated with industry R&D and manufacturing. A recent study by the Milken Institute examined four diseases and a limited number of technologies used to treat those diseases. It found significant increases in labor force participation and productivity directly attributable to the technologies' contribution to reducing the burden of illness. These increases in labor force participation and productivity, in turn, had expanded 2010 GDP by $106 billion.[3] Between 1980 and 2010, medical advancements helped add five years to U.S. life expectancy.[4] However, more than half of AdvaMed's member companies reduced R&D as the result of the medical device tax, and a similar proportion said that if the tax had continued they would be forced to make further or first-time reductions in R&D, with obvious implications for long-term competitiveness.[5]

With strong bipartisan support, Congress approved a two-year suspension of the device tax. Thanks to that suspension, medical technology companies are working to improve investment in R&D, restore employee benefits, and re-start delayed projects. It is crucial that Congress build upon the significant step on behalf of patients, researchers, employees and many others. As part of any large-scale tax reform effort, we urge Congress to take the next step of full repeal to protect American innovation.

America's corporate tax structure is not the only source of America's declining competitiveness in medical technology, but it is a key contributing factor. Today, America's tax structure is uncompetitive, and it is especially so for medical technology. Medical technology companies, whether domiciled in the U.S. or abroad, pay an average effective tax rate of 31 percent for activities located and taxed in the U.S. and only 14 percent for activities located and taxed abroad.[6] The medical device excise tax adds a heavy additional burden, raising total federal taxes paid by the industry by 29 percent.[7] This increase of almost one-third raises the tax burden on the medical technology industry to a level that is surely one of the highest experienced by any American manufacturing sector. The high tax burden on U.S.-based activities also has a significant negative effect on industry decisions about where to locate existing and new manufacturing and R&D.

While repealing the medical device tax remains our top priority, AdvaMed also is focused on improving the tax environment for our early-stage, pre-revenue companies. These companies are at the cutting edge of new medical technology inventions and represent the "seed corn" of our industry's future. Enacting specific incentives into the tax code to support these firms is vital to leveling the playing field with other developed economies and encouraging companies to establish and grow in the United States. A more detailed white paper, providing an analysis of several international tax regimes comparable to the U.S. and laying out specific policy options for supporting new innovator companies through the tax code, is attached as an appendix to this letter. In total, our specific recommendations will help ensure that the tax code supports, rather than diminishes, American competitiveness in medical technology.

Once again, AdvaMed thanks the Subcommittee for its commitment to tax reform and for its willingness to consider our comments. For our industry, tax reform is an essential ingredient for our long-term competitiveness. We look forward to working with you as your discussions move forward. Please do not hesitate to contact us if we can provide additional information.

Sincerely,

Scott Whitaker

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[1] PwC, "Medical Technology Innovation Scorecard: The Race for Global Leadership," January, 2011.

[2] Michael Spence and Sandrik Hlatshwayo, "the Evolving Structure of the American Economy and the Employment Challenge," Council on Foreign Relations, March, 20l1. For the special importance of manufacturing in driving economic growth, see *The Competitiveness and Innovative Capacity of the United States,* prepared by the U.S. Department of Commerce in consultation with the National Economic Council, January, 2012.

[3] Anusuya Chatterjee, Jaque King, Sindhu Kubendran, and Ross DeVol, *Health Savings: Medical Technology and the Burden of Disease,* July 2014.

[4] National Center for Health Statistics. "Health, United States, 2012: With Special Feature on Emergency Care."

Hyattsville, MD. 2013.
[5] "Impact of the Medical Device Tax."
[6] Survey of AdvaMed member companies.
[7] Ernst and Young, "Effect of the Medical Device Tax on the Federal Tax Liability of the Medical Device Industry," November 2012.

American Innovation at a Crossroads:

Tax Policy to Encourage Knowledge-Based Industries in a Global Economy

DLA Piper

May 2016

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Executive Summary

The presumption of this paper is that America's economic future depends in large measure on its ability to compete in knowledge-based, high value added, innovative industries. These are the industries where the U.S. has a comparative advantage, and only by maintaining that advantage can we hope to prosper and retain high living standards in a global economy.

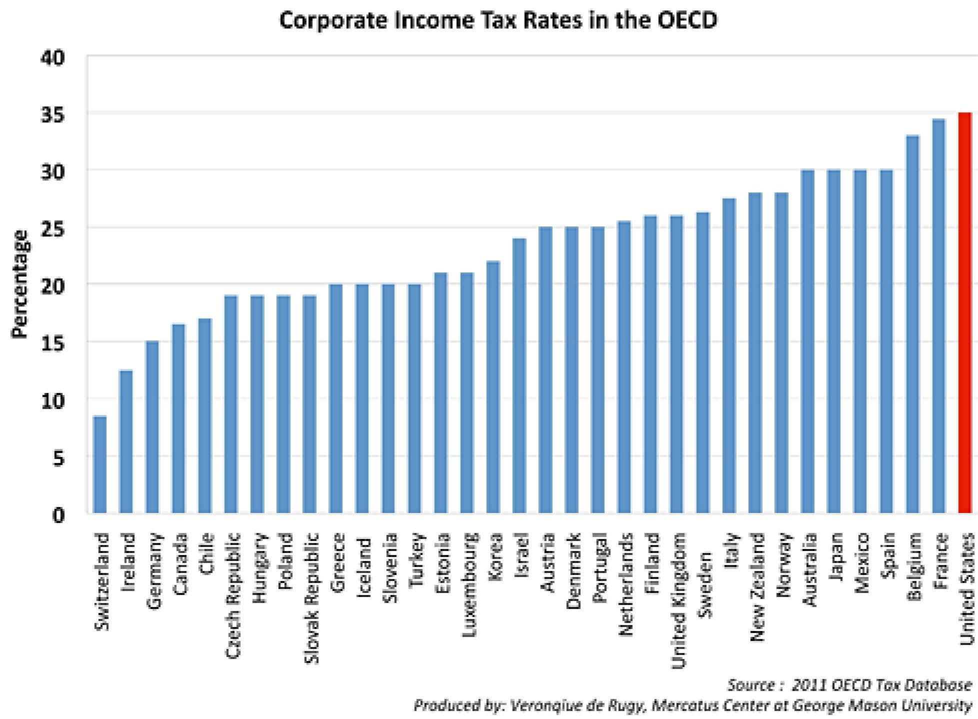
While America has immense historical capital in these industries, our historic advantages are eroding as other countries seek to develop their research and educational infrastructure, lure companies currently centered in the U.S. to locate much of their economic activity abroad, and provide incentives for home-grown companies to develop. Tax policy is a key incentive that can affect both location decisions and the likelihood of start-up companies flourishing.

However, the U.S. tax code, once considered a pace setter in encouraging innovative industries, is now considered obsolete and a significant drag on the U.S.'s ability to compete. The U.S. remains one of the few nations that continues to tax its companies on their worldwide incomes, and the U.S. corporate tax rate, 35%, once one of the lowest among industrialized nations, is now the highest of any nation in the OECD. The U.S. was the first country to establish a tax credit for research and development, but now has one of the least generous in the world. Numerous other countries have established special tax preferences or non-tax incentives to lure knowledge-based high value industries or help grow them domestically, while the U.S. has failed to institute comparable policies. Private capital has also followed the path of least resistance; recent data published by Thomson Reuters shows that the percent of global venture capital dollars invested in the U.S. has fallen to a near low of 54 percent in 2015, down from a high of 86 percent in 1997.

This paper discusses the major tax and non-tax incentives in foreign systems to attract and promote innovation and the need and possible means by which the United States can regain its role as the world's undisputed leader in the development and commercialization of new technologies. It is based on a presumption that the U.S.'s continued ability to nurture and compete for knowledge-based, high value industries is crucial to our economic future and that tax policy can make an important contribution to competitiveness.

The need for action by U.S. policymakers is urgent. While the U.S. Congress has debated tax reform for over a decade with no result, the European Union and the OECD through various means, including dramatic reductions in rates, the ongoing Base Erosion and Profit Shifting (BEPS) initiative, and an increased commitment to support innovative enterprises, have opened their doors to innovators.

The first factor is the very high U.S. corporate base tax rate compared to competitor nations.



The second tax factor that impacts U.S. competiveness interacts with the first. The U.S. has a world-wide tax system that defers taxation until profits are brought back to the U.S. No other major economy has such a regime in place, and the combination of the U.S. treatment of foreign earnings and the high U.S. tax rate is a strong incentive for companies to shift economic activity abroad and a strong disincentive for companies to invest foreign earnings in the U.S.

While the high overall rate is a significant anti-competitive factor, reform of the base rate alone is not likely to bridge the competition gap. Even the most ambitious corporate tax reform proposals recently introduced in Congress would lower the tax rate only to about 25 percent, and this lowering would be coupled with elimination of tax preferences that may have a countervailing effect on effective tax rates. The medical technology industry, which may be typical of other knowledge-based, research-intensive manufacturing industries pays an average effective tax rate of 31 percent for activities located and taxed in the U.S. and 14 percent for activities located and taxed abroad (the U.S. figure does not include the impact of the medical device excise tax which has been suspended for the years 2016 and 2017). [1]

A number of other countries have established special tax and non-tax incentives to attract and nurture innovative, knowledge-based industries, including advanced manufacturing industries. Knowledge-based manufacturing industries are special targets, as these industries create large numbers of well-paying jobs for both blue-collar and white collar workers. Adopting some version of these

[1] AdvaMed Member survey.

incentives in the U.S. could help make U.S. industries significantly more competitive and help compensate for what will likely be a substantially higher base corporate rate in the U.S., even under a reformed tax system. This paper reviews these incentives, with a special focus on patent or innovation boxes, and discusses how they might be adapted for the U.S.

Finally, except for potentially making the climate for innovative industries generally more favorable, most tax systems both in the U.S. and overseas do not address the needs of pre-revenue start-up companies, which are often the drivers of innovation, and, as they grow, a major source of job creation. Other countries use non-tax mechanisms, discussed in the following pages, to support these companies. Some are potentially adaptable to the U.S., but given the U.S. aversion to policies that pick "winner and losers," a more general tax approach may be more appropriate for the U.S. The paper concludes with a discussion of some tax incentives that could support innovative start-up companies in the critical pre-revenue phase.

I. Disproportionately high U.S. corporate tax rates and the worldwide tax system put U.S. companies at a competitive disadvantage and drive jobs and economic activity away from the U.S.

The U.S. has one of the highest corporate income tax rates in the world at 35% and after state taxes are layered in, the tax rate could exceed 40%.[2] Not only does this provide companies ample business justification to locate profits in low-tax jurisdictions, it hurts U.S. competitiveness either through the higher prices companies must charge to recoup investments or the inability of companies to reinvest sufficient after-tax funds to grow their businesses.

The high corporate tax rate creates a competitive imbalance between U.S. companies and their foreign counterparts, which U.S. companies have responded to, in part, by locating activities abroad. Given the growing global nature of international commerce, customers and businesses have wide flexibility in choosing between competing companies and products, and are less tied to geographical constraints of yesteryear. In addition, with the expansion of the availability of information, customers and businesses are the most educated than they have ever been. This current business landscape puts a premium on pricing and innovation, both of which are hindered by a tax rate that can be almost three times as high as other developed nations.

The U.S.'s worldwide system has a particularly insidious effect in the context of disproportionately high U.S. base tax rates. Under the U.S. corporate income tax system, profits earned by a foreign subsidiary are not subject to current U.S. taxation. Instead, these profits are only subject to

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[2] Some commentators have argued that the imbalance between U.S. and foreign tax systems is much less when the comparison is between effective tax rates, rather than statutory rates. The data cited above on the experience of medical technology companies shows a wide discrepancy between effective tax rates as well. A comparison of the effective tax rate on a hypothetical domestic manufacturing company based in the U.S. compared to a comparable company based abroad showed the U.S. to have the highest rate of nineteen companies examined, except for Japan, which subsequently significantly lowered its corporate tax rate (Grant Thornton, "International Taxation of Manufacturing: a Comparative Review.")

U.S. tax when repatriated back to the U.S. Because money repatriated back to the U.S. would be subject to the 35 per cent U.S. corporate income tax rate, companies generally prefer to keep those profits offshore to invest in foreign acquisitions, to increase activities outside the U.S., or simply to hold on their books According to reports, the cash holdings of U.S. multinationals nearly doubled between 2008 and 2013 to more than $2.1 trillion dollars. Thus, the U.S. has the worst of both worlds. The high U.S. tax rate creates an incentive for companies to locate activities abroad, where taxes are lower, and when the foreign investments reap profits, the company faces a strong disincentive against investing those profits in research and development or job creation back home. [3]

II. Special Tax Incentives For Knowledge-Based Industries

A. Overview

Knowledge-based industries are typically high value added and high wage. Advanced manufacturing, in particular, is an especially powerful engine of job creation, as it generates both white collar and blue collar jobs. For this reason, many countries regard attracting foreign companies in these sectors and encouraging home grown companies as national priorities. They employ a variety of tax and non-tax incentives to achieve this objective.

Tax incentives include Innovation boxes (also referred to as patent boxes or IP boxes), which segregate profits resulting from the creation or utilization of intellectual property and apply a tax rate to these profits that is significantly below the general tax rate. This approach may be especially well-suited to the U.S.

A number of countries also utilize other tax incentives in addition to, or instead of, an innovation box to support knowledge-based industries. These include targeted tax credits, preferential tax rates, targeted accelerated depreciation/amortization, tax deductions, including “super” deductions, tax exemptions, tax withholding incentives, and VAT incentives.

Some commentators have advocated against an IP Box or other targeted incentives by arguing that they put the government in the position of picking commercial winners and losers, an exercise they believe is neither appropriate nor effective. An IP Box regime, for example, can certainly incentivize innovations through preferential tax treatment. By definition, an IP box will have its most important impact on knowledge-based industries. But this is a broad category, and encouraging such industries is certainly quite different than trying to pick a particular company or even a very specific sector such as green energy. As a group, knowledge-based industries are high wage, high value added, and the industries in which the U.S. is struggling to retain its current comparative advantage. They are sectors

[3] The American Job Creation Act of 2004 allowed a one-time repatriation of earnings held abroad to the U.S. at a very low tax rate. This legislation was unsuccessful in stimulating productive investment, demonstrating that a one-time windfall has very different effects than a permanent change in incentives in altering corporate behavior.

where the problem is not simply incentivizing activity but competing with incentives offered by other countries in today's global market.

Another consideration in protecting the competitiveness of U.S. companies is the possible implementation of initiatives across Europe that attempt to limit tax benefits without appropriate local country substance or presence. These initiatives spearheaded by the Organization for Economic Co-operation and Development (OECD), and termed the Base Erosion and Profit Shifting (BEPS) initiatives, could increase pressure on U.S. companies to move employment and investment abroad in the absence of a domestic IP Box regime.

B. Designing An Innovation Box

The OECD has defined a "patent box" or "Intellectual Property ("IP") Box" [4] as a preferential tax regime offered by a country to support growth and innovation.[5] Such tax incentives may include a combination of lower income tax rates and beneficial expensing / credit regimes to encourage companies to locate their intellectual property and related development activities in the local country.[6]

While the vast majority of IP Box regimes are in the European Union (EU), the impact to global business is not restricted to that region. These regimes can provide non-EU companies with tangible benefits of locating IP and production within the region. U.S. multinationals typically leverage complex tax planning techniques to increase competitiveness with their foreign counterparts. The common theme with each of these techniques is to ameliorate the high U.S. corporate income tax rate. The common effect is a sustained migration of economic activity and potential economic growth outside U.S. borders. This migration compounds the anti-competitive environment in the U.S. as Congressional efforts are focused on *preventing* migration instead of promoting *retention*.

As IP is a movable asset that does not generally require a fixed place for exploitation, an IP Box regime has the ability to significantly influence a company's decision on where to locate such IP and those economic activities related to such IP (e.g., development and manufacturing). IP Box regimes have developed historically in the EU, and by the end of 2014, 12 European countries operated an IP box regime.

All IP Box regimes attempt to provide tax benefits to companies locating their IP within such jurisdiction. At its most basic level, all IP Box regimes provide preferential tax rates for income generated from qualifying IP. These rates vary from 0% in Malta to 15.5% in France. However, each IP Box regime contains distinct features affecting the mechanics of the regime, and consequently, its attractiveness. These distinct features include the type of income and IP qualifying under the regime. In addition, advantageous expensing methodologies can increase benefits provided by a particular regime. Each of these items is discussed below.

[4] An IP Box generally refers to a special tax regimes that provides tax incentives for profits derived from IP, including patents. For purposes of this paper, the umbrella of related tax regimes will be referred to as an "IP Box".
[5] http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm
[6] *Id.*

1. Income Qualification

IP Box regimes take different approaches with respect to the type of income that qualifies for preferential treatment. Multinationals earn various types of income from their valuable IP – royalty income from licensing the intellectual property, capital gain income from the sale of such property, or income from product sales incorporating the IP, to name a few. Thus, as a first step, the IP Box must differentiate between IP income streams to determine the type of income qualifying for benefits. Table 1 depicts the state of income qualification for EU jurisdictions as of the end of 2014.[7] Not surprisingly, all IP Box regimes allow royalty income to qualify for beneficial treatment. Most regimes allow for capital gains from the sale of qualifying IP to benefit for lower tax rates, while roughly half the regimes allow product sale income allocable to imbedded IP to qualify for preferential tax treatment.

Table 1	**Jurisdiction**											
Type of Income	Belgium	Cyprus	France	Hungary	Liechtenstein	Luxembourg	Malta	Netherlands	Portugal	Spain	Nidwalden, Switzerland	UK
Royalties	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Capital Gains	NO	YES	YES	YES	YES	YES	NO	YES	YES	YES	YES	YES
Embedded IP	YES	NO	NO	NO	YES	YES	NO	YES	NO	NO	NO	YES

Note that the qualification / disqualification of a certain type of income can significantly alter the attractiveness of a country's regime to a particular company or industry, and is especially necessary for efficient tax planning. For example, a manufacturing company that sells tangible products and allocates a significant portion of profits to such embedded IP would not find the French IP Box regime particularly attractive given such income does not qualify for preferential tax treatment. Instead, the company may find the Netherlands more attractive. Alternatively, an early-stage medical technology company that develops and sells its valuable IP upon maturation would likely avoid those countries that do not extend preferential tax treatment to capital gains.

Since the goal of a U.S. innovation box program would be to stimulate the maximum amount of economic activity and employment within the U.S., inclusion of embedded IP is crucial. Without such a definition of IP income, there would be no benefit for locating manufacturing based on IP within the U.S., even though manufacturing based on R&D rather than R&D alone will create the greatest value in terms of numbers of good jobs and volume of economic activity. Moreover, location of R&D is likely to be less impacted by tax factors then location of manufacturing.

2. Eligible Intellectual Property

A large differentiator across IP box regimes is the IP that qualifies for preferential tax treatment. The bundle of IP rights that may be exploited by a company vary across industries, and can include patents, trademarks, copyrights, formulae, inventions, know-how, trade secrets, software, design rights, contractual rights, licenses, systems, methods, customer lists, and technical data. This exhaustive list

[7] Information from the table obtained, in part, from "Intellectual Property Box Regimes: Effective Tax Rates and Tax Policy Considerations" Evers, Miller, Spengel (2014).

can provide a country flexibility to implement a program that promotes its policy goals, while allowing it sufficient opportunity to separate itself from other regimes. As described in Table 2 below, all of the IP Box regimes include patents as qualifying IP.[8] Other traditional IP, including software, copyrights and trademarks qualify in most of the jurisdictions.[9]

Table 2	**Jurisdiction**											
Type of IP	Belgium	Cyprus	France	Hungary	Liechtenstein	Luxembourg	Malta	Netherlands	Portugal	Spain	Nidwalden, Switzerland	UK
Patents	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
SPCs	YES	NO	YES	NO	YES	YES	NO	NO	NO	NO	NO	YES
Software	NO	YES	NO	YES	YES	YES	YES	YES	NO	NO	YES	NO
Copyrights	NO	YES	NO	YES	YES	NO	YES	NO	NO	NO	YES	NO
Trademarks	NO	YES	NO	YES	YES	YES	YES	NO	NO	NO	YES	NO
Designs / Models	NO	YES	NO	YES	YES	YES	NO	YES	YES	YES	YES	NO
Formulae and Processess	NO	YES	NO	YES	NO	NO	NO	NO	NO	YES	YES	NO
Know-How	NO	YES	NO	YES	NO	NO	NO	NO	NO	NO	YES	NO

3. Acquired Intellectual Property

Another important aspect to these IP regimes is whether acquired IP can qualify for preferential tax treatment, and if so, under what parameters. More specifically, whether IP existing at the time of application for the IP Box qualify and whether subsequently acquired IP qualifies. Please see Table 3 for a depiction of these considerations across EU patent boxes.[10]

Table 3	**Jurisdiction**											
Type of IP	Belgium	Cyprus	France	Hungary	Liechtenstein	Luxembourg	Malta	Netherlands	Portugal	Spain	Nidwalden, Switzerland	UK
Existing IP	NO	YES	YES	YES	NO	YES*	NO	NO	NO	YES	YES	YES
Acquired IP	NO	YES	YES	YES	YES	YES*	YES	NO	NO	NO	YES	YES*

* under certain circumstances

A medical technology company that acquires and then develops IP from an early stage start-up may require an IP Box regime that allows acquired IP to qualify. Only a handful of IP Box regimes do in fact allow acquired IP to qualify. Where such IP qualifies, it may on the condition that the acquired IP does not, itself, qualify, but that any profits associated with related IP further developed from such acquired IP does. In practice, this can be difficult to administer, as a company would be required to allocate income to the different types of IP within a specific bundle (i.e., acquired software v. further developed software). This complication could be avoided if profits from manufacturing derived from acquired IP could qualify for either a full or reduced tax incentive regardless of the degree to which the IP is further developed. This would serve the goal of encouraging location of knowledge-based manufacturing industries in the U.S., even if not all the knowledge behind the product is developed domestically.

[8] Id.
[9] Subject to new rules that are promulgated by Action 5 of the BEPS initiatives.
[10] Information from the table obtained, in part, from "Intellectual Property Box Regimes: Effective Tax Rates and Tax Policy Considerations" Evers, Miller, Spengel (2014).

In summary, an IP box can be an important competitive tool for attracting and encouraging knowledge-based industries. It would be especially valuable to the U.S. in helping the U.S. to compete for these industries, both with countries that offer such an incentive and with countries that do not, but have a substantially lower base corporate rate or provide other tax or non-tax incentives for this type of industry. Key design features include the type of income from IP eligible for favorable tax treatment, the definition of IP for the purpose of the tax preference, and whether acquired IP is eligible for favorable tax treatment. Providing a reward for embedded IP is critical to incentivizing knowledge-based manufacturing industries.

Appendix A further illustrates the impact of different decisions on the shape of an IP box.

C. Other Targeted Tax Incentives

An IP Box regime is not the only mechanism a jurisdiction may use to encourage innovation through domestic tax policy. Countries throughout the world use a variety of tax levers to establish beneficial rates for locating IP and IP based industries within their borders.
The following tax incentives are benefits provided by various countries:

- Tax credits
- Preferential tax rates
- Accelerated depreciation / amortization
- Tax deductions, including "super" deductions
- Tax exemptions and holidays
- Income tax withholding incentives
- VAT incentives

The application of these disparate mechanisms varies widely by jurisdiction, but all are focused on attracting investment, spurring domestic production and increasing competitiveness of their local businesses. For purposes of comparison to IP Box regimes, detailed below are three non-EU jurisdictions that leverage these tax incentives, as well as some non-tax benefits, to drive development of knowledge-based industries.

1. Brazil

- Super research and development deduction
- Accelerated depreciation
- Financial support

Brazil has a history of supporting research and development activities through tax policy, with many of its statutory tax benefits having been in place since 2006.

One such mechanism is the availability of a "super" deduction equal to 160-200% of qualifying research expenses. In addition, if a company has additional research expenses when compared to the previous year, the company can apply for an additional "super" deduction of 160-180%. This policy encourages companies to not only invest in local research activities, but also ensure their research expenses increase year-over-year. This policy can certainly help drive innovation, especially for small or immature companies looking to grow rapidly.

In addition, Brazil allows accelerated depreciation for assets used in current research investment. This accelerated depreciation can ensure a 100% deduction of research assets in the year of their acquisition. This immediate deduction can be a powerful driver of domestic production as companies consider the most efficient use of their funds. Companies would materially benefit from the bottom line tax benefit and could allocate these additional resources back into their business.

Finally, the Brazilian government offers financial support with reduced interest rates for up to 90% of a project's cost. This program requires a pre-approval process but can help alleviate high infrastructure costs, especially for growing companies that present risky investment for established banks.

Generally, these tax benefits are available to a wide variety of technological innovations and industries through a broad definition of qualifying innovation which include not only new products but also technological advances on existing products. This broad base allows taxpayers to significantly reduce their corporate tax burdens from Brazil's current 34% rate.

2. China

- Technologically Advanced Service Credit (TASC) & High-New Technology Enterprise (HNTE) tax regime
- Tax holidays
- Reduced tax rates / exemptions
- Super R&D deduction

China offers very competitive research and development benefits, especially for those companies eligible for their high technology company regimes – the TASC and HNTE. These regimes can significantly decrease the effective tax rate of the company well below China's standard 25% corporate income tax rate.

Companies that qualify as a Technologically Advanced Service Company (TASC) receive the following benefits through 2018:

- A reduced 15% corporate income tax (down from 25%)
- Exemption from business tax / VAT on certain offshore services
- Increased deduction limitation for employee education expenses (8%)

Companies that qualify for High-New Technology Enterprise status (HNTE) receive the following benefits:

- A reduced 15% corporate income tax (down from 25%)
- For those established in specific economic zones[11] or in the Shanghai Pudong New Area, a tax holiday for the first year it derives operating income

Both the TASC and HTNE regime have certain eligibility requirements and require pre-approval from local authorities. These eligibility requirements are centered around IP ownership and ensuring that the IP is considered the type of key technology falling within the scope of the regime. In addition, the regimes may require minimum research and development spend, IP-related revenues and / or specialized headcount requirements.

For those companies that cannot qualify as TASC and HNTE companies, other tax benefits of wider application may be available. One such benefit is a "super" deduction allowing a resident Chinese company to deduct 150% of qualifying research and development expenses in calculating taxable income. In addition, China provides an income tax exemption for certain technology transfers and VAT exemptions on technology development and outsourced technology services. Each of these benefits requires pre-approval from the tax authorities, but can provide tangible tax benefits to a local entity.

3. India

- Tax holidays (SEZ Scheme)
- "Super" deductions
- Financial support

India has been one of the worldwide leaders of encouraging innovation through domestic tax policy, with a clear mandate to support local research activities. From a tax perspective, India offers a variety of tax benefits, including tax holidays, super deductions, financial support, tax exemptions and reduced rates.

More specifically, India allows tax holidays for companies established in certain special economic zones (SEZ). These holidays can provide a 15 year tax benefit period for certain export profits, including a 100% tax holiday for the first 5 years, followed by 50% holidays for the next two successive 5-year periods.

Companies outside the SEZ scheme can benefit from a "super" deduction up to 200% on certain expenses paid to national laboratories and universities conducting specific, pre-approved research projects; a deduction up to 175% for general contributions to approved research institutions, and 125% for basic research and development costs. These benefits have dual effects – (i) to provide companies with tangible tax benefits related to research activities and (ii) to encourage companies to re-invest in

[11] The special economic zones are located in Hainan, Shantou, Shenzen, Zhuhai, Xiamen

Indian infrastructure by funneling research funds to Indian research institutions. This reinvestment can provide exponential growth opportunities domestically and drive growth.

In addition, Indian companies can benefit from grants and loans provided by the Indian governments under the Technology Development Program (TDR). As the name implies, companies and trade associations can be afforded financial support on pre-approved projects focused on developing new technologies or adapting current technologies for a wider-use application.

Each of these incentives provides Indian companies with tangible encouragement to drive domestic innovation and local reinvestment. It is this dual approach to technological development that is the hallmark of the Indian tax system, one that has made India a technological hub in this global economy.

II. Non-Tax Incentives

In addition to innovation incentives that operate through their tax laws, many of America's trading partners are increasing their spending on grants or other mechanisms to support innovation and knowledge based industries. Brazil's reduced interest loans and India's TDR program have already been mentioned. While it would be impossible to catalogue all of these programs (some are at the national government level, some local) the following are examples of major initiatives in this area:

1. The European Union – Horizon 2020.

Stating that "innovation has been placed at the heart of the EU's strategy to create growth and jobs," the European Union has agreed to an innovation agenda in which its members are encouraged to invest 3% of their GDP in research and development by 2020 (1% from public funding, 2% from private sector investment) to address the larger challenges facing the planet, including energy, food security, climate change, health and the aging population. According to the EU release, the purpose of the innovation agenda is to "remove bottlenecks which prevent ideas from reaching the market – including lack of finance, fragmented research systems and markets, under-use of public procurement for innovation and slow standard-setting."

As part of this program, the EU in 2014 created a pool of 80 billion euros (2014 through 2020) in funding for science research (25 billion), industrial innovation (17 billion), and social issues (climate change, food security), which will be used to help ensure that technological breakthroughs including new processes are developed into viable products with commercial potential through government/private sector partnerships. Innovators wishing to participate in this program must submit proposals through an EU portal.

2. The World Bank.

The World Bank also directs some of its lending to government towards the development and commercialization of innovation in the following areas: support for private and public research and development, strengthening entrepreneurial capabilities, financial support for early-stage start-ups, and fostering linkages between actors in the innovation system. A recent World Bank report found that over the decade between 2002 and 2012 the Bank had developed an investment portfolio of close to $19 billion for innovation and entrepreneurship activities.

3. Particular Country Programs.

Besides the investment of various international organizations, particular nations have well-developed innovation policies through which they directly support local innovators. The United Kingdom, for example, has established the U.K. Innovation Investment Fund. The Fund is designed to coordinate private and government sector investment in securing financing for innovation by small and medium enterprises, the commercialization of that innovation, and the development of business leadership and management skills. The spending goal for the current U.K. innovation program is around 5 billion pounds a year with a goal of supporting 26,000 British small and medium enterprises.

In 2010 Russia established the Skolkovo Innovation Center outside of Moscow with the intention of creating a Silicon Valley type of location where high-tech innovation could be developed and products brought to market. In establishing this Center, the Russian Government noted that it lagged behind the U.S. in research spending and was hoping to develop, aided by direct subsidies from the government, thousands of start-ups to provide a research base that would eventually grow the economy.

4. Sovereign Wealth Funds.

Sovereign wealth funds (SWFs) are state owned investment funds that are established from the balance of payment surpluses, foreign currency operations, proceeds from the privatization of formerly state-owned enterprises, fiscal surpluses, and revenues from resource exports. While funds of this type have existed since the 1950's (it is believed that the Kuwaiti Investment Fund was the first SWF), the number has proliferated over the past decade and the term SWF was first used in 2005.

The World Bank has identified three general groupings of SWF's: (1) stabilization funds, which have as their primary function to protect the domestic economy from trade revenue fluctuations mostly in commodity prices. These SWF's invest generally in heavily developed markets where they purchase stable long-term assets with a concentration in stable bonds; (2) savings funds, which are designed to convert wealth derived from nonrenewable natural resources, oil and gas, for example, into a diverse investment portfolio for the benefit of future generations; not surprisingly many of these were established by major oil producing states; and (3) reserve investment corporations that reduce the opportunity cost of holding excess foreign reserves by investing in ventures with potentially higher returns; as a result, this type of SWF has the most aggressive investment profile, takes greater risk than the others, and is very secretive. It is this category that is most likely to be used to support innovation and start-up enterprises that pose a greater risk profile.

Because SWFs are the creature of governments, many of which do not have public disclosure or transparency rules and are not regulated by international organizations, there is limited detailed information about them. Various sources estimate the assets under management in SWFs to be in the range of $20 trillion and growing.

A recent report on SWFs from the Federal Reserve Bank of Dallas stated that "as of July 2013, 61% of SWFs were actively invested in infrastructure – both domestically and internationally," and noted that "SWFs can afford to invest in experimental, socially responsible ventures that have not yet attracted private capital." SWFs could in that regard become a major source for the funding and commercialization of research and innovation.

III. PRE-REVENUE START-UPS

In the absence of robust grant programs to support pre-revenue start-ups, American innovators often find themselves stuck in the so-called "valley of death," the period in between the invention of a viable commercial product and its commercialization. The lack of funding during this critical pre-revenue period can doom a company and deprive a nation of the economic growth it could generate, as well as the benefits of the invention itself Unfortunately, the inability to raise capital in the U.S. has resulted in many innovators going overseas to obtain funding for their ideas.

Although a reduction in tax rates, as discussed above, would likely provide a very beneficial boost to the global competitiveness of American companies, reduced rates do little for pre-revenue start-ups: because they have no income subject to tax, adjustments to the tax rates do not help them. As a result, if tax reform focuses solely on rate reduction it will do very little to support the smaller entrepreneurs who drive must of American innovation.

As Congress considers tax reform there are a number of tax-driven programs that could provide financial support to pre-revenue start-ups and keep them in the U.S.

A. Passive Activity Loss Relief.

In an effort to address the concern that some partnerships had been created for the sole purpose of generating tax losses for their investors with no clear intent to ever produce a profitable product or service, Congress in 1986 changed the law to prevent passive investors (those who do not materially participate in running the business) from taking losses generated by the business against their unrelated incomes. A change in the passive activity loss rules directed towards partnerships that undertake considerable research for the development of high technological products, and that have no more than 250 employees and relatively low assets, would attract domestic investors and protect against the concerns that were at the core of the reforms that Congress enacted in 1986.

B. Angel Investor Credit.

Adopted already in a number of states, the angel investor credit would provide investors in small businesses a tax credit. In one version, eligible investments were defined as those in companies in existence for less than five years with less than 100 full-time employees and headquartered in the U.S. The credit was equal to 25% of the angel investment, limited to $2,000,000 a year and a total of $10,000,000 over five years.

C. Capital Gains Reform.

In the recently enacted PATH Act, Congress made permanent rules permitting investors to exclude from their incomes 100% of their gains on the sale of qualified small business stock (QSB). To qualify as QSB the small business entity must have gross assets below $50 million. While the concept of capital gains relief is an effective way to attract investment, the threshold for defining a small business is too low for many capital-intensive startups and should be raised to at least $150 million.

IV. Highlighting the Differences.

The marketplace is global and American innovators have greater options and incentives than ever before to raise capital and locate their operations overseas. The challenges America faces as it seeks to retain and build its knowledge-based, innovative industries in a global economy can perhaps best be illustrated by comparing the different tax treatments and other benefits domestically based activities would receive abroad compared to those available to similar companies in the U.S.

These are difficult comparisons to make because every tax system is complex in its own right and there are numerous factors that have an impact on the overall tax burden that any company faces. Moreover, it is imperfect to compare only statutory tax rates (i.e., the set rate under the law) because the use of deductions, credits, and other forms of tax planning can bring that rate down to a significantly lower effective rate, which is defined as the total amount of income tax divided by pre-tax income.

Nonetheless, the comparisons that follow demonstrate that innovators may find the basic tax rules in many foreign jurisdictions to be far more beneficial than those in the U.S.

A high-tech company in the U.S. is subject to Federal corporate tax at a 35% rate on taxable income over $10,000,000 (the rate is graduated below that amount at a 15% and 25% rate) and is eligible for a credit for research and experimentation that is computed against incremental research over a historical base. Currently the U.S. has no form of innovation box or special tax incentive rates for high-tech industries, and limited non-tax incentives at the Federal level. Most states also tax corporate income adding another potential layer of taxation. The company might be eligible for a small, early-stage grant from NIH or receive some modest benefits by locating its operations in a state-run technology incubator facility.

The U.S. taxes individuals and corporations on their worldwide incomes meaning that an American company with profits exceeding $10,000,000 is taxable on all of its worldwide income at the full 35% corporate rate. Global U.S.-based companies generally operate outside of the U.S. in the form of foreign controlled corporations that are not subject to immediate U.S. taxation, but to the extent that the profits of those foreign corporation are brought back to the U.S., usually in the form of dividends paid to the U.S. parent corporation, they are subject to tax at the 35% rate. There are estimates that U.S. companies are holding well in excess of $2 trillion in foreign profits overseas in order to avoid this high level of taxation.

By comparison a company resident in Ireland is subject to a corporate tax of 12.5%, and while Ireland also taxes on a worldwide basis, the tax is reduced by credits for taxes paid in other jurisdictions and Irish companies can also defer taxation in Ireland by operating through controlled foreign corporations. Ireland provides a research credit of 25% of research expenditures during the year, which includes the cost of buildings and improvements used for research activities. Ireland is also in the process of implementing a so-called “knowledge box” under which income from the development and commercialization of innovative technologies would be taxed at half the corporate rate, or 6.25%. The rate and research credits in Ireland are without question less burdensome than the U.S. corporate rate, and the U.S. does not have any type of innovation box regime at this time.

Israel has been very aggressive in attracting innovators, especially in the sciences. Currently Israel taxes corporate income at a 26.5% rate and has aggressive programs to provide direct grants for research ranging from 20% to 50% of outlays for research activities, and those grants are increased to the extent that a company may be located in one of two special research zones. Israel also provides special grants for the development of life sciences technologies, in addition to an “angel investor” credit to encourage investment in start-up high-tech companies.

In the case of Israel, the corporate rate is lower than the U.S. rate, although not as low as the Irish rate, but Israel has a robust subsidy program to encourage innovation in start-up pre-revenue companies.

The U.K. has decided to follow the lead of Ireland and several others of its European trading partners. The country has recently enacted further reductions in its corporate tax rate, which is currently set at 20%, but will drop to 19% in 2017 and 17% by 2020. There are no local corporate taxes in the U.K.

The U.K. taxes on worldwide income but there are exceptions to the worldwide taxation requirement for cases where the foreign entity engages in genuine economic activity abroad, i.e., by maintaining a permanent establishment in a foreign country. As noted earlier, Britain has a patent box regime that reduces even further the corporate tax burden on income derived from the commercialization of innovative technologies and an innovation fund that provides financing to high-tech start-ups.

In each of these cases, the corporate rate is significantly lower than the U.S. rate. Even where there is worldwide taxation, because the rate is low and credit is available for taxes paid to other jurisdictions, the likelihood is that the tax system will operate as territorial as a practical matter.

A U.S. company earning profits in Ireland, for example, will be subject to tax on those profits at the 35% rate, with 12.5% of that tax paid to Ireland and the rest to the U.S. The only way to avoid the high level of taxation by the U.S. would be to defer it by keeping the profits outside of the U.S. in a controlled foreign corporation, in which case the profits would only be subject to Irish tax when earned but would be taxed at the full U.S. rate when brought back into the U.S. By contrast an Irish company would be subject to the lower Irish rate generally while only its profits from sales in the U.S. would be subject to the U.S. tax (which is so much higher than the Irish tax that there would be no Irish tax on those profits in any event). The local corporate rates in all three of these examples, and in the case of most U.S. trading partners, are much lower than the U.S. rate.

These examples are also representative of countries that do more to promote innovation. The U.K. has a patent box that reduces the tax burden further on high-tech income, Ireland has a generous research credit and is implementing an even more generous knowledge box, while Israel has a robust subsidy program to support innovation.

While it is extremely difficult to compute the effective tax rate a company would have in all of these jurisdictions without extensive detail as to its likely operations (which might be structured differently in any event in each of the jurisdictions to take advantage of particular rules) in Ireland, Israel, and the U.K., business taxes begin with a lower rate than the U.S. which would likely result in an even lower effective rate as deductions and credits are taken against income. Using a very general methodology, a PWC/Business Roundtable Report issued in 2011 concluded that of sixty nations surveyed, the U.S. effective rate was the sixth highest, just slightly less burdensome that the rates in Germany, Indonesia, Italy, Morocco, and Japan. Of these, Germany and Japan have dramatically lowered their rates since the study, as have a number of countries that were less burdensome than the U.S. to begin with, most notably, the U.K.

A just released advance copy of a report by the International Monetary Fund (IMF) entitled "Acting Now, Acting Together" highlights the extent to which the US has fallen behind in promoting innovation. Among its findings the U.S. is at the low end in providing tax incentives to promote research and development (behind Korea, France, Slovenia, Belgium, Austria, Ireland, Canada, the U.K., Japan, the Netherlands, Australia and Portugal), while it does not even appear on a chart of the nations that provide more generous research and development incentives to smaller, rather than larger, firms (Japan, Norway, Australia, the Netherlands, Korea, Chile, the U.K., Canada and France). And, not surprisingly, the report cites the high U.S. corporate rate as a major impediment in attracting innovators and notes that the business entry rate, a measure of entrepreneurship, has declined steadily in the U.S. since the 1970's.

Congress has debated tax reform for over a decade, with key Congressional Leaders on both sides of the aisle in agreement that the current U.S. tax system contributes to the trends noted in the IMF Report. We need to do better.

Conclusion

In its most recent consultation report in the Spring of 2015, the International Monetary Fund concluded the U.S. economy was performing below potential and recommended, among other policies, comprehensive tax reform, which it characterized as "long overdue," as well as "supply-side measures that support future growth, job creation, and productivity"…including "incentivizing private innovation."

While the U.S. has struggled to find a consensus for tax reform and is engaged in a debate over whether it is appropriate for government to subsidize business, its trading partners have dramatically reduced their corporate tax rates while creating tax-driven incentives for innovators and have set in motion both on the international level and domestically programs that are intended to match and even exceed the historical levels of research and innovation spending in the U.S. economy.

By contrast, the U.S. basically offers a high corporate tax rate, very limited incentives for investors in high-tech start-ups, and a research credit that is of very limited value and extremely difficult to calculate and claim, as well as an overall tax system that encourages companies to move facilities overseas and keep their foreign profits offshore.

In order for the U.S. to stem the tide of innovation moving offshore, much more is needed. The U.S. tax system should be reformed comprehensively to include a significant reduction in the rates imposed on business income; modification of the current system of taxing American businesses on their worldwide incomes; creation of special tax incentives for knowledge-based, high value-added industries to level the playing field with competitor nations; and development of special incentives to encourage investment in in start-up companies.

The enactment of major reforms takes time in the American system of government, but in this instance, time is running out. Once the leader in global innovation, the U.S. is increasingly falling behind as competitor nations enact new tax systems and support programs to spur innovation in knowledge-based industries and grow their economies.

APPENDIX A: Illustrative Patent Box Regimes

Review of Certain IP Box Regimes

For comparison purposes, provided below is a more detailed review of IP Box Regimes in Hungary, Luxembourg and Belgium. These countries' IP box regimes range from the most generous (Hungary) to the most restrictive (Belgium). The comparison can best illustrate the different factors that go into creating an IP Box, as the base tax rate alone is not indicative of the benefit it can provide. Instead, those factors described above, e.g., qualifying income and qualifying IP are more substantive indicators of an IP Box's benefits than the stand-alone preferential rate afforded by the regime. These key features are the political pressure points that a jurisdiction must navigate to implement an IP Box regime that successfully meets its stated goals and provides requisite benefits to attract investment.

A. Hungary

- Preferential Tax Rate: 9.5%
- Qualifying Income: Royalty, Capital Gains
- Qualifying IP: Patents, Software, Copyrights, Trademarks, Designs, Formulae, Know-How

Hungary's IP Box regime is generally considered the most generous even though the base tax rate is higher than some of the other IP Box regimes. Hungary's IP box regime allows a 50% deduction for qualifying income earned from related or unrelated parties, up to 50% of pre-tax income. Hungary allows a wide variety of IP to qualify for the preferential rate other than patents, including income allocable to software, copyrights, trademarks, designs, formulae and know-how. This range of IP may be attractive to a number of different types of companies across multiple industries. In addition, Hungary allows *both* internally developed IP and acquired IP to qualify for the regime. This encourages mature companies to move valuable IP into the jurisdiction and benefit from the lower rates without an emphasis on further development required in other IP Box regimes. In addition, capital gains related to the sale of qualifying IP create an incentive for companies that desire flexibility on exit of their investment.

Although some of these same features are available in other jurisdictions, it is Hungary's expense mechanism that provides a substantial benefit not found elsewhere. Generally, an IP Box regime's benefits can be influenced by the country's treatment of expenses related to the qualifying IP. Countries either take a "gross income" or "net income" approach. Under the "gross income" approach, a company is allowed to deduct IP expenses at the gross income level, meaning that IP expenses can reduce both qualifying IP income and non-qualifying income. A "net income" approach instead segregates IP income first and then allocates qualifying expenses to that IP income without a cross deduction for non-qualifying income. Hungary's gross income approach provides an opportunity for companies with significant non-qualifying income to effectively benefit from the IP Box regime with the added bonus of reducing income on non-qualifying activities. This somewhat counterintuitive expense regime separates Hungary from other jurisdictions, as only Belgium, a far less beneficial regime, allows deductions to be taken from gross income in this manner.

Summarily, Hungary's IP Box regime is one of the most beneficial IP Box regimes due to the flexibility it provides in allowing a wide variety of IP to qualify and the ability for companies to use the IP Box for established IP and for IP that may be divested in the future. In addition, the IP expense regime in Hungary creates opportunities for companies to realize significant benefits through a cross-deduction of IP expenses against non-IP income.

a. Luxembourg

- Preferential Tax Rate: 5.76%
- Qualifying Income: Royalties, Capital Gains, Certain IP-Embedded Sales Income
- Qualifying IP: Patents, Trademarks, Designs, Domain Names, Models, and Software Copyrights

Luxembourg's IP Box regime can considered moderately beneficial, as many of its key features are "middle of road" in terms of benefits and restrictions. The preferential tax rate of 5.76% is relatively beneficial when compared to other regimes and the qualifying IP includes many different types of IP, but excludes non-software related copyrights, know-how and formulae. While Luxembourg does allow acquired IP to qualify for preferential treatment, certain conditions exist to limit its availability. More specifically, the IP obtained by the Luxembourg company cannot be acquired from a direct parent company, a direct subsidiary or a direct brother-sister company with a direct common parent. Although this may appear to be a significant hurdle to related-party transfers of IP, it may be possible to structure the acquisition from an eligible affiliate.

Luxembourg's IP regime does not require the Luxembourg company to be the legal registrant of the IP, meaning the beneficial rights to the IP (as opposed to legal rights) may be transferred between related entities, effectively saving the cost and administration of legally registering and tracking the IP in different jurisdictions. In addition, IP box benefits accrue even if the IP is not developed in Luxembourg.

In terms of qualifying income, Luxembourg's regime is somewhat generous. Besides royalty income, capital gains on the disposition of eligible IP qualifies for preferential treatment. Unlike many jurisdictions, the sale of IP imbedded products may qualify, but only with respect to self-developed patents. This can be a significant hurdle for companies, as those with acquisitive histories may find it difficult to satisfy this requirement, at least in the immediacy after acquisition.

b. Belgium

- Preferential Tax Rate: 6.8%
- Qualifying Income: Royalties, IP-Embedded Sales Income
- Qualifying IP: Patents, SPCs

Belgium's IP Box regime is generally considered one of the least beneficial regimes. Although the preferential tax rate is competitive with other IP Box regimes, it is the nuanced limitations of the regime that complicates its qualification and erodes its benefits.

One main detraction is the limited types of IP that qualifies for the regime. Only patents and SPCs qualify, and only those granted or first commercially used on or after January 1, 2007. Other types of IP, including know-how, trademarks, designs, models, formulae and processes are specifically excluded under Belgium law. Furthermore, existing and acquired IP do <u>not</u> qualify for the regime, although improvements to such IP would. These improvements are not required to result in additional patents, however.

In addition, certain harsh affirmative requirements must be met related to IP development to guarantee qualification. The patent development work must be performed by a research and development center that is owned by the Belgian entity. The work need not be performed in Belgium, and may be performed by related or unrelated subcontractors, but the Belgian company must have sufficient substance to supervise the research activity. The research center must qualify as a branch or line of business that operates independently within a given entity.

Only royalties and deemed royalties from IP embedded in manufactured products qualify for the regime. Capital gains from the sale of such qualifying IP is specifically excluded. One beneficial aspect of the regime is that research and development costs are deductible at the standard 34% rate, while research credits may be claimed in addition to the preferential IP rate. Therefore, companies can likely reduce the effective tax rate on qualifying income well below the 6.8% rate.

On the whole, the Belgian IP Box regime lacks the beneficial attributes seen in other regimes. The fact that acquired IP does not qualify for the box likely steers away mature companies looking to take advantage of IP box benefits. Also, the significant limitations on where and how the patent improvements are made lack the flexibility multinationals desire when determining tax planning strategies.

D. Boustany/Neal Proposal

Representatives Charles Boustany (R-Louisiana) and Richard Neal (D-Massachusetts) have released a proposal under which patent box profits would be taxed at a 10% rate rather than the current 35% corporate rate. To determine patent box profits, however, the taxpayer first must determine its IP profits -- gross receipts from the sale, lease, or other disposition of qualified patent property (any patent, invention, formula, process, design, pattern, know-how, computer software, and motion picture film or video-tape or <u>any product produced using any of the foregoing</u>) -- over costs of goods sold that are allocable to patent gross receipts and other allocable expenses, and multiply these by the ratio of the taxpayer's research and development costs over total costs for the past five years. The resulting amount, patent box profits, are subject to a 71% exclusion from tax resulting in a tax rate on those profits of around 10% at a 35% rate.

While the definition of IP profits is generous in that it covers much more than income derived from traditional patents, the use of the ratio that considers how much of a taxpayer's costs were related to research are development tends to result in a very limited benefit (a reduction of two or three points in the corporate rate) except in industries in which domestic research is, even for a knowledge-based industry, an especially large expense relative to the cost of goods sold. This is an especially challenging standard for knowledge-based manufacturing industries. Combined with the already high U.S. corporate rate, the Boustany/Neal innovation box is conceptually a step in the right direction but will do very little as a practical matter to address the issue of America's competitiveness in global innovation for many industries. Boustany and Neal have requested comments on their proposal and are considering a number of suggestions to address this issue, including the relaxation of the research/costs ratio and the use of a different formula that would simply apply a lower rate (15% for example) to IP profits without the ratio.

Statement by the
Association of Equipment Manufacturers
Milwaukee, WI

U.S. House of Representatives
Committee on Ways & Means
Subcommittee on Tax Policy

Hearing on "Perspectives on the Need for Tax Reform"

Wednesday, May 25
1100 Longworth House Office Building
Washington, D.C.

The Association of Equipment Manufacturers (AEM) welcomes the opportunity to submit a written statement for the record of the Committee on Ways and Means Subcommittee on Tax Policy Hearing on "Perspectives on the Need for Tax Reform."

AEM is the North American-based international trade association providing innovative business development resources to advance the off-road equipment manufacturing industry in the global marketplace. AEM membership comprises more than 850 companies and more than 200 product lines in the agriculture, construction, forestry, mining and utility sectors worldwide.

Manufacturing employs nearly 12 million men and women, contributes more than $1.8 trillion to the U.S. economy annually, has the largest economic impact of any major sector and accounts for two-thirds of private-sector research and development.

AEM members know firsthand that our current tax system is fundamentally flawed and discourages economic growth and U.S. competitiveness. As a result of manufacturing's critical importance to our nation's economy, any effort to rewrite the federal tax code should result in a balanced, fiscally responsible plan that allows manufacturers in the United States to prosper, grow and create jobs and enhances their global competitiveness.

We applaud Chairman Boustany, Ranking Member Neal and the other members of the Subcommittee on Tax Policy for holding a hearing about comprehensive tax reform. It is a critical topic that needs to be addressed when considering how to make the United States a more attractive place to invest and create jobs and how to help keep the U.S. manufacturing industry competitive in the global economy.

As the Subcommittee on Tax Policy continues to work on crafting a comprehensive, pro-growth tax plan, AEM would like to provide an overview of a few elements we believe ought to be part of any meaningful tax reform effort.

First, lower the corporate tax rate. As other nations have realized, a significant cut to corporate tax rates would encourage businesses both at home and abroad to invest in the United States.

Second, do away with the worldwide structure and implement a tax territorial tax system like those in most other industrialized nations. This would provide a level playing field for American companies operating in markets at home and abroad.

Third, comprehensive tax reform also presents an opportunity for creative thinking on investing in our nation's infrastructure. We encourage the Subcommittee on Tax Policy to make infrastructure investment part of comprehensive tax reform.

Lastly, give thoughts to the type of jobs you want in the United States. Other countries have given this serious consideration and built their tax structures around a desire to maintain a manufacturing base versus moving strictly to services-based economies.

We thank Chairman Boustany, Ranking Member Neal and the members of the Subcommittee on Tax Policy for diligently leading the conversation about comprehensive tax reform. Equipment manufacturers recognized the need to attract high-value jobs and investments to the United States and improve the competitiveness and the urgent need for commonsense reforms of our tax system. We look forward to further discussions of this critically important issue and to working with you and your staff to achieve a pro-growth, pro-competitiveness and pro-manufacturing tax system.

Statement of the American Farm Bureau Federation

SUBMITTED FOR THE RECORD
UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS
SUBCOMITTEE ON TAX POLICY

HEARING ON PERSPECTIVES ON THE NEED FOR TAX REFORM

MAY 25, 2016

600 Maryland Ave. SW | Suite 1000W | Washington, DC 20024 | p. 202.406.3600 | f. 202.406.3606 | www.fb.org

Reform of the tax code will drive economic growth, spur business expansion and contribute to job creation in the agriculture sector. Farm Bureau appreciates the opportunity to submit this statement on tax reform for the record for the House Ways and Means Tax Policy Subcommittee hearing on "Perspectives on the Need for Tax Reform."

Farm Bureau supports replacing the current federal income tax with a fair and equitable tax system that encourages success, savings, investment and entrepreneurship. We believe that the new code should be simple, transparent, revenue-neutral and fair to farmers and ranchers. Agriculture operates in a world of uncertainty. From unpredictable commodity and product markets to fluctuating input prices, from uncertain weather to insect or disease outbreaks, running a farm or ranch business is challenging under the best of circumstances. Farmers and ranchers need a tax code that recognizes the financial challenges they face.

Tax reform should embrace the following overarching principals:

- Comprehensive: Tax reform should help all farm and ranch businesses: sole-proprietors, partnerships, sub-S and C corporations.
- Effective Tax Rate: Tax reform should reduce rates low enough to account for any deductions/credits lost due to base broadening.
- Estate Taxes: Tax reform should repeal estate taxes. Stepped-up basis should continue.
- Capital Gains Taxes: Tax reform should lower taxes on capital investments. Capital gains taxes should not be levied on transfers at death.
- Cost Recovery: Tax reform should allow businesses to deduct expenses when incurred. Cash accounting should continue.
- Simplification: Tax reform should simplify the tax code to reduce the tax compliance burden.

<u>Pass-through Businesses</u>: Any tax reform proposal considered by Congress must be comprehensive and include individual as well as corporate tax reform. More than 96 percent of farms and 75 percent of farm sales are taxed under IRS provisions affecting individual taxpayers. Any tax reform proposal that fails to include the individual tax code will not help, and could even hurt, the bulk of agricultural producers who operate outside of the corporate tax code.

<u>Effective Rates</u>: Any tax reform plan that lowers rates by expanding the base should not increase the tax burden of farm and ranch businesses. Because profit margins in farming and ranching are tight, farm and ranch businesses are more likely to fall into lower tax brackets. Tax reform plans that fail to factor in the impact of lost deductions for all rate brackets could result in a tax increase for agriculture.

<u>Cash Accounting</u>: Cash accounting is the preferred method of accounting for farmers and ranchers because it provides the flexibility needed to optimize cash flow for business success, plan for business purchases and manage taxes. Cash accounting allows farmers and ranchers to improve cash flow by recognizing income when it is received and recording expenses when they are paid. This gives them the flexibility they need to plan for major investments in their businesses and in many cases provides guaranteed availability of some agricultural inputs. Loss

of cash accounting could create a situation where a farmer or rancher would have to pay taxes on income before receiving payment for sold commodities.

Accelerated Cost Recovery: Because production agriculture has high input costs, farmers and ranchers place a high value on immediate expensing of equipment and equipment repairs, production supplies and preproduction costs. This includes fertilizer and soil conditioners, soil and water conservation expenditures, the cost of raising dairy and breeding cattle, the cost of raising timber, endangered species recovery expenditures and reforestation expenses. Farm Bureau also places a priority on Sect. 179 small business expensing and supports bonus depreciation, shorted depreciation schedules, and the carry forward and back of unused deductions and credits. There should be annual expensing of preproduction expenditures and equipment repair costs should be treated as an expense rather than a capital improvement.

Estate Taxes: Farm Bureau supports permanent repeal of federal estate taxes. Until permanent repeal is achieved, the exemption should be increased, and indexed for inflation, and it should continue to provide for portability between spouses. Full unlimited stepped-up basis at death must be included in any estate tax reform. Farmland owners should have the option of unlimited current use valuation for estate tax purposes.

Capital Gains Taxes: Farm Bureau supports eliminating the capital gains tax. Until this is possible, the tax rate should be reduced and assets should be indexed for inflation. In addition, there should be an exclusion for agricultural land that remains in production, for transfers of farm business assets between family members, for farmland preservation easements and development rights, and for land taken by eminent domain. Taxes should be deferred when the proceeds are deposited into a retirement account. Farm Bureau supports the continuation of stepped-up basis.

Like Kind Exchanges: Farm Bureau supports the continuation of Section 1031 like kind exchanges, which help farmers and ranchers upgrade and improve their businesses by deferring taxes when they sell business capital and replace it with like-kind assets. Without the ability to defer taxes on exchanges, some farmers and ranchers would need to incur debt to continue their farm or ranch businesses or, worse yet, delay mandatory improvements to maintain the financial viability of their farm or ranch.

Other Provisions Important to Farmers and Ranchers: Farm Bureau supports the continuation of the Domestic Production Activities Deduction (Sect. 199), farm and ranch income averaging, installment land sales, elimination of the UNICAP rules for plants, and the tax deduction for donated food and donated conservation easements.

BDA Bond Dealers of America

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Statement for the Record
of the
Bond Dealers of America
to the
House Committee on Ways & Means
Subcommittee on Tax Policy
Hearing on Perspectives on the
Need for Tax Reform

May 25, 2016

This statement is submitted on behalf of the Bond Dealers of America (BDA), the only Washington, DC-based association representing the interests of middle-market securities dealers and banks focused on the U.S. fixed income markets. We write to urge the U.S. House of Representatives Committee on Ways and Means Subcommittee on Tax Policy to retain current law as it applies to the tax-exemption for municipal bonds in order to preserve the most effective and efficient financing method for our nation's critical infrastructure.

Investment in schools, education loans, transportation, housing, healthcare clinics, non-profit hospitals, electrical facilities, water and wastewater treatment systems, police, fire, ambulance services, and other public infrastructure is critical to a growing and well-functioning economy. For over 100 years, tax-exempt municipal bonds have been used by state and local governments to finance infrastructure and community improvement projects including schools, hospitals, roads, highways, bridges, subways, seaports and marine terminals, water and wastewater facilities, multi-family housing, libraries and town halls, electric power and natural gas equipment for city-owned utilities, and other public projects. Infrastructure financed by municipal bonds makes possible nearly every aspect of daily life and are a critical component in building and maintaining a strong economy for every citizen and company in this country. Attempts to curb or repeal the municipal exemption would dramatically increase the cost of infrastructure to the public and undermine the efforts of America's state and local governments to move their communities forward.

In recent years, both Congress and the Obama Administration have put forth proposals to cap the value of the tax-exemption tied to municipal bonds. These proposals would have the resultant effect of increased borrowing costs for state and local governments, which, in turn, would drive up infrastructure costs significantly. Such a dramatic increase could leave issuers with few choices other than to raise taxes, utility rates, and user fees or to direct less capital toward public infrastructure. None of these options is desirable to any state or local government or to taxpayers and businesses, especially at a time when the country is seeking ways to jump-start the economy—an economy that places a heavy reliance on well-functioning, up-to-date infrastructure.

An abundance of caution should also be placed on the negative consequences to investors and the municipal market from proposals seeking to alter the tax treatment of municipal bonds. Taxing a previously untaxed security would destroy investor confidence and create volatility and uncertainty in the historically stable municipal bond market. Federal legislative proposals to restrict the tax exemption that have been released (or rumored to exist) in the last two Congresses have sent tremors through the municipal markets. The perceived risk to the tax exemption led some investors to seek higher yields on municipal bonds and to pull much-needed capital and liquidity out of the municipal markets. This, in turn, forces municipal governments to pay significantly higher issuance costs—and the continuing domino effect forces some governments to reduce or abandon infrastructure projects they can no longer afford.

Finally, proposals to reduce the value of the tax-exemption would have its greatest negative impact on investors. Elderly Americans (those over age 65) own three-fifths of outstanding municipal bonds, which provide a stable, fixed income to retirees. Moreover, roughly one-half of municipal bond interest is paid to households with annual income of less than $250,000. Capping the value of the tax exemption would reduce the value of outstanding municipal bonds by roughly $200 billion with the market erosion falling most heavily on middle-income investors—some of whom may have their entire retirement portfolios invested in municipal bonds.

Chairman Boustany, as the Subcommittee continues its examination and deliberations on ways to reform our federal tax code, we strongly urge you to look beyond the words and calculations in the tax code to the real world implications of proposals to change current laws governing the tax-exempt status of municipal bonds. A key step in rebuilding our economy is providing cost-effective financing for our nation's infrastructure. Tax-exempt municipal bonds are the only proven mechanism to accomplish this task. The current law tax-exemption for municipal bonds must be preserved.

Sincerely,

Michael Nicholas
Chief Executive Officer
Bond Dealers of America

Comments for the Record
United States House of Representatives
Committee on Ways and Means
Subcommittee on Tax Policy
Hearing on Perspectives on the Need for Tax Reform

Wednesday, May 25, 2016, 2:00 P.M.

By Michael G. Bindner
Center for Fiscal Equity

Chairman Boustany and Ranking Member Neal, thank you for the opportunity to submit these comments for the record to the Tax Policy Subcommittee. As usual, we will preface our comments with our comprehensive four-part approach, which will provide context for our comments.

- A Value Added Tax (VAT) to fund domestic military spending and domestic discretionary spending with a rate between 10% and 13%, which makes sure very American pays something.
- Personal income surtaxes on joint and widowed filers with net annual incomes of $100,000 and single filers earning $50,000 per year to fund net interest payments, debt retirement and overseas and strategic military spending and other international spending, with graduated rates between 5% and 25%.
- Employee contributions to Old Age and Survivors Insurance (OASI) with a lower income cap, which allows for lower payment levels to wealthier retirees without making bend points more progressive.
- A VAT-like Net Business Receipts Tax (NBRT), which is essentially a subtraction VAT with additional tax expenditures for family support, health care and the private delivery of governmental services, to fund entitlement spending and replace income tax filing for most people (including people who file without paying), the corporate income tax, business tax filing through individual income taxes and the employer contribution to OASI, all payroll taxes for hospital insurance, disability insurance, unemployment insurance and survivors under age 60.

Our comments will address our perspective on each consideration identified in the Hearing Advisory and how our four-part approach meets them.

Value added taxes act as instant economic growth, as they are spur to domestic industry and its workers, who will have more money to spend. The Net Business Receipts Tax as we propose it includes a child tax credit to be paid with income of between $500 and $1000 per month. Such money will undoubtedly be spent by the families who receive it on everything from food to housing to consumer electronics.

The high income and inheritance surtax will take money out of the savings sector and put it into government spending, which eventually works down to the household level. Growth comes when people have money and spend it, which causes business to invest. Any corporate investment manager will tell you that he would be fired if he proposed an expansion or investment without customers willing and able to pay. Tax rates are an afterthought.

Our current expansion and the expansion under the Clinton Administration show that higher tax rates always spur growth, while tax cuts on capital gains lead to toxic investments – almost always in housing. Business expansion and job creation will occur with economic growth, not because of investment from the outside but from the recycling of profits and debt driven by customers rather than the price of funds. We won't be fooled again by the saccharin song of the supply siders, whose tax cuts have led to debt and economic growth more attributable to the theories of Keynes than Stockman.

Simplicity and burden reduction are very well served by switching from personal income taxation of the middle class to taxation through a value added tax. For these people, April 15th simply be the day next to Emancipation Day for the District. The child tax credit will be delivered with wages as an offset to the Net Business Receipts tax without families having to file anything, although they will receive two statements comparing the amount of credits paid to make sure there are no underpayments by employers or overpayments to families who received the full credit from two employers.

Small business owners will get the same benefits as corporations by the replacement of both pass through taxation on income taxes and the corporate income tax with the net business receipts tax. As a result, individual income tax filing will be much simpler, with only three deductions: sale of stock to a qualified ESOP, charitable contributions and municipal bonds – although each will result in higher rates than a clean tax bill.

For the Center, the other key motivator is expanding employee-ownership. We propose to do that by including an NBRT deduction, to partially reduce income to Social Security, to purchase employer voting stock, with each employee receiving the same contribution, regardless of salary or wage level. In short order, employees will have the leverage to systematically insist on better terms, including forcing CEO candidates to bid for their salaries in open auction, with employee elections to settle ties.

Employee-ownership will also lead multi-national corporations to include its overseas subsidiaries in their ownership structure, while assuring that overseas and domestic workers have the same standard of living. This will lead to both the right type of international economic development and eventually more multinationalism.

Simultaneously, the high income and inheritance surtax will be dedicated to funding overseas military and naval sea deployments, net interest payments (rather than rolling them over), refunding the Social Security Trust Fund and paying down the debt.

Both employee-ownership with CEO pay reduction and paying off the debt will lead to two things – less pressure to deploy U.S. forces overseas and sunset of the income tax.

Military spending both overseas and domestic will decline under this plan. The VAT will make domestic military spending less attractive and overseas spending on deployments will be fought by income taxpayers, who are currently profiteering from such expenses. Instead, defense spending can shift to space exploration, which also increases invention and economic growth while keeping the defense industrial complex healthy, although now they can pursue profitable enterprises rather than lethality.

In short, our plan promises both peace and prosperity, not for the few but for the many. Prosperity bubbles up. It has never flowed down and tax reform should reflect that.

Thank you for the opportunity to address the committee. We are, of course, available for direct testimony or to answer questions by members and staff.

Contact Sheet

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Subcommittee on Tax Policy
Hearing on Perspectives on the Need for Tax Reform
Wednesday, May 25, 2016, 2:00 P.M.

All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears:

This testimony is not submitted on behalf of any client, person or organization other than the Center itself, which is so far unfunded by any donations.

COALITION FOR FAIR EFFECTIVE TAX RATES

May 24, 2016

Dear Members of the House Ways and Means Tax Policy Subcommittee:

The Coalition for Fair Effective Tax Rates congratulates you for holding this week's hearing about Perspectives on the Need for Tax Reform. We are eager to work with you to overhaul the U.S. Tax Code. As you collect views on this important topic, we urge you to place comprehensive tax reform among your top priorities.

The Coalition believes that a comprehensive approach must be taken to fix our broken federal income tax code. The tax system needs to be simplified and the tax base should be broadened. In addition, tax rates should be lowered both for corporations and for the vast majority of businesses that pay taxes through the individual rate system.

Indeed, true reform must address tax laws that impact both corporations and “pass-through” entities that pay taxes using individual rates. Repairing the tax system of one without the other would be woefully incomplete.

The current Tax Code is needlessly complicated and unfair. Large disparities exist between industries in the amount of taxes they pay – their effective tax rates. Our Coalition believes that tax reform should be viewed through the lens of effective tax rates. Successful reform should be measured by lawmakers’ ability to reduce these discrepancies and create a more level playing field for businesses of all sizes across all industry sectors.

The disparity in effective tax rates paid by different U.S. industries is huge. According to the U.S. Treasury, effective actual federal corporate tax rates paid between 2007 and 2010 ranged from 30.3 percent by construction firms, 29.4 percent by services companies and 27.9 percent by wholesaler-distributors and retailers to 17.7 percent by leasing companies and 14.5 percent by utilities. The gap is simply unfair.

The Coalition for Fair Effective Tax Rates is a diverse group of national, regional and state associations representing more than 1,500,000 businesses, large and small, that support comprehensive tax reform. The importance of lowering tax rates for both corporations and pass through entities while also reducing disparities in effective tax rates is what binds us together.

Thank you in advance for pressing forward with tax reform and remembering to keep your focus on effective tax rates, the amount businesses actually pay in taxes.

We look forward to working with you to develop and eventually approve comprehensive tax reform.

Sincerely,

Management Committee, Coalition for Fair Effective Tax Rates:

Retail Industry Leaders Association, Chair

Associated Builders & Contractors

Associated General Contractors

International Foodservice Distributors Association

International Franchise Association

National Association of Wholesaler-Distributors

Small Business and Entrepreneurship Council

About the Coalition for Fair Effective Tax Rates:

The Coalition for Fair Effective Tax Rates is a diverse group of national, regional and state associations representing more than 1,500,000 businesses, both large and small, whose mission is to educate Congress and key stakeholders that tax reform should be viewed through the lens of effective tax rates, the amount of taxes businesses actually pay. The Coalition intends to use the metric of effective tax rates to bolster the case for comprehensive tax reform that broadens the tax base while lowering tax rates for corporations and pass-through businesses that pay taxes using individual tax rates. More information about the coalition is available at http://www.faireffectivetaxrates.com/.

A list of the Coalition members is attached to this letter.

COALITION FOR FAIR EFFECTIVE TAX RATES

COALITION FOR FAIR EFFECTIVE TAX RATES

NATIONAL ORGANIZATION MEMBERS

American Apparel & Footwear Association
American Council of Engineering Companies
American Lighting Association
American Rental Association
American Subcontractors Association, Inc.
American Supply Association
American Trucking Associations
American Veterinary Distributors Association
Asian American Hotel Owners Association
Associated Builders & Contractors
Associated Equipment Distributors
Associated General Contractors
Association for Hose & Accessories Distribution (The)
Association of Pool & Spa Professionals
Auto Care Association
Business Solutions Association
Construction Financial Management Association
Convenience Distribution Association
Education Market Association
Equipment Marketing & Distribution Association
Food Industry Suppliers Association
Food Marketing Institute
Foodservice Equipment Distributors Association
FPDA Motion & Control Network
Gases and Welding Distributors Association
Health Industry Distributors Association
Healthcare Distribution Management Association
Heating, Airconditioning & Refrigeration Distributors International
Independent Electrical Contractors
Independent Insurance Agents & Brokers of America
Independent Office Products & Furniture Dealers Association
Industrial Supply Association

COALITION FOR FAIR EFFECTIVE TAX RATES

International Association of Plastics Distribution
International Foodservice Distributors Association
International Franchise Association
International Pizza Hut Franchisee Association
International Warehouse Logistics Association
Irrigation Association
ISSA-The Worldwide Cleaning Industry Association
Material Handling Equipment Distributors Association
Metals Service Center Institute
Motorcycle Industry Council
National Association of Chemical Distributors
National Association of Electrical Distributors
National Association of Wholesaler-Distributors
National Beer Wholesalers Association
National Community Pharmacists Association
National Confectioners Association
National Electrical Contractors Association
National Funeral Directors Association
National Grocers Association
National Insulation Association
National Marine Distributors Association
National Restaurant Association
National Roofing Contractors Association
North American Equipment Dealers Association
NPES-The Association for Suppliers of Printing, Publishing and Converting Technologies
Outdoor Power Equipment & Engine Service Association
Pet Industry Distributors Association
Petroleum Equipment Institute
Power Transmission Distributors Association
Printing Industries of America
Retail Industry Leaders Association
S Corporation Association
Secondary Materials and Recycled Textiles Association
Security Hardware Distributors Association
Small Business and Entrepreneurship Council
Taco Bell Franchise Management Advisory Council
Textile Care Allied Trades Association
Truck Renting and Leasing Association
Water & Sewer Distributors of America
Wholesale Florist & Florist Supplier Association

COALITION FOR FAIR EFFECTIVE TAX RATES

Woodworking Machinery Industry Association
World Millwork Alliance

CompTIA

May 25, 2016

The Honorable Kevin Brady
Chairman
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Sander Levin
Ranking Member
U.S. House of Representatives
1139E Longworth House Office Building
Washington, DC 20515

Dear Chairman Brady and Ranking Member Levin,

On behalf of the Computing Technology Industry Association (CompTIA), I would like to applaud your ongoing effort to reform our corporate tax system.

CompTIA is a non-profit trade association serving as the voice of the information technology industry. With approximately 2,000 member companies, 3,000 academic and training partners and nearly 2 million IT certifications issued, CompTIA is dedicated to advancing industry growth through educational programs, market research, networking events, professional certifications and public policy advocacy.

Our system of corporate taxation puts U.S. companies at a competitive disadvantage with their global competitors and is in urgent need of an overhaul. The last major tax reform occurred in 1986. On behalf of our membership, we will work to ensure that any corporate tax reform proposals treat the technology industry equitably – both large companies, as well as small and medium-sized businesses. Specifically, CompTIA recommends the following issues be included in comprehensive corporate tax reform:

1. Lower Corporate Tax Rate. U.S. companies are burdened with a corporate tax rate that is the highest among OECD (Organization for Economic Co-operation and Development) countries. The U.S. corporate tax rate is 39.2 percent, which is the highest in the industrialized world. This tax rate makes U.S. companies less competitive globally. CompTIA supports lowering the corporate tax rate to 25%, without increasing taxes on small and medium-sized businesses.

2. Territoriality. Currently the U.S. is one of the few developed countries that taxes corporate earnings on a global basis. This means that a U.S. company's foreign earnings are subject to U.S. tax when repatriated. Of the few countries that maintain a territorial tax system, the U.S. corporate tax rate is more than 50% higher (39.2%) than the next ranking country (24.2%). CompTIA supports enactment of a territorial international tax system that removes this punitive tax that effectively prevents foreign earnings from being repatriated to the United States.

3. Intellectual Property. CompTIA supports tax policy that fosters innovation such as a "innovation box" to attract and retain domestic IP development and ownership. In 2015, Reps. Boustany (R-LA) and Congressman Neal (D-MA) released a discussion draft of innovation box legislation designed to attract and retain R&D and IP in the United States. Under that proposal, "Innovation Box Profits" would be taxed at about 10%, as opposed to the regular corporate tax rate of 35%.

4. CFC Look-through Rule. Currently, the Internal Revenue Code requires that U.S. shareholders with a 10-percent or greater interest in a controlled foreign corporation ("CFC") include certain income of the CFC on a current basis for U.S. tax purposes, regardless of whether the income is distributed to shareholders. The territoriality provisions of most other developed countries allow companies to structure their foreign operations without the additional home country tax of the sort imposed by the U.S. Subpart F rules. CompTIA supports making the CFC look-through rule permanent in order to allow U.S. based companies to marshal their capital outside the United States in a way that would enable them to compete on a more level playing field with foreign competitors.

5. Repatriation of Profits. CompTIA supports legislation that would incentivize U.S. based companies to bring profits back into the U.S., by allowing those repatriated profits to be taxed at a lower tax rate. This influx of capital back into the U.S. could be used for capital investment to create technology advancement and job growth. Currently, companies are discouraged from bringing profits back into the U.S. because of the high corporate tax rate that would result. Repatriation of profits would encourage U.S. multinational corporations to return offshore profits, which nearly doubled between 2008 and 2013 to more than $2.1 trillion.

CompTIA

CompTIA believes that a competitive tax policy is critical for American technology companies to thrive in the U.S. and internationally, with lower corporate tax rates and movement to a territorial tax system. Accordingly, we urge you to work to restructure our outdated and overly complex federal tax code to provide a level playing field for the tech industry in both domestic and international tax issues.

We look forward to working with you and your staff as your tax reform plan is developed, and we stand ready to provide any assistance to further this goal.

Sincerely,

Elizabeth A. Hyman

Elizabeth Hyman, Executive Vice President
CompTIA

October 31, 2016

Re: Hearing on Perspectives on the Need for Tax Reform

Subject: The moral imperative to abolish Citizenship Based Taxation

<u>Summary of key points</u>

- The United States is the only country besides Eretria to use CBT as opposed to RBT or source. This means that if you are a US citizen you must file and report your worldwide income to the US regardless of where you actually live. An RBT based system only requires people who are resident of a country to pay tax on their worldwide income to that country.

- CBT can have some very serious consequences especially for "Accidental Americans". Accidental Americans are people who live overseas who are US citizens because of being born in the US or because they were born to US citizen parents overseas, but have no emotional ties to the United States. Many don't see themselves as US citizens, or do not even know they are US citizens under US law. Many have never lived in the US or left when they were very young. Regardless of their lack of ties to the United States, they are legally required under US law to file and report their worldwide income.

- US citizens aboard must be careful with how they invest their money. A US citizen living overseas who invests their money in mutual funds in their country of residence, will face US taxation under rules of Passive Foreign Investment Companies (PFIC). These are rules designed to wipe out any meaningful investment in foreign mutual funds.

- US citizens have restricted options for investing for retirement. US citizens have to be careful with using Foreign retirement accounts because unless there is a tax treaty to exempt retirement accounts (as in the case of Canada or the UK) or the funds account can be treated as an employee benefits trust, then it is likely that the fund could be treated as a foreign grantor trust, and subject to full taxation on the growth of the fund each year, and subject to erroneous reporting requirements.

- Forcing people to renounce is unfair because the cost of renouncing is astronomical. A person seeking to renounce their citizenship must pay at least $2350 to renounce. In many cases the exit tax may also apply. US citizens living abroad are not necessarily that wealthy, especially those who are "Accidental Americans" or second generation Americans abroad, and US citizens who have lived abroad for many years should have the right to return to the US in light of unforeseen circumstances. This is not possible if they renounce.

- With the repeal of CBT, there would also be no need for FATCA as the US could rely on the Common Reporting Standard (CRS) made by the OECD as it would get the same information about US residents.

To whom it may concern,

I write to you to put my case for the moral imperative for the United States to abolish Citizenship Based Taxation (CBT) and replaced with Residence Based Taxation (RBT) as part of the US tax reform agenda.

I write to you as a United States citizen who was born and raised abroad, but nonetheless has strong emotional ties to the United States. The current CBT system forces me to reconsider my ties to the United States.

Firstly, let me lay out the facts. The United States is the only country besides Eretria to use CBT as opposed to RBT or source. This means that if you are a US citizen you must file and report your worldwide income to the US regardless of where you actually live. An RBT based system only requires people who are resident of a country to pay tax on their worldwide income to that country. If a citizen leaves then they will not be taxed on their worldwide income. For example an Australian citizen in Australia will be taxed on their worldwide income as an Australian resident. If that Australian citizen moved to the United States, they would no longer be taxed on their worldwide income by Australia, regardless of their citizenship. They would however be taxed on Australian sourced income. This would be no different to Australia taxing a US citizen in the US on Australian sourced income.

CBT can have some very serious consequences especially for “Accidental Americans”. Accidental Americans are people who live overseas who are US citizens because of being born in the US or because they were born to US citizen parents overseas, but have no emotional ties to the United States. Many don’t see themselves as US citizens, or do not even know they are US citizens under US law. Many have never lived in the US or left when they were very young. Regardless of their lack of ties to the United States, they are legally required under US law to file and report their worldwide income. Theoretically its possible for someone to be subject to US taxation on their worldwide income without ever stepping foot in the United States. This is the reason why I argue there is a moral imperative to abolish CBT.

To give further justification for the moral imperative to abolish CBT, allow me to highlight the complexity of making financial decisions for US citizens living abroad. Firstly, US citizens aboard must be careful with how they invest their money. A US citizen living overseas who invests their money in mutual funds in their country of residence, will face US taxation under rules of Passive Foreign Investment Companies (PFIC). These are rules designed to wipe out any meaningful investment in foreign mutual funds.

Secondly, US citizens have restricted options for investing for retirement. US citizens have to be careful with using Foreign retirement accounts because unless there is a tax treaty to exempt retirement accounts (as in the case of Canada or the UK) or the funds account can be treated as an employee benefits trust, then it is likely that the fund could be treated as a foreign grantor trust, and subject to full taxation on the growth of the fund each year, and subject to erroneous reporting requirements. Placing retirement savings in the US may not be the answer because, other countries may not recognize US 401 k's or IRA's either, and thus US plans could be subject to the tax rules of the US Citizens residents' country. Also in countries like Australia, retirement funds are compulsory under law.

Many US citizens living abroad have taken to renouncing US citizenship as a method to solving this problem. I would argue this is unfair. Firstly, the cost of renouncing is astronomical. A person seeking to renounce their citizenship must pay at least $2350 to renounce. In many cases the exit tax may also apply. US citizens living abroad are not necessarily that wealthy, especially those who are "Accidental Americans" or second generation Americans abroad. Many are working class, living paycheck to paycheck, and simply can't afford this fee. Also why should someone who became a US citizen by circumstance of place of birth, or by circumstance of their parent's nationality and has lived abroad their entire life have to go through such a costly process to fix something that was of no fault of their own making?

Secondly, US citizens who have lived abroad for many years should have the right to return to the US. There are many reasons as to why a US citizen may chose to leave the US and go overseas. The two biggest would be a work opportunity that requires a US citizen to move overseas, or marrying someone from another country and choosing to live in that country as opposed to the US. The reality is unforeseen situations may occur, the job opportunity may cease, or the marriage may fall apart. In such cases it may be best for that US citizen to return home to rebuild their life. This is not possible if a US Citizen had to renounce because of US tax laws. US citizenship for a person living abroad should be treated as the right for that person to return, not as a tax liability.

In the past many US citizens living abroad were unaware of their US filing requirements. This should be understandable as RBT is the dominate system used throughout the world. Now however, with the Foreign Account Tax Compliance Act (FATCA), many Americans abroad are slowly learning their US tax obligations. The cost of coming into compliance because of taxes, penalties, and interest can be potentially life altering. FATCA is an extremely unfair law because of the sudden burden it places on people who have simply been unaware of their requirements. With the repeal of CBT, there would also be no need for FATCA as the US could rely on the Common Reporting Standard (CRS) made by the OECD as it would get the same information about US residents.

I hope you will consider the issues I have raised here as part of any reform to the US tax code.

Statement of the New Markets Tax Credit Coalition

Subcommittee on Tax Policy

Member Proposals for Tax Legislation

May 23, 2016

My name is Robert Davenport and I am the President of the National Development Council (NDC). Focusing on Homes, Jobs and Community, NDC was founded as a national nonprofit in 1969 to create economic opportunity in America's low income communities. NDC invests capital to support the development and preservation of affordable housing, the creation of jobs through training and small business lending and the advancement of livable communities through investment in social infrastructure. Through its subsidiary, the NDC Housing and Economic Development Corporation (HEDC), NDC has made more than 90 loans and investments using the New Markets Tax Credit. This financing has revitalized economically distressed urban neighborhood and rural communities, creating jobs and business opportunities and improving industrial, commercial and community facilities.

I also serve as the President of The New Markets Tax Credit Coalition, a national membership organization with more than 150 community development organizations, financial institutions and public officials that advocates and supports the New Market Tax Credit. The Coalition is pleased to submit this statement in support of the New Markets Tax Credit and to indicate strong support for H.R. 855, *The New Markets Tax Credit Extension Act of 2015*, sponsored by Reps. Tiberi, Neal, Reed and 62 other Members of the House from both parties.

H.R. 855 does three things:

- Provides an indefinite extension of the New Markets Tax Credit (NMTC);
- Provides an increase in the annual NMTC allocation and indexes the allocation to inflation in future years; and
- Provides Alternative Minimum Tax (AMT) relief for NMTC investments thereby ensuring NMTC investors the same consideration under the AMT as is currently provided to investors in many other federal tax credits.

The NMTC was originally authorized in the *Community Renewal Tax Relief Act of 2000* (P.L. 106-554) as part of a bipartisan effort to stimulate investment and economic growth in low income urban neighborhoods and rural communities that lack access to the patient capital needed to support and grow businesses, create jobs, and sustain healthy local economies. That legislation authorized NMTC for 2001-2007 and made $15 billion in annual credit authority available. Since that time, Congress has extended the NMTC several times:

- An additional $1 billion was authorized for communities hard-hit by Gulf Coast hurricanes, *Gulf Opportunity Zone Act of 2005* (P.L. 109-135);
- In 2006, Congress extended the NMTC for 2008 at $3.5 billion in annual credit authority through the *Tax Relief and Health Care Act of 2006* (P.L. 109-432);
- The *Emergency Economic Stabilization Act of 2008* (P.L. 110-343) extended the Credit for 2009, again at $3.5 billion in annual credit authority;
- The *American Recovery and Reinvestment Act of 2009* (P.L. 111-16), increased credit authority to $5 billion for both 2008 and 2009;
- The *Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010* (P.L. 111-312) provided a two-year extension of the NMTC (2010 and 2011) with annual credit authority of $3.5 billion;
- The *American Taxpayer Relief Act of 2012* (P.L. 112–240) provided a two-year extension of the NMTC (2012 and 2013) with annual credit authority of $3.5 billion; and
- The *Tax Increase Prevention Act of 2014* (P.L. 113-295) extended the NMTC for 2014 at $3.5 billion in annual credit authority.

Most recently, the *PATH Act* (P.L. 114-113) extended the NMTC for five years, from 2015 to 2019, at $3.5 billion in annual credit authority. The *PATH Act* was the longest authorization for the NMTC since the *Community Renewal Tax Relief Act* and, at $17.5 billion, the largest in the history of the Credit.

The NMTC program works by attracting capital to eligible communities by providing private investors with a modest federal tax credit for investments made in businesses or economic development projects located in some of the most distressed communities in the nation – census tracts where the individual poverty rate is at least 20 percent or where median family income does not exceed 80 percent of the area's median income. NMTC investors receive a tax credit equal to 39 percent of the total Qualified Equity Investment made in a Community Development Entity with the Credit, realized over a seven-year period. This amounts to 5 percent annually for the first three years, and 6 percent in years four through seven. Returns on NMTC investments are taxable, so the cost of each dollar of NMTC allocation to the federal government is not 39 cents, but rather, 26 cents.

The basis for the NMTC is that businesses' success depends on access to capital. There are attractive investment opportunities in low income communities, but the cost and availability of capital in these 'New Markets' is an impediment to economic growth. Investors and firms often lack sufficient data to assess property value or consumer demand in low income communities, where informal economies distort data. The capital gap deprives businesses of the investment dollars they need to set up shop and expand. It impedes the construction or renovation of community facilities and revitalized industrial and commercial facilities that would create jobs, economic opportunity and improve the quality of life.

Fifteen years after the NMTC's inception, the need for patient, flexible capital is as great as ever in low and moderate income rural, urban, and native areas underserved by commercial lenders.

A 2011 study by the Initiative for a Competitive Inner City found that "firms in low income census tracts received 21 percent fewer loans than would be expected, based on the number of firms in the tracts," even with a healthy demand for capital and an untapped consumer base. As a result, inner city neighborhoods are under-retailed, forcing residents to leave their neighborhoods to shop.

Small towns and farming communities also continue to be underserved by conventional lenders. A 2013 analysis by the Federal Financial Institutions Examination Council found that while rural low income census tracts include about 6 percent of the population and about 6 percent of the businesses, they only received around 5 percent of the loans and about 6 percent of the total dollar amount of small business loans in 2012. The decade's long trend of community bank closure and consolidation has hit rural areas particularly hard. The number of community banks in the United States has declined by an average of 300 per year over the past 30 years, according to data from the Federal Deposit Insurance Corporation.

The Office of the Controller of Currency found that residents of Indian Country[1] face challenges securing commercial credit, including "limited access to brick-and-mortar offices of regulated financial institutions; the perception by tribal business enterprises, even those with adequate collateral and good credit histories, that commercial bank financing is difficult to secure; a lack of diversity in funding sources; a lack of equity resources, collateral, and credit history, resulting in commercial credit denials for Indian small business owners."

The NMTC has a strong and proven track record in meeting the capital needs of these communities. Between 2003 and 2014, $38 billion[2] in direct NMTC investments were made in businesses. In turn, these NMTC investments leveraged nearly $75 billion[3] in total capital investment to businesses and revitalization projects in communities with high rates of poverty and unemployment. By law, all NMTC investments must be made in economically distressed communities. However, more than 72 percent of all NMTC investments have been in communities exhibiting severe economic distress, including unemployment rates

[1] Commercial Lending in Indian Country: Potential Opportunities in a Growing Market", the Office of the Controller of Currency, February 2016
[2] CDFI Fund's FY 2015 Agency Financial Report
[3] NMTC Coalition Estimate

more than 1.5 times the national average, a poverty rate of 30 percent or more, or a median income at or below 60 percent of the area median.

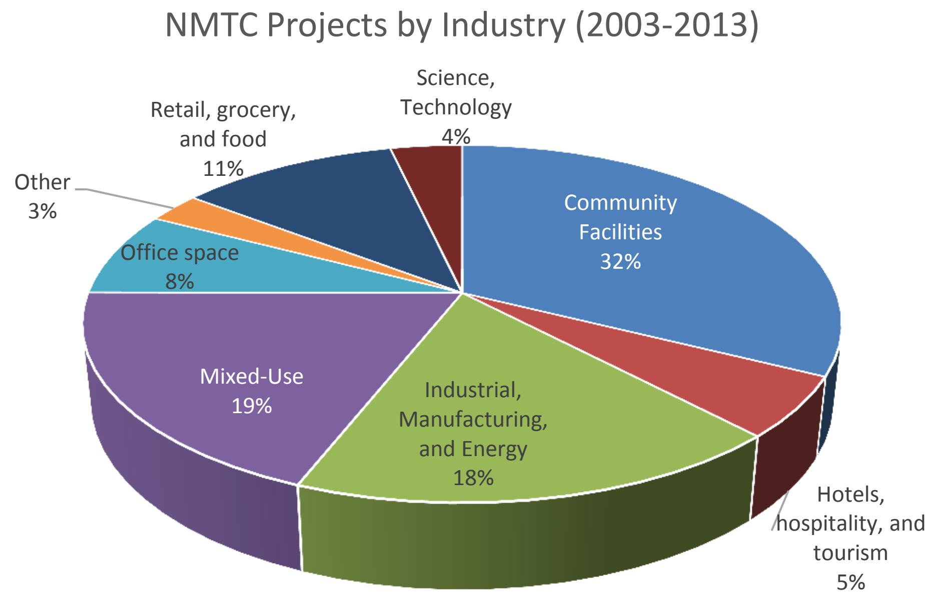
Between 2003 and 2012, the NMTC generated about 750,000 jobs[4], at a cost to the federal government of less than $20,000 per job. The New Markets Tax Credit generates economic activity, providing a return on investment to the federal government. In 2012, NMTC-financed businesses generated $984 million in federal tax revenue which more than covered the estimated $800 million cost of the Credit in terms of lost tax revenue in 2012. In addition in 2012, NMTC investments nationwide generated $542 million in state and local tax revenue.

Beyond creating jobs and generating economic activity, the NMTC helps enhance community revitalization efforts by financing community facilities and other important quality of life amenities. Between 2003 and 2013, more than 1,300 NMTC projects involved community amenities like healthcare facilities, schools, nonprofit service providers, and childcare centers. A recent Urban Institute study examined the extent to which the NMTC helps communities add amenities, improve services, and finance community facilities. The study found that 88 percent of NMTC projects brought direct or indirect quality-of-life improvements to their communities, including parks, playgrounds, shopping centers, health clinics, and other amenities.

From business expansions to new healthcare and childcare facilities, the program was designed as a flexible incentive for economic development that meets evolving community needs. Instead of Washington picking winners and losers, the New Markets Tax Credit empowers local decision-making on important economic development projects. The nonprofit and industry sectors receiving NMTC financing are diverse, reflecting a cross-section of the American economy.

Nearly one-third of NMTC projects involve healthcare facilities, affordable space for innovative nonprofits and social enterprises, educational facilities, and other amenities that directly improve the quality of life for local residents. Another popular use of the NMTC is to finance facilities and/or equipment for industrial, manufacturing, and energy production firms. Approximately 20 percent of NMTC projects involve industrial activity. (See Chart below).

[4] A Decade of the NMTC (2003-2012), NMTC Coalition (December 2014).

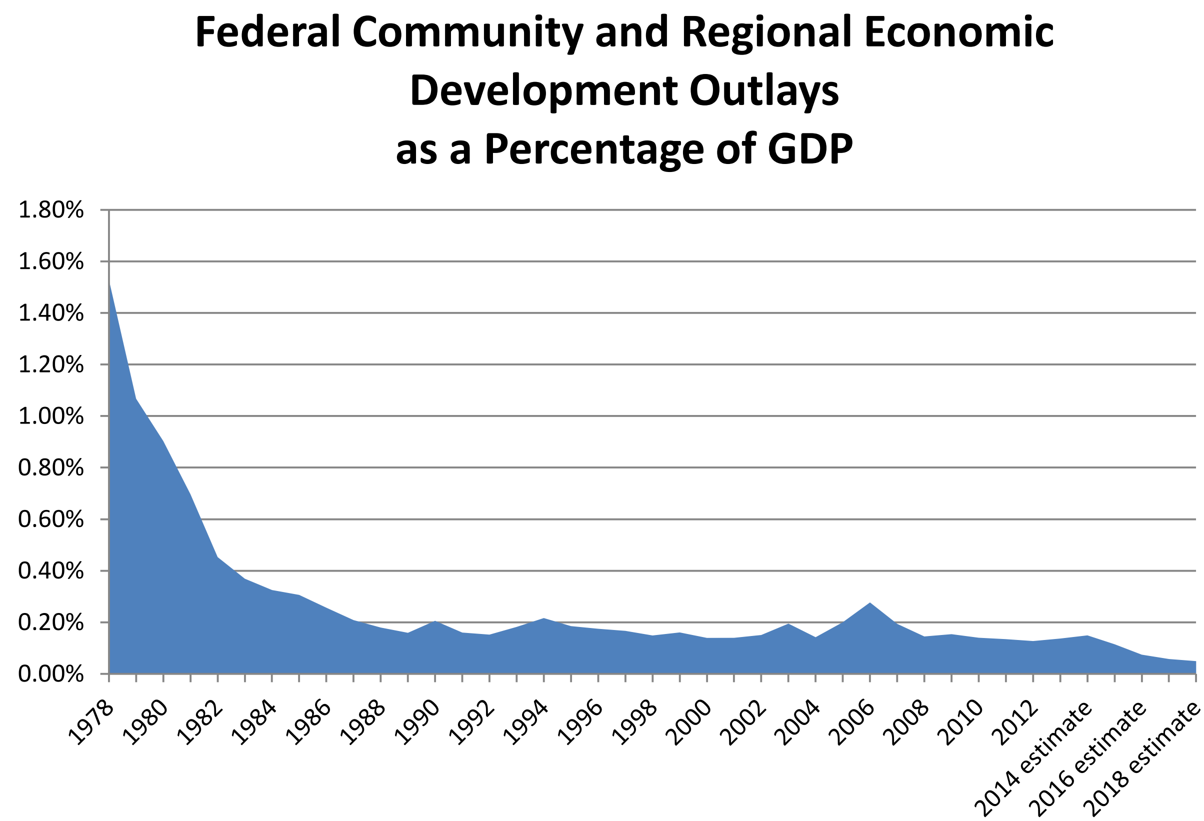


The New Markets Tax Credit is unique in its targeting and purpose. The NMTC is the only federal incentive that is primarily intended to drive capital to credit-starved businesses in economically distressed urban and rural communities, accounting for about 8 percent of annual tax expenditures for community development[5]. Unlike other programs that address a policy concern (such as affordable housing) that may overlap with low income communities, the NMTC provides both (1) the flexibility to finance a variety of businesses and projects in these low income communities along with (2) an effective established system to deliver that financing.

NMTC projects vary widely in size and scope – from a microloan fund in Portland Oregon that makes $5,000 loans to minority entrepreneurs in low income neighborhoods, to the financing of a hospital in the GO Zone in Louisiana and a healthcare center in a very poor city in Massachusetts, to a tire factory in rural South Carolina, which created 1,600 permanent jobs in a county with an unemployment rate of 12.1 percent. Yet, all produce the same impact: better lives, communities and opportunity for urban neighborhood and rural communities that are left of the economic mainstream.

Because of reductions in federal spending, tax expenditures for community development are an increasingly important element in the federal support for housing as well as economic and community development. According to data from OMB, as measured as percentage of GDP, federal spending for community development – HUD, Agriculture, Commerce, and Interior -- has fallen by 75 percent since 1980[6]. (See Chart below).

[5] The NMTC cost the federal government about $1 billion in forgone revenue in 2014. In total, tax expenditures for community development amounted to $12.035 billion.
[6] OMB Historical Tables.



Intense competition for Credits and a demonstrated record of success in placing Credit where the need and impact is greatest has increased the efficiency of NMTC. Over the history of the program demand for Credits has vastly outstripped the amount authorized. Treasury made the first NMTC allocation in 2003. Between 2003 and 2015, Treasury has received allocation applications for $314.7 billion and has had just $50.6 billion in NMTC allocation available.

The allocation application includes questions related to prior performance of the applicant, including how past NMTC use benefited low income businesses and distressed communities. The application requires applicants to quantify outcomes for previous loans and investments. If CDEs cannot demonstrate they used NMTC financing to maximize tangible outcomes and impacts in communities, they will be at a disadvantage in the intense competition for Credits.

The NMTC "but-for" test limits the amount of NMTC-generating financing necessary for financial feasibility. The NMTC typically provides "last-in" gap financing, meaning it is the last financing secured to make a project viable. CDEs and investors evaluate the sources and uses of available capital, the business plan of the enterprise in question, and its impact on the low income community in order to determine how much NMTC financing is needed to complete the project and maximize community impact.

If additional subsidies are not needed, the project will not receive NMTC financing. The NMTC is a scarce resource, which CDEs deploy accordingly. CDEs have no incentive to provide more NMTC-backed financing than what is absolutely necessary to make a project viable. Only after all the financing from other sources is committed, and the impact is clear, does a CDE commit to provide NMTC financing.

Under the law, CDEs are required to invest at least 85 percent of Qualified Equity Investments (QEIs) into projects. According to the GAO's survey for 2011-2012[7], fees and retentions only totaled 7.1 percent of total NMTC Qualified Equity Investments (QEIs). The Urban Institute's Evaluation of the NMTC indicated that CDEs invested 97 percent of QEIs into businesses and projects[8]. In other words, the two most recent reports on NMTC indicate that investment rates are well above the requirements established in law and regulation.

Broadening the NMTC investor base would increase competition and efficiency, leading to better pricing, and driving even more subsidy to businesses operating in NMTC-qualified communities. By enacting H.R. 855 Congress can take steps to increase the NMTC's efficiency. The real obstacles to greater efficiency are the lack of a longer time horizon for the program and an exemption from the Alternative Minimum Tax (AMT) for New Markets investments. A long term or permanent authorization will provide investors and CDEs more time to plan and invest in the infrastructure necessary to support the program.

Exemption from the AMT would diversify the pool of investors who could invest in the NMTC. Unlike other investment tax credits, including the Low Income Housing Tax Credit (LIHTC) and the Historic Tax Credit (HTC), NMTC investments are subject to the AMT. Providing an AMT exemption for NMTC investments would bring the NMTC in line with those other credits and open up the NMTC investor market to new investors, including community banks and corporate investors who are currently restrained by AMT.

It is time to expand and make the New Markets Tax Credit permanent. The NMTC meets an important and critical need for private-sector investment in economically distressed urban and rural communities. It blends the market incentive of Jack Kemp's Enterprise Zones with the flexible community-driven approach of Lyndon Johnson's Economic Opportunity Act. Furthermore, data on the impact of the NMTC shows that it has not only achieved its purpose, but it has done so at a relatively low cost to the federal government, particularly when compared to traditional economic development grant programs. Perhaps most importantly, these investments drive and attract additional and new investments to the community, creating a ripple effect of economic development in some of the poorest and hardest hit areas in America. With dwindling government resources, the priority should be given to programs that achieve their purpose efficiently, and the NMTC hits the mark.

[7] GAO-14-500: Published: Jul 10, 2014.
[8] Urban Institute Evaluation of the NMTC: June 2013.

Testimony to the House Ways and Means Committee
Submitted for the Record by
National Rural Electric Cooperative Association
May 25, 2016

National Rural Electric Cooperative Association (NRECA) is the national service organization for America's Electric Cooperatives. The nation's member-owned, not-for-profit electric cooperatives constitute a unique sector of the electric utility industry – and face a unique set of challenges. NRECA represents the interests of the nation's more than 900 rural electric utilities responsible for keeping the lights on for more than 42 million people across 47 states. Electric cooperatives are driven by their purpose to power communities and empower their members to improve their quality of life. Affordable electricity is the lifeblood of the American economy, and for 75 years electric cooperatives have been proud of providing affordable, reliable, and accessible electric service in the communities they serve.

NRECA stands in strong support of HR 5167 "Technologies for Energy Security Act."

Many of our distribution electric cooperatives offer their members a way to save energy and money by promoting the use of geothermal heat pumps. According to a survey conducted in 2014 by our Business and Technology Strategies Group, over 40% of electric distribution cooperatives utilize geothermal heating/cooling pumps as part of their energy efficiencies programs. (Attachment 1)

These super-efficient systems can be scaled to any size, produce clean energy 24 hours per day and can cut utility bills by up to 70 percent. Our electric cooperative member-owners install geothermal systems utilizing the geothermal tax credit. Many of the electric distribution cooperatives throughout the US also provide additional incentives including energy rebates and on-bill financing for geothermal pumps. The tax credits for geothermal technologies for both residential and commercial purpose expire at the end of this year jeopardizing the continued implementation of this energy efficient technology. Electric cooperatives rely on this tax credit as an incentive to reduce the upfront costs and to encourage members to install geothermal heating systems and reduce their energy consumption.

At the end of last year Congress passed an omnibus appropriation bill which contained many tax provisions including phasing out or phasing down the solar tax credits in sections 25D and 48. Geothermal heat pumps, small wind property, and other technologies listed in the very same section of law were left out of the year end package. NRECA is seeking parity for the technologies that were orphaned last year giving them the same phase-out or phase down in these sections.

Under Section 48 (commercial tax credit) solar receives 30% tax credit. Starting in 2020, the value of the credit for solar decreases to 26% in 2020, then 22% in 2021, and is made permanent at 10%. Because the rest of Section 48 was not included in the yearend deal, the credit ends for geothermal heat pumps at the end of 2016. (Figure 1)

Under Section 25D (residential tax credit), both solar and geothermal receive the same 30% of the investment. However, solar was extended and phased-out the same way as it is phased-out under Sec. 48 (26% in 2020, 22% in 2021) but the credit then sunsets at the end of 2021. In a similar manner, the geothermal credit was not extended and ends at the end of 2016. (Figure 1)

Geothermal, Small Wind Turbines and other technologies were not given the same consideration as wind and solar at the end of last year. We are seeking tax parity for technologies that many of our members utilize. These tax credits go directly to our member/owners.

We thank the Ways and Means Committee for their consideration of HR 5167 which extends and phases out geothermal and other technologies in sections 25D and 48.

Attachment 1

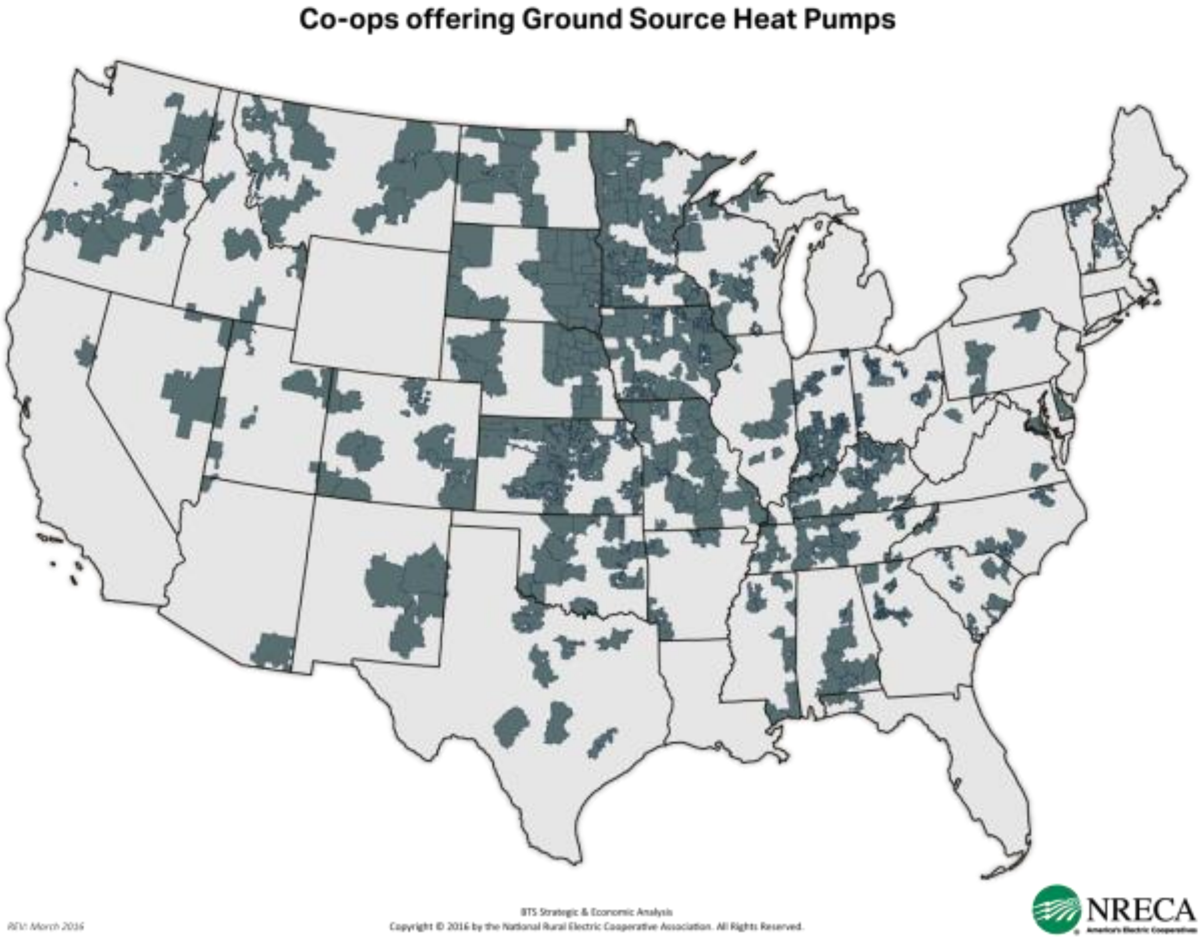
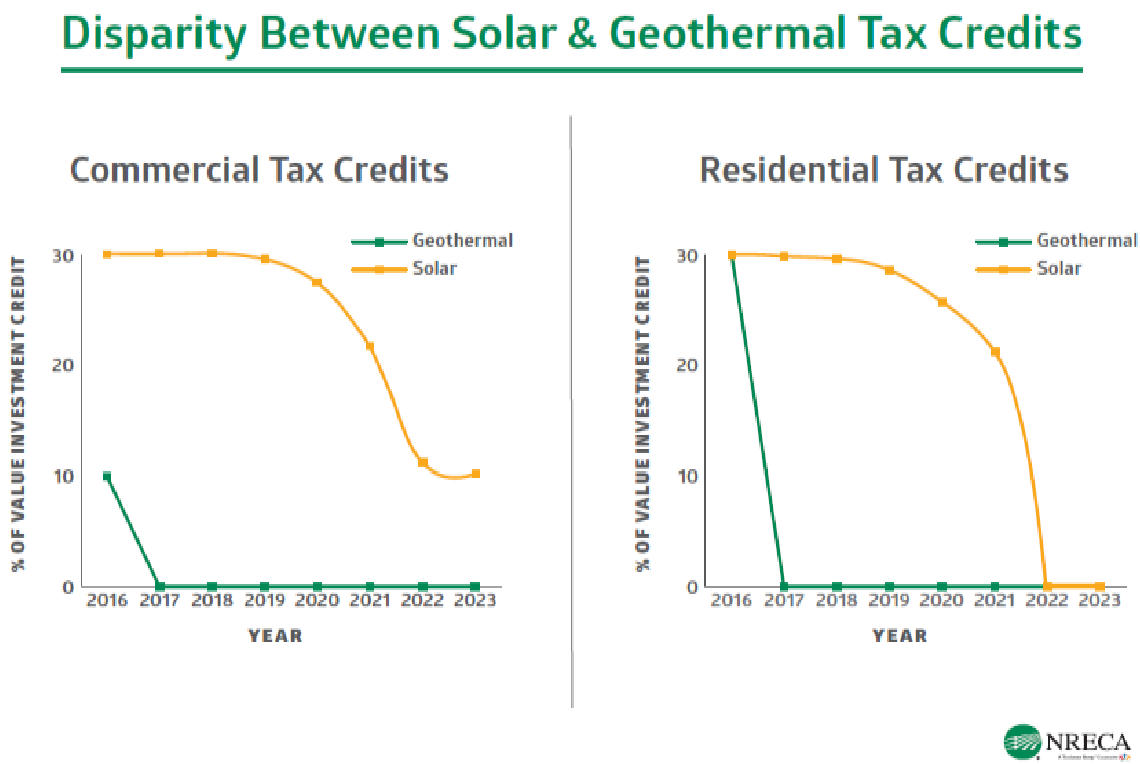


Figure 1



Disparity Between Solar & Geothermal Tax Credits
Commercial Tax Credits
Geothermal
Solar
% OF VALUE INVESTMENT CREDIT
30
20
10
0
2016
2017
2018
2019
2020
2021
2022
2023
YEAR
Residential Tax Credits
Geothermal
Solar
% OF VALUE INVESTMENT CREDIT
30
20
10
0
2016
2017
2018
2019
2020
2021
2022
2023
YEAR
NRECA

The Honorable Charles Boustany
Chairman
Ways and Means Tax Policy Subcommittee
1431 Longworth House Office Building
United States House of Representatives
Washington, D.C. 20515

The Honorable Richard Neal
Ranking Member
Ways and Means Tax Policy Subcommittee
341 Cannon House Office Building
United States House of Representatives
Washington, D.C. 20515

May 24, 2016

Dear Chairman Boustany and Ranking Member Neal:

As the House Ways and Means Tax Policy Subcommittee considers proposals to improve the U.S. tax system, we strongly urge the adoption and enactment of the Master Limited Partnerships (MLP) Parity Act, H.R 2883, introduced by Representatives Poe (R-TX-2) and Thompson (D-CA-5). The expansion of MLPs for the U.S. energy sector will enable greater parity in the tax code, encourage technology diversity, spur private investment, enhance national security, and protect the environment.

MLPs are investment vehicles taxed as partnerships but whose ownership interests trade like corporate stock. They provide access to large amounts of low-cost capital for traditional energy projects -- primarily oil and gas pipelines -- with a current market capitalization of more than *$450 billion*. Bipartisan, bicameral legislation has been introduced in multiple sessions of Congress that would open up MLPs to a broader set of energy technologies from wind, solar, and storage to carbon capture, energy efficiency, and cogeneration.

Congress first authorized MLPs in 1987, limited primarily to fossil fuel-based resources. This has allowed companies to finance projects deploying the qualifying technologies at lower interest rates. However, clean and efficient energy companies are not allowed to utilize this effective financial instrument. Congress should expand MLPs to ensure a level playing field for a broader array of energy sources and technologies and expand investment opportunities for American investors.

We urge you to include, and support enactment of, the MLP Parity Act as part of any legislation aimed at improving the U.S. tax system.

Sincerely,

Advanced Biofuels Association

Advanced Energy Economy

AEC Science & Technology, LLC

Algae Biomass Organization

Alliance for Industrial Energy Efficiency

Alliance to Save Energy

Amazon

American Council of Engineering Companies

American Council on Renewable Energy

Biomass Power Association

Biomass Thermal Energy Council

Biotechnology Industry Organization

CERES

Combined Heat and Power Association

Energy Storage Association

Environmental and Energy Study Institute

First Solar

Geothermal Energy Association

Growth Energy

Heat is Power Association

High Performance Building Coalition

Illuminating Engineering Society of North America

International Code Council

International Facilities Management Association

Malachite LLC

National Association of State Energy Officials

National Electrical Manufacturers Association

Natural Resources Defense Council

R Street Institute

Sheet Metal and Air Conditioning Contractors' National Association

Solar Energy Industries Association

The Pew Charitable Trusts

Third Way

Union of Concerned Scientists