100 Years Standing Up for American Enterprise

U.S. CHAMBER OF COMMERCE

Statement of the U.S. Chamber Of Commerce

ON: **Hearing on Extension of Certain Expired and Expiring Tax Provisions**

TO: **Subcommittee on Select Revenue Measures of the Ways & Means Committee**

DATE: **April 26, 2012**

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

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

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

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

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

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

Introduction

The Chamber thanks Chairman Tiberi and Ranking Member Neal for this opportunity to provide feedback on the annual tax extender provisions. These tax provisions, which benefit a wide range of taxpayers, are important to U.S. jobs and the broader economy. The failure to extend these provisions has brought more instability and uncertainty into the economy and has created significant challenges for taxpayers planning for the future. The Chamber strongly urges this Congress to act as soon as possible to extend these vital provisions.

Extenders and Comprehensive Tax Reform

The Chamber strongly supports comprehensive, fundamental tax reform to increase simplicity, efficiency, transparency, compliance and global competitiveness. While the Chamber applauds the hearings and other efforts this Subcommittee and the Ways and Means Committee have undertaken on tax reform and strongly supports the continuation of these efforts, we believe that true fundamental tax reform is still a long way down the road. Thus, in the interim, we believe Congress must take action on the annual extender provisions now.

The Need for Immediate Action on Extenders

The Chamber believes that Congress needs to act immediately to prevent the negative impact on jobs and the fragile economy that is likely to result from inaction on these annual extenders. We believe that the best way to get the economy growing fast enough to create jobs and drive the unemployment rate down is to ensure that taxes do not increase for consumers and businesses. Leaving income in the hands of businesses is the best way to spur investment and job creation. Thus, to help drive the economic recovery, these annual provisions should be extended immediately.

The Chamber believes Congress should provide businesses with certainty and predictability in the Internal Revenue Code (the "Code")[1], which in turn improves compliance and reduces the cost of administration for both taxpayers and the government. Many of the extenders provisions have long been part of the Code, and taxpayers have come to expect they will be extended annually. The President has also called for extending all of these provisions.[2] Extending these provisions later and later in the legislative sessions causes greater uncertainty and bigger obstacles to business planning. Recently, extensions of these provisions have been done retroactively, which exacerbates this problem, while also undermining any incentive effects that Congress had envisioned in enacting particular provisions. In short, retroactive extensions are hardly ideal tax policy.

The Chamber appreciates that all tax policies, including these annual extender provisions, must be carefully examined in the context of fundamental tax reform. However, we must not delay extending these provisions while we engage in that debate.

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

[2] *See* Department of the Treasury, "General Explanations of the Administration's Fiscal Year 2012 Revenue Proposals," (February 2011).

Longstanding Policies

As noted above, many of these extender provisions encompass deductions and credits that have been in the Code for many years and have been extended multiple times. Despite their expiration dates, such provisions in reality are longstanding deductions and credits that taxpayers have come to rely on when making business decisions. Nevertheless, the uncertainty of expired deductions and credits can have a material impact on a business' bottom line in certain cases, requiring certain disclosures such as in financial statements filings, which can adversely affect the business more broadly.

For example, consider the active financing exception. Generally, under the U.S. tax system, American worldwide companies are subject to tax on the *active* foreign earnings of their foreign subsidiaries only when those earnings are repatriated. The Subpart F rules operate to subject American worldwide companies to current U.S. tax on certain *passive* income earned by foreign subsidiaries. The active financing exception generally ensures that income from active foreign business operations in the financial sector is not subject to current taxation in the United States. Thus, this provision mitigates the double taxation of such income, thereby bringing the tax treatment of American worldwide financial service providers into parity with their international competitors. This provision was in the Code for 77 years and was repealed by the 1986 Act. The historical treatment was reinstated in 1997 and has been in the Code since then.[3] A provision that has been in the Code for 91 of the 102 years it has existed can hardly be considered temporary.

The research and development (R&D) tax credit has been in the Code for almost 30 years and is a proven incentive for driving investment in R&D, encouraging long term capital investment, creating jobs, strengthening the economy, and spurring innovation in the United States.[4] Since coming into office, President Obama, in each of his Greenbook explanations of his budgetary tax proposals, has proposed expanding and making permanent the R&D credit.[5]

The above examples are not, by any means, intended to be a comprehensive list of provisions that are of importance to the business community. They simply demonstrate that there

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[3] *See* Statement by the Active Financial Services Working Group, For the Record of the Hearing on Expiring Tax Provisions Before the Committee on Finance, U.S. Senate on March 16, 2005, "The Subpart F Active Financial Services Provision Should Be Made Permanent" (March 30, 2005).

[4] *See, e.g.,* U.S. Department of the Treasury, "Investing in U.S. Competitiveness: The Benefits of Enhancing the Research and Experimentation (R&E) Tax Credit" (March 25, 2011) (noting that the R&D credit in its current form offers a cost-effective way to encourage research spending and supports high-wage jobs). *See also* Carroll, Prante, and Quek, "The R&D Credit: An effective policy for promoting research" (September 2011) (estimating the higher wage and employment impacts of the R&D credit).

[5] *See* General Explanations of the Administration's Fiscal Year 2012 Revenue Proposals (February 2011), General Explanations of the Administration's Fiscal Year 2011 Revenue Proposals (February 2010), General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals (May 2009). *See also* U.S. Department of the Treasury, "Investing in U.S. Competitiveness: The Benefits of Enhancing the Research and Experimentation (R&E) Tax Credit" (March 25, 2011) (suggesting that a strengthened credit would leverage more than $100 billion in domestic private sector research in next 10 years, support nearly 1 million U.S. research workers in higher than average wage jobs, strengthen the incentive effect of the credit "*by providing certainty to taxpayers*") (emphasis added).

are longstanding and sound tax policy reasons for many of the annual extender provisions and that these kinds of provisions have very real impacts on American businesses.

Provisions That Incentivize Certain Behavior

Inaction on these provisions has real consequences. Businesses need certainty and predictability. Retroactive tax policy simply does not achieve this goal. In fact, at times, the failure to extend these provisions hurts the very purpose for which these provisions have been enacted.

This is particularly apparent with provisions intended to incentivize certain behaviors. When Congress fails to act, provisions such as the energy efficient appliance credit, the biofuels credit, and the production tax credit, do not operate effectively. Industries that are in their infancy are damaged because the incentives they need in the Code to get those industries up and running are not there and thus, expansion of those industries does not occur. The damage is very real as projects are not undertaken and products are not developed.

Competitiveness

As this Subcommittee considers renewal of the annual tax extenders provisions, it must consider the damages inaction brings on provisions that strive to ensure competitiveness.

Global Competitiveness

These provisions play a vital role in the global competitiveness of American worldwide companies. These extenders not only help level the playing field for American worldwide companies today, they offer these companies a chance to compete as we strive to overhaul the Code in the long run to make it more in line with other countries' tax laws.

Mitigating Double Taxation

The United States is currently the only Organisation for Economic Cooperation and Development (OECD) nation to continue to employ a worldwide system of taxation, thus subjecting American worldwide companies to a second layer of taxation that their foreign competitors don't face. While provisions such as deferral and certain foreign tax credits mitigate some of this double taxation, other provisions, such as the active financing exception (discussed above) and controlled foreign corporation (CFC) look-through rules, require annual Congressional action to make sure companies affected by those rules are not subjected to double taxation.

As discussed above, the active financing exception is a longstanding piece of the Code, essential for mitigating double taxation. Likewise, the related CFC look-through rules also are essential to mitigating double taxation. These rules were originally designed to help American worldwide companies simplify and organize their numerous subsidiaries without creating issues for those companies with the Internal Revenue Service (IRS). Under the rule, related CFCs of a common U.S. parent company can make cross-border dividend, interest, rent, or royalty payments without creating subpart F income, as long as the amounts are paid from active foreign business profits or effectively connected income of the payor. According to the legislative history,[6] Congress believed that the provision would make American worldwide companies and American workers more competitive. The rule permits CFCs to reinvest their active foreign earnings where they are most needed without incurring the immediate additional tax that companies based in many other countries never incur.

These annual extenders are essential pieces of the Code that give American worldwide companies a fighting chance against foreign competitors by lowering our anti-competitive marginal tax rate, providing R&D incentives to encourage research within our borders, and mitigating the potential double taxation of large segments of the American business sector.

Mitigating the Burdensome High Marginal Rate

Currently, American worldwide companies face the highest highest marginal tax rate among the 34 countries in the OECD. On April 1, 2012, Japan reduced its rate, and the United States rose to the top spot with the highest marginal corporate tax rate in the OECD.[7]

The credits and deductions included in the annual extenders provisions help mitigate the impact of our over-burdensome marginal rate and outdated Code structure, reducing taxpayers' effective tax rates to levels that gives them a chance to compete on a level playing field with foreign competitors. Congress' failure to extend these provisions seriously hampers the ability of American worldwide companies to compete, create jobs, and drive economic growth.

Research & Development (R&D)

In 1981, the United States was one of the first countries to add an incentive for research and development to the Code. For a period in the 1980's, the United States was at the forefront of R&D incentives. However, other countries soon followed, introducing their own R&D incentives. By 2008, the United State's R&D tax incentive ranked 17th overall amongst OECD nations.[8]

Other countries have moved to incentivize R&D, through adoption of super deductions, credits, and patent and innovation boxes. These countries use these incentives to promote the relocation of R&D operations to their countries as part of "innovation-led economic development strategies."[9] Thus, the United States' R&D credit must compete with the aggressive incentives marketed by other countries. The failure to, at very least, simply maintain our current credit increases the risk that the jobs, capital investment, and intangible property developed in the R&D process will move outside our borders.

National Competitiveness

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[6] *See* Joint Committee on Taxation, "Bluebook Of Legislation Enacted By 109th Congress," (JCS-1-07).
[7] *See* President's Council On Jobs And Competitiveness, "Road Map to Renewal" (January 2011) (commenting on U.S. marginal corporate rate and comparing to other countries).
[8] *See* Information Technology and Innovation Foundation, "Create Jobs by Expanding the R&D Tax Credit," (January 26, 2010).
[9] *See* Deloitte, "Global Survey of R&D Tax Incentives," (July 2011).

Global competitiveness is not only the only aspect of the economy impacted by inaction on extenders. Consider the deduction for state and local sales tax. Absent from the Code for 16 years, it was reinstated in 2004.[10] This provision is essential for taxpayers who live in "sales tax states." By allowing residents of those states to deduct state and local sales tax, it places them on an even footing with residents in income tax states who can deduct their state income taxes for federal purposes. This provision was in the Code for an extended period of time and then was reinstated to bring parity to those taxpayers in sales tax states. The damage to competition, both globally and locally, is felt when these provisions are not extended.

Ability of Businesses to Grow

Inaction also hurts the ability of businesses to grow and expand. Provisions targeted to quicker cost recovery, which put cash in the pockets of business to create jobs and make capital investments, are also hindered.

Consider the 15-year depreciation period for leasehold improvements, restaurant improvements and new construction, and retail improvements, which reflects the tax policy principle that costs of assets are allocated over the period in which they are used. The 15-year recovery for such improvement is predicated on the rationale that the current 39.5-year depreciation period for buildings bears little relationship to the economic life of such structures and even less to building improvements and upgrades required in successful businesses, in particular restaurants and retailers. Business property must be remodeled and updated periodically to maintain a positive consumer environment and to remain competitive, and the lifespan of such updates is far shorter than the 39.5-year depreciation building life. Similarly, the duration of leases of real property are typically for a period well short of 39.5 years, giving improvements to such property a shorter lifespan. Thus, this 15-year recovery period reduces the cost of capital expenditures and increases cash flow. In turn, this provides needed capital for American businesses – which translates into American jobs.

Consider also the railroad track maintenance tax credit. Enacted in 2004, it enables small and mid-sized railroads to modernize and enhance their own infrastructure to meet the country's growing freight needs. The Federal Highway Administration has forecast a more than 60 percent increase in freight demand across all transportation modes by 2040, yet we lack adequate capacity to meet this demand. We cannot compete in the global economy without significant upgrades to our infrastructure, and this is an industry which pays its own way, without direct government involvement, that is expanding on its own to the benefit of the entire U.S. economy.

Additionally, the section 181 film production tax credit plays an important role in putting cash back into the pockets of businesses that create American jobs and make capital investments. Enacted in 2004, this credit provides vital cost recovery for an industry that is otherwise excluded from availing itself of the general bonus depreciation provision. Extending section 181 will continue to promote capital investment and production in the United States. This not only provides jobs within the film industry, but also has ripple effects across broad sectors of the economy by generating revenue and jobs for a range of local businesses.

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[10] *See* Joint Committee on Taxation, "Description Of H.R. 4520, The "American Jobs Creation Act Of 2004," (JCX-41-04) (June 10, 2004).

In sum, these extenders are essential to providing the access to capital businesses require to succeed.

Conclusion

The Chamber thanks the Subcommittee for the opportunity to comment on the extension of these vital tax provisions. The Chamber applauds this subcommittee's continuing work towards comprehensive fundamental tax reform. However, we believe that the extension of these annual extender provisions cannot be delayed until work on comprehensive tax reform is complete. Taxpayers need stable and predictable rules they can rely upon while that important process is completed. We strongly urge Congress to act quickly to extend these longstanding policies and prevent unnecessary damage to the economy and job creators.