CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

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Senator Orrin G. Hatch
Chairman, Committee on Finance
Hart Senate Office Building, SH-104,
Washington, DC 20510-4402

Dear Senator Hatch:

The U.S. Chamber of Commerce welcomes the opportunity to comment on how to reform the federal tax code.[1] The Chamber appreciates the commitment of the Committee to comprehensive, pro-growth tax reform. We applaud you for engaging stakeholders through this process. We also understand the challenges presented by this kind of reform, but urge the Committee to continue its work to reform the code as soon as possible.

COMPREHENSIVE TAX REFORM

The Chamber believes that Congress should undertake comprehensive tax reform – both the individual and corporate tax codes should be reformed simultaneously. The individual and corporate codes are intertwined in such a manner that they need to be reformed at the same time.

For example, the tax code for both corporations and pass-through businesses (non-corporate firms such as sole proprietors, S-corporations, limited liability corporations, and partnerships) follows nearly identical principles. If Congress reformed the corporate tax reform separately from individual tax reform, and the corporate rate were lowered in exchange for the elimination or reduction of certain business tax provisions, then pass-through entities could lose the benefit of these provisions without a corresponding rate reduction, thereby harming those businesses.

Likewise, many additional interactions between the individual and corporate codes occur, such as the double taxation of dividends. As such, the Chamber believes reform must look at both parts of the code simultaneously to ensure consistency across the code and overall pro-growth tax policies.

MARGINAL RATE REDUCTION

Low marginal tax rates promote capital formation and minimize the effects of other distortions in the tax code, all of which contributes to economic growth. Thus, the Chamber believes tax reform should lower marginal tax rates to enable U.S. businesses to compete

[1] All references to the code are to the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

successfully in the global economy, attract foreign investment to the United States, increase capital for investment, and drive job creation in the United States.

Corporate Rate Reduction

The United States has the highest marginal corporate tax rate among the 35 industrialized countries of the Organisation for Economic Cooperation and Development ("OECD")[2] and the third highest in the world.[3] At 35% (and nearly 39% when state taxes are considered), the U.S. marginal corporate tax rate is completely out of step with other major industrialized OECD nations. Further, even the United States' *effective* tax rate (ETR)[4] is among the highest in the world. As noted in a recent PricewaterhouseCoopers (PwC) report examining four international comparison studies of corporate ETRs,[5] "the US corporate ETR ranks in the highest 12 percent of the respective comparison countries and thus is relatively high by international standards" and "the US corporate ETR was between 26 percent and 114 percent higher than the average for the comparison countries."[6]

Through the 1986 Tax Reform Act the United States led the world in lowering tax rates on productive activity. But then the United States stopped while the rest of the world continued to reduce rates, and continues to this day. As the Tax Foundation notes, over the past 13 years, countries worldwide have reduced their corporate income tax rates, thus reducing the worldwide average tax rate.[7] They note that in 2003, the worldwide average tax rate was approximately 30% but by 2016, the average rate had declined by roughly 7 percentage points to 22.5%.[8]

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[2] See OECD Tax Database, Table II.1 – Corporate income tax rates: basic/non-targeted, April 2017, http://www.oecd.org/tax/tax-policy/tax-database.htm.

[3] See Pomerleau, "CBO Report Compares U.S. Corporate Tax to G20," Tax Foundation, *available at* https://taxfoundation.org/cbo-report-compares-us-corporate-tax-g20/ (noting that "At approximately 39 percent (the combined federal and average of state and local rates), the United States has the highest marginal corporate tax rate in the OECD and the third highest in the world.") See also Aurenius, "How the U.S. Corporate Tax Rate Compares to the Rest of the World," Tax Foundation, *available at* https://taxfoundation.org/how-us-corporate-tax-rate-compares-rest-world/.

[4] As the study notes, as a result of tax provisions adopted by governments to promote domestic research and investment and to avoid double taxation of income, among other things, effective tax rates typically are lower than the generally applicable statutory tax rates in the United States and other countries. The study looks at four international comparison studies of corporate ETRs that meet the criteria of: (1) published by government or academic organizations; (2) use of a consistent methodology; (3) wide country coverage, and (4) use of the most recent data available.

[5] See PricewaterhouseCoopers, "International Comparison of Effective Corporate Tax Rates," (Sept. 2016), *available at* http://www.actontaxreform.com/wp-content/uploads/2016/09/International-Comparison-of-Effective-Corporate-Tax-Rates_FINAL_20160926.pdf.

[6] *Id.*

[7] See Pomerleau, "Corporate Income Tax Rates around the World, 2016," Tax Foundation, *available at* https://taxfoundation.org/corporate-income-tax-rates-around-world-2016/.

[8] See id.

A recent OECD report on tax changes around the world notes that Japan, Spain, Israel, Norway and Estonia all lowered their tax rates for corporate profits in 2015.[9] Further, future reductions have been announced by Italy, France and the UK, while Japan also plans further cuts.[10] Germany, in response to these actions, is also now considering further rate reduction. The OECD report notes that the trend of corporate rate reductions, which slowed after the 2008 fiscal crisis, seems to be gaining renewed momentum.[11] In sum, as the rest of the world is dramatically reducing corporate tax rates, the United States is falling behind simply by standing still. Tax reform must address the U.S.'s uncompetitive marginal corporate tax rate.

Foreign Direct Investment (FDI)

Foreign direct investment in the United States provides a vital contribution to our economy. According to a March 2017 Organization for International Investment (OFII) report, in 2016, at $396 billion, investments by international companies in the United States broke the previous record of $353 billion in 2015, rising 12%.[12] However, while the United States remains the top choice for international investment, its global share has dropped dramatically in recent years, down from 37% in 2000 to 22% in 2015, largely due to increased competition from other countries.[13] The U.S.'s high corporate tax rate not only affects the ability of American companies to compete worldwide, but is also a factor that can deter foreign companies from investing in the United States.

Estimates of the responsiveness to corporate tax rates on FDI vary, but a 2008 OECD analysis[14] of the literature finds "an average semi-elasticity value of –3.72 (measuring the percentage change in FDI in response to a 1 percentage point change in the tax rate)." In other words, a one percent increase in a tax rate can result in a decrease in FDI of 3.72%.[15] The OECD study further notes that "studies using more recent data are found to produce larger semi-elasticities, indicating that FDI is becoming more responsive to taxation over time."[16]

While greater competition for global investment and emerging markets plays a role in the global allocation of investment, the tax sensitivity articulated in the OECD report cannot be

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[9] See OECD, "Tax Policy Reforms in the OECD 2016," (Sept. 2016), *available at* http://www.oecd-ilibrary.org/taxation/tax-policy-reforms-in-the-oecd-2016/tax-policy-developments-in-2015_9789264260399-5-en at 40.
[10] See id. at 41.
[11] See id. at 39.
[12] See OFII, "Foreign Direct Investment in the United States, Preliminary 2016," (March 2017), *available at* http://ofii.org/sites/default/files/FDIUS%202016%20preliminary.pdf.
[13] See id. at 2.
[14] See OECD, "Tax Policy Study No. 17: Tax Effects on Foreign Direct Investment: Recent Evidence and Policy Analysis," Executive Summary, *available at* http://www1.oecd.org/ctp/tax-policy/39866155.pdf.
[15] See also Hodge, "Ten Reasons the U.S. Should Move to a Territorial System of Taxing Foreign Earnings," Tax Foundation, *available at* http://taxfoundation.org/article/ten-reasons-us-should-move-territorial-system-taxing-foreign-earnings.
[16] See OECD, "Tax Policy Study No. 17: Tax Effects on Foreign Direct Investment: Recent Evidence and Policy Analysis," Executive Summary, *available at* http://www1.oecd.org/ctp/tax-policy/39866155.pdf.

ignored. If the United States wishes to increase its attractiveness to foreign investment, a lower tax rate is a vital aspect of achieving that goal.

High Tax Rate and Impact on Labor

Not only are there detrimental competitiveness and investment issues with the U.S.'s high corporate tax rate, studies suggest that higher corporate tax rates mean lower wages. A December 2010 study by Kevin Hassett and Aparna Mathur[17] examined 65 countries over 25 years and concluded that a 1 percent increase in corporate tax rates leads to a 0.5-0.6 percent decrease in wage rates. Likewise, a study by Desai, Foley, and Hines[18] reinforces this finding, concluding that the burden of corporate taxation is borne by labor to a significant degree, a view shared by both the U.S. Treasury Department and the congressional Joint Committee on Taxation.[19] More recently, a Canadian study by McKenzie and Ferede[20] also concluded that corporate taxes are indeed borne to a significant extent by labor through lower wages.

Pass-Through Entity Tax Rates

High Rates

As Congress considers lowering the corporate tax rate, it must also address the tax rates of those businesses that operate as pass-through entities. Like corporations, pass-through entities face nearly the highest rate among industrialized countries on business income. Under the individual code, pass-through entities face a top marginal rate of 39.6%, even higher than the anti-competitive 35% rate faced by C corporations. Pass-through's combined federal and state marginal rates are close to 45%.[21]

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[17] See Hassett and Mathur, "Spatial Tax Competition and Domestic Wages," (December 2010), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2212975. See also Hassett and Mathur, "The Cure for Wage Stagnation," *Wall Street Journal* (Aug. 14, 2016), *available at* https://www.wsj.com/articles/the-cure-for-wage-stagnation-1471210831 (reiterating the findings of their 2010 study that lower corporate tax rates equal higher wages). See also Liu and Altshuler, "Measuring the Burden of the Corporate Income Tax Under Imperfect Competition," *National Tax Journal* (March 2013), *available at* http://www.ntanet.org/NTJ/66/1/ntj-v66n01p215-37-measuring-burden-corporate-income.pdf ("Over all industries, our estimates suggest that a $1.00 increase in corporate tax revenue decreases wages by approximately $0.60.").

[18] See Desai, Foley, and Hines, "Labor and Capital Shares of the Corporate Tax Burden: International Evidence" (2011).

[19] Even the Tax Policy Center (TPC) now treats 20% of the corporate income tax burden as falling on labor. See "How TPC Distributes The Corporate Income Tax," (September 2012), *available at* http://www.taxpolicycenter.org/publications/how-tpc-distributes-corporate-income-tax. See also Ljungvist and Smolyansky, "To Cut or Not to Cut? On the Impact of Corporate Taxes on Employment and Income," Divisions of Research & Statistics and Monetary Affairs Federal Reserve Board, *available at* https://www.federalreserve.gov/econresdata/feds/2016/files/2016006pap.pdf ("Our results suggest that increases in corporate tax rates are uniformly harmful for workers.").

[20] See McKenzie and Ferede, "Who Pays The Corporate Tax?: Insights From The Literature And Evidence For Canadian Provinces" (2017).

[21] See "A Better Way: Our Vision for a Confident America," (June 24, 2016), *available at* https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf.

Pass-Through Footprint

The number of businesses facing these high rates and their importance to the broader economy is impressive. According to the Tax Foundation, between 1980 and 2012, the number of pass-through businesses filing tax returns rose substantially, from 10.9 million businesses to 31.1 million.[22] Likewise, in 1998, pass-through businesses had begun to earn a greater share of business income than C corporations. In 2012, pass-through businesses earned $1.63 trillion in net income, compared to $1.10 trillion of net income earned by C corporations.[23]

Additionally, the Tax Foundation found that more than 90% of businesses in the United States are organized as pass-through entities.[24] This data echoes the finding of a 2011 study[25] by Ernst & Young that also concluded that more than 90% of businesses in the United States are organized as pass-through entities. The Ernst & Young study also found that individual owners of pass-through entities paid 44% of all federal business income taxes between 2004 and 2008 and, moreover, that pass-through businesses employed 54% of the private sector work force in the United States.[26] The Tax Foundation found that as of 2014 57.3% of the U.S. private-sector workforce was employed or self-employed at a pass-through business.[27] The Ernst & Young report found that if corporate tax reform is undertaken separately from pass-through tax reform, then the income taxes paid by pass-through entity owners would increase, on average, by 8%, or $27 billion annually between 2010 and 2014.[28]

Entity Choice Considerations

As Congress considers comprehensive tax reform and the appropriate marginal rates for businesses, the Chamber believes it is crucial that consideration be given to why taxpayers choose to operate as pass-through entities.

From a tax perspective, operating as a pass-through entity avoids the double taxation C corporations face – C corporations are taxed at the corporate level on their profits and many of their shareholders pay tax again when those same earnings are distributed as dividends or when shareholders sell their stock and recognize capital gains; conversely, pass-through entities pay no entity level tax and, instead, profits are reported on the individual returns of owners.

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[22] See Greenburg, "Pass-Through Businesses: Data and Policy," Tax Foundation, *available at* https://taxfoundation.org/pass-through-businesses-data-and-policy/.
[23] See id.
[24] See id.
[25] See Carroll and Prante, "The Flow-Through Business Sector and Tax Reform," *available at* http://www.s-corp.org/wp-content/uploads/2011/04/Flow-Through-Report-Final-2011-04-08.pdf.
[26] See id.
[27] See Greenburg, "Pass-Through Businesses: Data and Policy," Tax Foundation, *available at* https://taxfoundation.org/pass-through-businesses-data-and-policy/.
[28] See Carroll and Prante, "The Flow-Through Business Sector and Tax Reform," *available at* http://www.s-corp.org/wp-content/uploads/2011/04/Flow-Through-Report-Final-2011-04-08.pdf.

From a non-tax perspective, taxpayers choose to operate as pass-through entities for a variety of non-tax reasons. Pass-through entities provide flexibility that the C corporation structure does not allow. For example, partnerships can have one partner put in cash, another put in property, and another expertise. They can then set up their own agreement for how the profits will be divvied up; a C corporation structure does not have that flexibility.

Simplicity is another non-tax reason taxpayers choose a pass-through entity form. To form a partnership, all that is needed is two people with a profit motive and an agreement. Conversely, with a C corporation, a taxpayer has to file articles of incorporation, elect a board of directors, have regular shareholder and director meetings, etc. Further, filing as a pass-through entity makes it easier to plan for business succession and ease estate tax planning concerns.

INTERNATIONAL

It is to the mutual advantage of all countries that the exchange of goods, capital, and services in international trade not be unduly hindered by taxation. Even if other conditions are favorable, excessive taxation by a single country or multiple taxations by two or more countries of the same property or income will destroy the incentives to incur the risks involved in international business.

Pro-growth international tax policies are instrumental to both the ability of American companies to compete globally and grow not only their global footprint, but also U.S. jobs and operations. Additionally, as noted above, international tax policies must not hinder foreign investment in the United States and the economic and job growth it brings.

Territorial Tax System

The Chamber believes the U.S.'s current worldwide tax system, dating back to the first Civil War-era income tax,[29] should be replaced with a territorial system for the taxation of foreign source income. Whereas a worldwide tax system is expressly designed to inhibit international investment, a territorial system advances tax neutrality and would thereby permit American companies to compete globally more effectively while also promoting economic growth domestically. A territorial tax system will allow American companies to build their global franchises while continuing to strengthen American operations.

In 2017, the United States suffers not only the highest marginal tax rates on businesses in the world, but is the only major industrialized OECD country that continues to employ a worldwide system of taxation.[30] Through the mid-1990s, about half the OECD countries

[29] See "A Better Way: Our Vision for a Confident America," (June 24, 2016), *available at* https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf.
[30] See Toder, "Is a Territorial Tax System Viable for the United States," Tax Policy Center, *available at* http://www.urban.org/sites/default/files/publication/89241/2001204-is-a-territorial-tax-system-viable-for-the-united-states.pdf. (Noting that "Except for the United States, every country in the Group of 7 (Canada, France, Japan, Germany, Italy, and the United Kingdom) and most countries in the Organisation for Economic Co-operation and Development (OECD) now mostly satisfy the second criterion by exempting the active foreign-source income of

employed some variation of a worldwide system while half employed a variation on a territorial system. In the intervening period, competitive pressures and sound theory combined to compel every other country in the OECD with a worldwide system to jettison that system for a territorial system.

In recent years, countries concerned about the global success of their domestic companies have recognized the myriad economic benefits of territorial systems of taxation. From increased global competitiveness to decreased lockout impacts,[31] countries have recognized these benefits and reformed their tax codes accordingly. As a result, the remaining number of countries employing worldwide systems of taxation has decreased from 17 in 2000 to only six in 2015.[32]

For example, prior to Japan's adoption of a quasi-territorial tax system, Japanese companies faced issues similar to those of United States companies. The Japanese government was concerned about earnings trapped overseas and the inability of Japanese firms to compete globally.[33] Since its international tax reform changes, Japan has seen greater repatriated earnings and its companies have gained more footing in global competition, evidenced through increased acquisitions of foreign companies.[34] Likewise, countries like Germany[35] and the United Kingdom[36] also have adopted territorial systems to confront competitiveness challenges and compliance concerns.[37] Once again, the United States has been left behind and must now catch up. High tax rate and the possibility of double taxation on foreign source income, the latter only

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their resident multinationals"). See "A Better Way: Our Vision for a Confident America," (June 24, 2016), *available at* https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf (noting that "virtually all of our major trading partners have adopted territorial tax system).

[31] For a complete discussion of the benefits of territorial tax systems, see Hodge, "Ten Reasons the U.S. Should Move to a Territorial System of Taxing Foreign Earnings," Tax Foundation, *available at* http://taxfoundation.org/article/ten-reasons-us-should-move-territorial-system-taxing-foreign-earnings. See also Dubay, "A Territorial Tax System Would Create Jobs and Raise wages for U.S. Workers", The Heritage Foundation, *available at* http://www.heritage.org/taxes/report/territorial-tax-system-would-create-jobs-and-raise-wages-us-workers (noting that a territorial system "would be a boon for U.S. workers by removing the worldwide system's disincentive to invest and its barriers to international competitiveness.").

[32] See Pomerleau, "Worldwide Taxation is Very Rare," Tax Foundation, *available at* https://taxfoundation.org/worldwide-taxation-very-rare/.

[33] See "Japan Disproves Fears of Territorial Taxation," Tax Foundation, *available at* http://taxfoundation.org/article/japan-disproves-fears-territorial-taxation-0. See also Ernst & Young, "International Tax Alert: Japan's move to territorial taxation contrasts with US international tax policy," *available at* http://pace4jobs.org/files/TNI_Neubig%204-27-09.pdf; Testimony of Gary M. Thomas, before House Ways & Mean, May 24, 2011, *available at* https://waysandmeans.house.gov/UploadedFiles/Thomastestimony.pdf.

[34] See "Japan Disproves Fears of Territorial Taxation," Tax Foundation, *available at* http://taxfoundation.org/article/japan-disproves-fears-territorial-taxation-0. See also "Lessons in Reform—Discussion of Recent Tax Reform in Other Countries," TCPI 11th Annual Tax Policy and Practice Symposium (Statement of Jonathan Stuart-Smith).

[35] See Morrison, "Germany Promotes Competition with Shift to Territorial Tax System," Tax Foundation *available at* https://taxfoundation.org/germany-promotes-competition-shift-territorial-taxation-system/.

[36] See Hodge, "U.K. Strives to have "Most Competitive Tax System Among G20," Tax Foundation, *available at* https://taxfoundation.org/uk-strives-have-most-competitive-tax-system-among-g20//.

[37] See "Lessons in Reform—Discussion of Recent Tax Reform in Other Countries," TCPI 11th Annual Tax Policy and Practice Symposium (Statement of Anneli Collins).

partially mitigated by provisions such as deferral and the foreign tax credit, substantially harms the ability of American companies to compete globally.[38]

While the Chamber urges a shift to an internationally competitive, territorial system of taxation, we also believe that the details of a territorial system are of the utmost significance. Proper consideration must be given to issues such as the specific exemption system applicable to foreign dividends, the treatment of other foreign income, exceptions to the exemption regime, the use of foreign tax credits for income that continues to be subject to foreign tax levies, the treatment of expenses, and anti-base erosion provisions. These issues are unquestionably complex but must be addressed if the United States wishes to keep pace in the global economy.[39]

Anti-Base Erosion Proposals

Discussions of changes to our international system of taxation are rarely without discussion of anti-base erosion proposals. Most recently, Chairman Camp's international tax reform proposal,[40] discussions by the OECD,[41] and the House "A Better Way" Proposal[42] have each considered the need for and options on anti-base erosion proposals. The Chamber believes it is important to pay great attention to how these proposals would reduce the competitiveness of American companies and, further, such proposals should in no way punish the success of these companies. If needed, proper time and attention should be spent further developing these alternatives and narrowing their impact so as only to affect the activity intended to be discouraged. Further, careful consideration should be given so that anti-base erosion proposals, like tax reform, do not unfairly penalize or impact any one industry or sector.

Previously Untaxed Foreign Earnings

While adoption of a territorial tax system alleviates concerns about global competitiveness and the lockout effect prospectively, any reform efforts also likely would look back at previously untaxed foreign earnings. In most instances, proposals have suggested that

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[38] See Pomerleau, "2016 International Tax Competitiveness Index", Tax Foundation, *available at* https://taxfoundation.org/2016-international-tax-competitiveness-index (concluding that the United States ranks 31 out of 35 in tax competitiveness).

[39] See Chamber Written Testimony, Subcommittee on Select Revenue Measures, House Committee on Ways & Means, Hearing on Ways and Means International Tax Reform Discussion Draft, *available at* http://www.uschamber.com/sites/default/files/111117commentstoWMsonCampint'lPlan.pdf, for additional detail on international tax reform issues.

[40] See Chairman Camp International Tax Reform Proposal, the "Tax Reform Act of 2011," Title III, Subtitle 3, Part 2, *available at* https://waysandmeans.house.gov/UploadedFiles/Statutory_Text_Tax_Reform_Act_of_2014_Discussion_Draft__022614.pdf.

[41] See "Action Plan on Base Erosion and Profit Shifting," OECD (2013), *available at* https://www.oecd.org/ctp/BEPSActionPlan.pdf (calling for "the adoption of new consensus-based approaches, including anti-abuse provisions, designed to prevent and counter base erosion and profit shifting").

[42] See "A Better Way: Our Vision for a Confident America," (June 24, 2016), *available at* https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf (providing for a system of border adjustments to combat base erosion).

these earnings be subject to tax under a deemed repatriation scheme, whereby they are taxed regardless of whether actually repatriated or not. The Chamber feels it is extremely important to note that a large portion of these previously untaxed overseas earnings are not in liquid form; as noted on balance sheets, they are "permanently reinvested overseas," such as in property, plant, or equipment or having been used to fund expansion of overseas operations or in restructurings. As such, the Chamber urges that any forced or deemed repatriation utilize a bifurcated rate to reflect the economic reality that much of the untaxed offshore earnings are not in liquid form.

A Note on Individuals

While this section discusses a territorial system of taxation for businesses, the concept of a territorial system for individuals also merits mention. As with corporations, the United States has long taxed the foreign-earned income of its citizens residing abroad, resulting in double taxation and disincentivizing the hiring of U.S. citizens. Studies have shown that U.S. expatriates employed as managers in foreign affiliates of American worldwide companies are a powerful driver of U.S. exports, so this practice significantly undermines the global competitiveness of U.S. exporters. No other country taxes its citizens working abroad, and any transition to a territorial tax system should take this into consideration and end this damaging practice.

COST RECOVERY

In General

The Chamber believes cost recovery provisions are another key aspect of tax reform. Tax reform legislation should eliminate the bias in the current U.S. tax system against capital investment in productive plant and equipment. Capital investment should be expensed or recovered using a capital cost recovery system providing the present value equivalent to expensing with due regard to the impact the system may have on cash flow.

As the Committee and Congress work toward comprehensive tax reform, the Chamber believes that provisions must be included in the code to allow businesses to recover their capital investments properly. Failure to include such provisions, even if coupled with a lower marginal rate, would permit the tax code to continue to inhibit economic growth and job creation.

By way of illustration, the United Kingdom has reformed its corporate tax regime by gradually reducing the main corporate tax rate from 28% to a scheduled rate of 17% in 2020. This rate reduction has been partly paid for in part by reducing the allowances for capital costs. This is the wrong prescription for growth.

While the U.K.'s tax system has moved in the right direction in terms of the marginal corporate rate and its taxation of foreign source income, a recent study by Oxford University's Centre for Business Taxation[43] assessed the current competitiveness of the new U.K. corporate

[43] See Devereux, Habu, Lepoev, and Maffini, "G20 Corporation Tax Ranking," Oxford University Centre for Business Taxation (March 2016), *available at*

tax system relative to other G-20 countries and OECD countries. Noting that the intent of the United Kingdom in reforming its corporate tax system was "to create the most competitive corporate tax regime in the G20, while protecting manufacturing industries," the study concluded the United Kingdom still suffers from a high effective marginal tax rate relative to other OECD countries. According to the study, this relatively weaker position of the United Kingdom is due primarily to "lower allowances in the UK, including the non-existence of allowances for industrial structures and buildings."[44]

The U.K. study drives home the point that many elements of the tax system must be properly designed and implemented to minimize the system's ill-consequences for economic growth. Thus, as Congress strives to reform the tax code and create a more pro-growth economic environment, the Chamber urges that cost recovery provisions be given appropriate attention.

Research and Development Costs

The Chamber has long advocated that research and development (R&D) expenses should be deductible in the year incurred and a larger credit for increases in research expenditures should be allowed. Further, as other countries expand R&D benefits, the Chamber believes we should consider how the tax code impacts the decision whether to conduct research and development in the United States and, also, where the ensuing intellectual property that is created is located.

The economic rationale for an R&D credit is straightforward. R&D advances human knowledge which disseminates quickly. The value of certain key R&D outcomes can through patents and other intellectual property protections be captured and internalized by the company funding the R&D, but much of what is leaned spreads quickly through the research community to the benefit of all interested parties. This process of knowledge dissemination is extremely important and beneficial in general, but it means the company or individual funding the research is unable to capture some or even much of the benefit. This, in turn, discourages the amount of R&D activity funded. The rationale for an R&D credit is therefore to restore some of the value of the research which is otherwise socialized to the funder to ensure a more robust research budget.

Congress first enacted the R&D credit in 1981, finding that "a substantial tax credit for incremental research and experimental expenditures [would] overcome the resistance of many businesses to bear the significant costs of staffing, supplies, and certain computer charges which must be incurred in initiating or expanding research programs."[45] Congress extended the research credit repeatedly, most recently in 2015, when they made the credit permanent.[46] Legislative history surrounding the credit concludes that "[a] research tax credit can help promote

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https://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Policy_Papers/g20-corporation-tax-ranking-2016_0.pdf.

[44] See id.

[45] H.R. Rep. No. 97-201, pt. 1, at 106 (1981).

[46] See P.L. 113-114 (Consolidated Appropriations Act, 2016, which contained the Protecting Americans from Tax Hikes (PATH) Act, making the R&D credit permanent).

investment in research, so that research activities undertaken approach the optimal level for the overall economy."[47]

While the United States once was a leader in R&D incentives, the United States has slipped significantly in recent years. A study by the Information Technology and Innovation Foundation found that, in 2012, the United States ranked just 27th out of 42 countries studied in terms of R&D incentive generosity, a downward movement from its 23rd ranking of 10 years ago.[48]

The Chamber believes that innovation is a crucial long-term driver of growth and wages. Any reform to the tax code should contain incentives for companies to conduct research and development activities in the United States and locate the resulting intellectual property within U.S. borders.

INVESTMENT

The Chamber has long suggested that investment taxes should be minimized. Taxes on investment income and capital gains drive up the cost of capital, thereby reducing the amount of capital productively employed, productivity, wage gains, and international competitiveness.

Capital Gains

Capital gains taxes inflict significant damage on economic growth. Accordingly, the Chamber strongly urges that any comprehensive tax reform consider the adverse impact capital gains tax has on investment activity, productivity growth, and economic growth.

Individual short-term capital gains are taxed at ordinary income tax rates, while long-term capital gains are taxed through the individual income tax at a top rate of 20%. Since the beginning of 2013, capital gains also faced Medicare HI tax, adding another 3.8% tax to the capital gains tax rate.[49] Corporate capital gains tax rates are even higher, at 35%.

Capital gains taxes hurt investment. As the CBO notes, "reductions in capital taxation increase the return on investment and therefore the formation of capital. The resulting increase in the capital stock yields greater output and higher incomes throughout much of the economy."

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[47] Staff of J. Comm. on Taxation, 104th Cong., General Explanation of Tax Legislation Enacted in the 104th Congress 105 (Comm. Print 1996).

[48] The Information Technology and Innovation Foundation, "We're 27th! The United States Lags Far Behind in R&D Tax Incentive Generosity" (July 2012), *available at* http://www2.itif.org/2012-were-27-b-index-tax.pdf. See also "Tax Incentives for Research and Development: Trends and Issues," OECD, *available at* http://www.oecd.org/science/inno/2498389.pdf (noting also that "[a]n increasing number of OECD governments are offering special fiscal incentives to business to increase spending on research and development (R&D)").

[49] See also Pomerleau, "The High Burden of State and Federal Capital Gains Tax Rates in the United States," Tax Foundation, *available at* http://taxfoundation.org/sites/taxfoundation.org/files/docs/TaxFoundation_FF460.pdf (noting that the average combined federal, state, and local top marginal tax rate on long-term capital gains in the United States is 28.6%, the 6th highest in the OECD.)

A 2010 study by Allen Sinai[50] indicates that the net effect of lower capital gains taxation is a significant plus for U.S. macroeconomic performance. The study found capital gains tax causes significant damage to the economy, reducing growth in real GDP especially by reducing productivity growth. The study concluded that these losses outweigh the benefit of capital gains tax receipts.

According to the CBO[51] and other studies,[52] capital gains taxes also create a "lock-in effect" where investors defer tax by not selling assets. If investors are unwilling to sell taxable real assets such as land, the lock-in effect can reduce economic growth by preventing the reallocation of capital to more efficient investments.[53]

Dividend Taxes

Dividends are taxed at a top rate of 20%. As with capital gains taxes, dividends are also subject to the Medicare HI tax, adding another 3.8% tax to the dividend tax rate.

As with capital gains taxes, taxes on dividend income produce substantial deleterious economic consequences. In simplest terms, the dividend tax multiplies all the distortions in play arising from the corporate income tax. To whatever extent the corporate income tax distorts the allocation of capital or reduces the amount of productive capital employed, the dividend tax builds on and thereby exacerbates this effect. The corporate income tax raises the cost of capital; the dividend tax does so even further.

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[50] See Sinai, "Capital Gains Taxes and the Economy." See also Sinai, "Cap Gains Taxation: Less Means More", Wall Street Journal, *available at* https://www.wsj.com/articles/SB10001424052748703556604575501892210065882. For a more recent discussion, see Clemens, Lammam, and Lo, "The Economic Costs of Capital Gains Taxes in Canada", Fraser Institute, *available at* https://www.fraserinstitute.org/sites/default/files/economic-costs-of-capital-gains-taxes-in-canada-chpt.pdf (concluding that capital gains taxes carry considerable economic costs, substantially impacting the reallocation of capital, the stock of capital, and the levels of entrepreneurship"). While this study focused on Canada, its basic economic conclusions are nonetheless applicable.

[51] See CBO, Capital Gains Taxes and Federal Revenues (October 2002), available at http://www.cbo.gov/doc.cfm?index=3856&type=0.

[52] See Heritage Foundation, Web Memo 1891, Economic Effects of Increasing the Tax Rates on Capital Gains and Dividends, available at http://www.heritage.org/research/reports/2008/04/economic-effects-of-increasing-the-tax-rates-on-capital-gains-and-dividends#_ftn2. See also Caro and Cebada, "Taxation of capital gains and Lock-in effect in the Spanish Dual Income Tax," (January 2016), *available at* http://www.sciencedirect.com/science/article/pii/S101968381500058X (confirming the findings of earlier studies in both the United States and Europe suggesting that "high taxes on capital gains generated a greater lock-in effect on capital gains, both in their realization and amount").

[53] The lock-in effect also extends to the actual ownership of businesses. See Gentry, "Capital Gains Taxation and Entrepreneurship", Williams College (March 2016), *available at* https://www.law.upenn.edu/live/files/5474-capital-gains-taxation-and-entrepreneurship-march (noting that "[e]ntrepreneurs may become locked into closely-held businesses; this lock-in effect may distort whether firms are owned by the most efficient manager for the firm.").

The dividend tax has other ill consequences. For example, according to the Tax Foundation,[54] dividend tax reduces the amount of dividends paid to shareholders or, expressed another way, creates a tax bias toward a corporation's retaining income, a conclusion echoed by a 2010 J.P. Morgan study.[55]

The same J.P Morgan study[56] concluded that dividend taxes could increase economic instability. As dividend income is subject to tax while dividends paid are not deductible to the corporation, the tax system creates a bias against equity finance compared to debt which is taxable but also deductible. The tax system therefore creates a bias toward debt finance, increasing the risk of failure and adding to the potential for instability during a widespread downturn. For all these reasons, the Chamber strongly urges that investment taxes be kept as low as possible to avoid damaging economic ramifications.

COMPLIANCE

The Chamber believes Congress should enact simple, predictable, and easy-to-understand tax rules to improve compliance and reduce the cost of tax administration. By enacting less complex tax rules, Congress could significantly reduce compliance costs and reduce the tax gap without levying new onerous and punitive taxes.

As noted by observers ranging from the National Taxpayer Advocate[57] to the Tax Foundation,[58] the tax code imposes huge compliance burdens on taxpayers. As a result of a complex tax code totaling almost 4 million words, the Tax Foundation estimates that Americans will spend more than 8.9 billion hours complying with IRS tax filing requirements in 2016.[59] Further, it is suggested that tax compliance will cost the U.S. economy $409 billion this year. As this data clearly indicates, these compliance costs are unduly burdensome.

The burdens brought by the complexity of our tax code also harm the global competitiveness of American worldwide companies. Companies must engage in complex tax planning and deal with outdated and inefficient tax provisions simply to compete in the global

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[54] See Tax Foundation, The Economic Effects of the Lower Tax Rate on Dividends, available at https://taxfoundation.org/economic-effects-lower-tax-rate-dividends/. See also Entin and Schuyler, "Are Dividend Taxes Harmless? Don't Bet On It!," Tax Foundation, *available at* https://taxfoundation.org/are-dividend-taxes-harmless-don-t-bet-it/.

[55] See also "Corporate dividend and capital gains taxation," E&Y (April 2015), *available at* http://theasi.org/assets/EY-ASI-2014-International-Comparison-of-Top-Dividend-and-Capital-Gains-Tax-Rates.pdf (noting that "[i]ncreasing the dividend tax rate relative to the capital gains tax rate could discourage companies from distributing corporate earnings to shareholders through dividends."). See also J.P. Morgan, Unintended Consequences: How higher investor taxes impact corporate finance decisions, available at https://www.jpmorgan.com/jpmpdf/1320675768353.pdf.

[56] See id.

[57] See National Taxpayer Advocate, 2016 ANNUAL REPORT TO CONGRESS, *available at* https://taxpayeradvocate.irs.gov/Media/Default/Documents/2016-ARC/ARC16_Volume1.pdf.

[58] See Hodge, "The Compliance Cost of IRS Regulations," Tax Foundation, *available at* https://taxfoundation.org/compliance-costs-irs-regulations/.

[59] See id.

economy. These compliance burdens cause valuable resources to be diverted from productive investments to addressing compliance burdens, an inefficient allocation of resources.[60]

TRANSITION RULES

The Chamber believes that a critical component of the tax reform debate is how to transition to the new tax regime. The tax code has deep and profound influences on the nature and structure of current transactions and long-term investment. Tax reform should produce a new tax system greatly reducing these effects. Thus, tax reform should include effective transition rules to provide adequate time for implementation of any new system of taxation and to help minimize economic hardships that businesses may encounter in moving to a new tax system.

Generally, these transition rules[61] must give consideration to issues including, but not limited to, treatment of existing deferred tax assets and liabilities, effects on asset valuation, treatment of existing debt, and the impact on methods of accounting for existing inventory. In the international arena, consideration must be given to issues such as the treatment of untaxed earnings, the treatment of unused foreign tax credits, and the impact of potential border tax adjustments.

CERTAINTY

The Chamber believes tax reform should address the uncertainty currently plaguing the business community under the current Code, both due to the temporary nature of some business tax provisions as well as the unclear timing and content of tax reform. The Chamber therefore urges that changes to the Code as part of comprehensive tax reform be permanent to ensure certainty for businesses striving to expand, create jobs, and remain competitive in the United States and abroad. However, the Chamber also adheres to its longstanding policy that the tax policy process be conducted in an open manner which allows for public comment. Thus, should changes be necessary in the future as a result of findings made during the tax policy process, the Chamber urges Congress to ensure that the tax policy process allows for the implementation of those changes.

THE BUDGET DEFICIT, SCORING, AND PERMANCY

No tax bill enacted by Congress and signed into law by the President will be the last tax bill. Tax policy will change over time as circumstances change and as prevailing views evolve.

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[60] See Dave Camp, Chairman, House Ways and Means Committee, Letter to Paul Ryan, Chairman, House Budget Committee, *available at* http://images.politico.com/global/2013/03/10/fy14_budget_letter_from_wm.html (dated 3/6/13). See also "A Better Way: Our Vision for a Confident America" (June 24, 2016), *available at* https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf (noting that, among other things, "America's tax code in 2016 …encourages businesses to move overseas.").

[61] For a discussion of transition rule issues in tax reform, see Foster, Tax Foundation, "Principles and Practice of Tax Reform Transition," Background Paper No. 23, *available at* http://taxfoundation.org/sites/taxfoundation.org/files/docs/650b130d58b4ed525549effef358a0fc.pdf.

Consequently, the twin goals of certainty and permanency need to be understood within the context of the current debate and current context. A languishing economy is part of that context and provides much of the imperative for comprehensive tax reform. The overall fiscal picture provides another part of the context for tax reform.

The federal budget deficit has come down in recent years from its trillion dollar plus lofty heights of the early Obama Administration, but the deficit remains well north of a half trillion dollars, and even under current policy, absent spending increases or recessions, will soon migrate to again exceed a trillion dollars "for as far as the eye can see."

This fiscal reality creates certain practical realities for tax reform. For tax reform to spur the economy as intended, businesses must hold that the main provisions relating to improving growth contained in the tax bill will endure for many years. If tax reform significantly exacerbates the already difficult fiscal picture, then the changes are unlikely to endure and so the growth effects will likely fail to materialize.

The Chamber believes taxes should be levied for the purpose of obtaining those revenues necessary to fund limited government expenditures and so as to minimize the negative impact on taxpayers, overall economic growth, job creation, investment, and the international competitiveness of American businesses. Further, in the pursuit of fiscal discipline and to permit restraint on overall tax burdens, Congress should separately consider and give equal attention to government spending restraint.

Revenue estimates are an integral part of the tax policymaking process, therefore how they are calculated is of paramount importance. Thus, as Congress considers comprehensive tax reform, the Chamber urges Congress to direct its revenue estimators to take into account likely changes in taxpayer behavior and the consequences thereof for the determinants of economic growth such as the labor supply and the amount of capital employed, and the efficiency with which these factors of production are employed, rather than assuming that taxpayers will not take changes in the tax law into consideration.

A study[62] by the nonpartisan Tax Foundation highlights the need for such "dynamic" revenue scoring. While noting that static scoring has "the advantage of simplicity, and it is not too far from the truth for tax changes that either have little impact on incentives at the margin or affect parameters that do not respond much to incentives," the authors of the study note that for a

[62] See Schuyler, Tax Foundation, "Growth Dividend from a Lower Corporate Tax Rate," *available at* http://taxfoundation.org/article/growth-dividend-lower-corporate-tax-rate. Note that a majority of the Senate endorsed "dynamic scoring" of changes in tax law during the budget process in 2013. See "The Senate Gets Dynamic," *Wall Street Journal* (April 1, 2013), *available at* http://online.wsj.com/article/SB10001424127887324685104578386280984564380.html?mod=ITP_opinion_2. Also note that a majority of the House endorsed "dynamic scoring" of changes in tax law in 2015. See "House adopts 'dynamic scoring', *The Hill* (January 6, 2015), *available at http://thehill.com/blogs/floor-action/house/228684-house-adopts-dynamic-scoring-rule*. See also Hodge, "Dynamic Scoring Made Simple," Tax Foundation, *available at* https://taxfoundation.org/dynamic-scoring-made-simple/ (noting that the "use of dynamic scoring is crucial to ensure that comprehensive tax reform grows the economy and meets revenue expectations.")

great many tax changes this is an "extremely unrealistic assumption," particularly in the case of the corporate income tax rate. They further note that:

> [c]hanges in that rate do alter rewards at the margin and investors respond strongly to incentives. In other words, when the full economic effects of cutting the corporate income tax rate are taken into account, the federal treasury would collect more in total revenue than it would lose from the lower rate.

The Chamber agrees that behavioral changes should be considered as comprehensive, pro-growth tax reform is explored and strongly urges Congress to consider the dynamic impacts of tax policies.

A NOTE ON RETIREMENT ISSUES AND THE TAX TREATMENT OF EMPLOYEE BENEFITS

The U.S. federal tax system creates clear and strong biases against saving and investment. A fundamental goal of comprehensive tax reform is to reduce and, where possible, to eliminate those biases. Therefore, the Chamber believes that preserving and improving the current tax provisions relating to retirement saving as well as employer-sponsored health care coverage is critical. For example, eliminating or diminishing the current tax treatment of employer-provided retirement plans would exacerbate the bias against saving while jeopardizing the retirement security of tens of millions of American workers, impact the role of retirement assets in the capital markets, and create challenges in maintaining the quality of life for future generations of retirees. [63] Similarly, any changes to the long-standing tax treatment of employer-sponsored coverage would discourage employers from offering, and employees from electing, comprehensive health care coverage. At a time when our country is focused on addressing the plight of the uninsured and strengthening the individual insurance market, it would be a mistake to threaten the source of health care coverage for over 177 million Americans.

CONCLUSION

The Chamber appreciates the opportunity to comment on comprehensive, pro-growth tax reform. We believe that considerations of scoring issues, tax rates, international issues, compliance burdens, the impact of uncertainty, and transition rules are essential components in the conversation on comprehensive tax reform. We look forward to working with Committee, the Congress, and the Administration as this process continues to make improvements to the code to create a tax environment that is increasingly pro-business and pro-growth.

[63] Additional and more detailed comments on retirement issues in tax reform are being submitted under separate cover.

Sincerely,

Caroline L. Harris

Cc: The Honorable Gary D. Cohn, Director, National Economic Council
The Honorable Steven T. Mnuchin, Secretary, U.S. Department of the Treasury
The Honorable Ron Wyden, Ranking Member, Senate Committee on Finance
The Honorable Kevin P. Brady, Chairman, House Committee on Ways and Means
The Honorable Richard E. Neal, Ranking Member, House Committee on Ways and Means
Members of the Senate Committee on Finance
Members of the House Committee on Ways and Means