AMERICAN CHEMISTRY COUNCIL

WRITTEN STATEMENT SUBMITTED FOR CONSIDERATION TO

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

HEARING ON "HOW TAX REFORM WILL GROW OUR ECONOMY AND CREATE JOBS"

DATE OF HEARING: MAY 18, 2017

The American Chemistry Council (ACC) thanks the Committee for continuing to examine comprehensive tax reform and for examining the effects of tax reform on the U.S. manufacturing sector. Because of the importance of manufacturing to the U.S. economy and the effect of tax rules on manufacturers, we are particularly interested in the Committee's consideration of a reformed business tax system.

ACC and its place in U.S. manufacturing:

ACC represents the leading companies engaged in the business of chemistry. ACC member companies apply the science of chemistry to create and manufacture innovative products that make people's lives better, healthier and safer. The business of chemistry is a $768 billion enterprise and a key element of the nation's economy. Over 26% of U.S. GDP is generated from industries that rely on chemistry, ranging from agriculture to oil and gas production, from semiconductors and electronics to textiles and vehicles, and from pharmaceuticals to residential and commercial energy efficiency products. Our industry directly employs over 810,000 Americans in high-paying, quality jobs and each of those jobs supports an additional 6.3 American jobs in other manufacturing industries, meaning that nearly 6 million Americans are working in the industries that rely on chemistry to drive economic growth, innovation, and American competitiveness. Importantly, our industry is one of the nation's largest exporting sectors, with over $173 billion in exports in 2016, or more than ten cents out of every export dollar. The U.S. chemical industry is a leader in the amount of R&D performed, innovation delivered, and exports shipped, contributing enormously to the nation's economy. Further, given the recent surge in the development and availability of domestic natural gas, which is an important feedstock and energy source for the production of chemical products, the U.S. chemical industry has reacted by announcing plans for over $181 billion of new U.S. based investment. These investments will spur the U.S. economy, increase employment and increase the U.S. standard of living.

As a major U.S. advanced manufacturing industry, we are keenly interested in how tax reform can, and will, affect our industry and manufacturers generally. To ensure the U.S. regains its competitive edge, our tax code should be reformed to drive U.S. investment, innovation and productivity to create U.S. jobs. The focus of your hearing was timely, and the decisions you make can be critical to the health of the manufacturing sector in general, and to the American chemical industry in particular. In considering the outlook for tax reform, the ACC Board adopted the following "Guiding Principles for Corporate Tax Reform":

- *Tax reform should produce a fair, simpler, and internationally competitive tax system that promotes economic growth and job creation in America.*
- *Tax reform should recognize and reflect the important role of American manufacturing and the jobs it creates.*
  - *Manufacturing is a capital intensive activity, and therefore, tax treatment of capital cost recovery is of key importance.*
  - *Advanced manufacturing techniques and products rely on research, and therefore, incentives for research and development expenses also should be supported.*
- *ACC supports adoption of a competitive territorial system for the taxation of income earned outside the United States.*
- *ACC supports a substantial income tax rate reduction to reflect rates at least comparable to Organization for Economic Development and Cooperation (OECD) averages.*
- *Tax reform must produce a "level playing field concept" such that American companies investing abroad can compete equally with foreign investors, and American and foreign companies investing in the United States are treated equally.*
- *Tax reform should be enacted comprehensively, not piecemeal, and should include transitional rules that allow taxpayers to adjust to a new tax regime without financial dislocation, contraction, or reduction in employment.*

ACC regards the principles not as a menu of alternatives, but as a template for a reformed corporate tax system that would achieve the overriding goal of economic growth. Our comments below reflect these principles.

Proposals for business tax reform:

As our principles state, ACC believes that business tax reform should produce a fair, simpler, and internationally competitive tax system that promotes economic growth and job creation in America. The measure of each decision and trade off made in the process of tax reform should be whether it advances these goals. We also support the adoption of a competitive territorial system where foreign earnings are not subject to significant additional U.S. tax.

We note that business tax reform is generally proposed within a framework of revenue neutrality, under which the reformed system of business income taxes would produce the same amount of tax revenue as the current system, but at a lower tax rate—requiring repeal of a broad range of so-called "tax expenditures." In assessing whether such reforms would need to be revenue neutral, we respectfully suggest that the Committee take into account the impact on revenues that would result from a reformed globally competitive system that is more supportive of economic growth. We fear that embarking on a complex and difficult tax reform process that simply achieves revenue neutrality on a "static basis" would

be less effective in promoting economic growth since, by definition, it would create winners and losers in a zero sum game.

We are also concerned that a base broadening effort to repeal a number of so-called tax expenditures could disproportionately and adversely affect U.S. manufacturing. For example, accelerated depreciation is highly significant in encouraging and supporting investments and job creation by the manufacturing sector. Without careful balancing of the impact of changes in current law on the manufacturing sector, solid, middle class jobs could be impacted.

A poorly designed system could reduce the chemical industry's ability to compete in U.S. and global markets could cause the industry to experience reduced growth or contraction, resulting in a corresponding reduction of the manufacturing workforce. Likewise, spill-over consequences would adversely affect suppliers and service-providers that depend upon manufacturing customers.

Our concerns arise from recent economic analyses of certain tax expenditures and the consequent effect of repeal of such provisions on economic growth.[1] Specifically, unless the statutory tax rate under a reformed business tax system is low enough to compensate industry for the loss of tax provisions for investment, reductions in capital investment and economic growth are likely to result.

Finally, any comprehensive changes to the tax code must include transition rules in order to ensure that taxpayers have time to adjust to a new tax regime without economic contraction and consequent reduction in employment.

Rate reduction –

The U.S. has the highest marginal corporate tax rate of any major industrial nation in the world. This high tax rate acts as an impediment to U.S. investments and expansions for both U.S. and foreign owned firms. The U.S. needs to enact comprehensive tax reform that *significantly* reduces the tax rate. Doing so can provide powerful incentives for U.S. investment, particularly when not neutralized by other changes that directionally increase the cost of capital. ACC realizes that coupled with the tax rate, a wide number of tax expenditures may be eliminated or reduced to fund the lower tax rate. But if the rate reduction is not sufficiently large and if the loss of tax expenditures disproportionately affects the manufacturing sector, the result may be less, not more, growth.

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[1] See, e.g., Joint Committee on Taxation Report, "Background and Present Law Relating to Manufacturing Activities Within the United States", July 2012, p. 87.

Accelerated Cost Recovery --

The accelerated depreciation of capital assets, known as "accelerated cost recovery" or "ACR," has been allowable under the tax code for decades ACR is a central element in the business plans of most chemical manufacturers. It allows recovery of the cost of capital investment more quickly for tax purposes than under financial accounting rules that amortize asset value over a longer period of time, but slower than under expensing or recent "bonus depreciation" rules.

ACR encourages new investment in manufacturing by providing cost-recovery rules that compensate companies in part for the risk of investing large amounts of capital in relatively low-profit enterprises. For the chemical industry, this typically means longer start-up periods for bringing new assets on line and longer pay-out times in order to achieve returns commensurate with the investment.

Because ACR is extremely significant to manufacturing, repeal would have an obvious and disproportionate adverse effect on the industry. ACR *leverages* the value of capital investment in productive assets. Accordingly, greater investment means more growth and more U.S. jobs, all of which could be at risk if tax reform removed the provision. Rather, if ACR is to be repealed, it must be supplanted by an even more aggressive provision, such as immediate expensing, so that capital intensive industries are able to expand and reach their full economic and job-creating potential.

We respectfully question whether "reform" and the progress the term implies would occur if changes in the tax law meant a significant economic discouragement from making new capital investments, with less growth, and erosion of the national economic ballast that the manufacturing sector currently represents.

Incentives for research and development –

The chemical industry is among the largest creators and users of technology. Accordingly, current federal tax incentives for research and development represent key factors in retaining a domestic chemical industry that can compete with chemical manufacturers globally that typically enjoy more favorable home-country tax regimes. The tax reform debate should consider the continuing and important role of competitive incentives for creation of U.S. technology, including expensing and an effective R&D credit, while addressing the mobile nature of capital and intellectual property. As a goal, the tax system should encourage investment in the U.S. in R&D activities, the ownership of resulting intellectual property (IP) in the U.S. and exploitation of the IP from the U.S.

A territorial system for taxation of foreign earnings –

ACC endorses adoption of a competitive territorial taxation system in replacement of the obsolete and overburdened world-wide system for taxation of foreign earnings from active business operations. The U.S. is the only major industrial nation with a worldwide tax system. The incremental U.S. tax imposed upon ACC member companies' foreign operations causes such companies to be less competitive than their foreign competitors. This is not just a matter of abstract theory since 95% of the world's

population is outside the U.S. To serve this large and growing market, we encourage the Committee to continue to search for ways to promote exports of property manufactured in the U.S. to meet these global needs. But in addition to serving such markets by exports, as explained below, ACC member companies must also expand overseas to grow and prosper. It is important to note that as these companies expand throughout the world, new high value jobs in R&D, engineering and administration are created in the U.S.

The manufacture of chemical products is a global and highly competitive industry. Freight is a significant cost for ACC member companies; to compete effectively they cannot produce all products in the U.S., ship them across an ocean and truck them to a customer in the interior of a continent. We must be local to compete effectively and the current U.S. tax code acts as an impediment to our competitiveness.

Finally, movement to a territorial taxation system would eliminate the current "lock out" effect of existing tax law and allow substantial amounts of cash, (particularly from industries outside the chemical sector,) to be repatriated to the U.S. This result, when coupled with pro-growth domestic tax changes, would drive additional capital investment and employment in the U.S.

Repatriated earnings–

Outside of comprehensive tax reform and absent recognition of the unique circumstances of the chemical manufacturing sector's operations abroad, ACC strongly opposes proposals to tax historical foreign earnings.

In previous years, proposals under consideration for raising tax revenue to pay for highway and infrastructure projects included a device referred to as "deemed repatriation" or "mandatory repatriation" to U.S. parent corporations of foreign earnings accumulated by foreign subsidiary corporations and permanently reinvested abroad. Use of the term "repatriation" in these contexts is inaccurate and misleading because the proposals do not require nor anticipate any actual return of cash. The proposals mandate U.S. tax on foreign earnings as though the earnings *were* distributed to U.S. parent corporations as dividends. In the case of the chemical industry and other manufacturers, the distinction between actual and deemed dividends is very real and has very serious consequences.

With the exception of relatively small amounts of working capital to pay receivables and meet other current expenses, foreign subsidiaries of U.S. parent chemical companies typically keep only incidental cash funds offshore. Earnings from manufacturing operations of the foreign subsidiaries are reinvested in plant and equipment in order to serve foreign markets and compete internationally. As a consequence, only a relatively small amount of earnings is represented as cash and cash equivalents and available for actual repatriation, and therefore parent companies would need to borrow money in order to pay the U.S. tax with respect to deemed transfers of deemed cash.

Absent comprehensive tax reform that includes significant corporate rate reductions, adoption of a territorial tax system, and sufficiently lengthy transition periods, the tax on reinvested earnings would reduce amounts and availability of capital in the U.S. This would also lead to weakened balance sheets, lowered share prices, limited investment in new plant and equipment, stifled growth, and eroded payroll and job creation. As noted above, the chemical industry is among the largest U.S. exporters, with an

outsized share of export dollars, with many jobs in the industry supporting exports as well as foreign operations.

LIFO–

Congress enacted the LIFO tax accounting method in 1939, concluding that for some taxpayers, LIFO is a more accurate means of calculating taxable income. A business cannot thrive and maintain operations, unless it generates enough after-tax cash flow to produce and purchase replacement goods at current—not historical prices. By matching current revenues against current inventory costs, LIFO can provide a better measure of the true economic performance of a business.

Without LIFO, a business could not deduct current prices from taxable income and its ability to produce or purchase new, replacement inventory and to maintain and grow investment would be impaired. Purely inflationary gains would be masked and taxed as "profit."

Like ACR, inventory accounting methods have been designed to appropriately reflect taxable income and to serve as prime instruments for encouraging reinvestment of earnings. Far from a "loophole," LIFO is an essential element in the structure of a tax on business net income. Elimination of LIFO absent a correlating offset elsewhere and a significant transition period would represent a tax increase to manufacturers, a significant cash cost, and would hinder growth.

Interest deductions–

The chemical industry has tentatively budgeted approximately $181 billion for investment in plants to utilize ethane from domestic shale gas as the feedstock in manufacture of chemical products. This new source of lower-cost feedstock can mean a significant cost advantage for U.S. manufacturers and a manufacturing renaissance. But exploitation of the shale gas resource requires capital investment commensurate with the enormous growth potential for the U.S. economy. A significant concern for those considering investment in new plants is the ability to use both debt and equity capital to finance the ventures. Full deductibility of interest expense is vital to all industries in this regard, but of key importance to manufacturers and other capital intensive industries.

In the case of a long-term project that requires large up front outlays, like the building of a new plant, investment dollars are tied up for a period of years before completion of construction and onset of production at a profit. During this period, the interest on company debt compounds. Accordingly, long-term, capital intensive projects are especially sensitive to changes in the cost of capital. Limiting or eliminating the deductibility of interest, once again absent other reforms that act to offset the effects of such policy, would directly increase the cost of capital and would have a dramatic effect on investment decisions that of necessity rely upon analysis of the time-value of money.

Interest paid on debt is recognized as a cost of doing business and virtually every business relies on debt at some level to finance its operations. Investing activity targeted for growth is based upon achieving certain rates of return over and above their cost of capital. Reducing or eliminating the interest

deduction would immediately increase the cost of capital, thereby increasing hurdle rates companies use to evaluate investment opportunities. This will lead to reduced investment and capital spending activity with the potential for companies to reevaluate capital decisions that have already been made or are under consideration.

Companies need flexibility in raising capital for their operations, whether through debt or equity. They use a range of factors in striking the right balance: cash flow, capital costs, types of projects to be financed, risk profile, and desired financial profitability. We appreciate the concern with companies that are too heavily in debt and are over-leveraged, but the market is a very efficient mechanism for sorting this out. Companies with too much debt will see their cost of capital increase in the market, which would probably move them toward a more balanced mix of debt and equity that will keep their capital costs more in line with their competition. There is no need to legislate what the market already manages efficiently and effectively.

Moreover, imposing a limit or reducing interest expense deductibility would have an immediate and sustained impact on capital costs. The resulting decrease in corporate investment activities would threaten the already low economic growth experienced in the U.S. over the last several years. Accordingly, as with changes to the ACR rules and mandatory repatriation tax, absent comprehensive tax reform that includes significant corporate rate reductions, adoption of a competitive territorial tax system, and sufficiently lengthy transition periods, the disallowance of deductions on interest expenses would reduce amounts and availability of capital in the U.S.

Summary: "Level playing fields"

As reflected in the attached Guiding Principles for Corporate Tax Reform and as an overall principle to guide policymakers, ACC believes that U.S. tax reform must provide for a "level playing field" where U.S. companies investing abroad can compete equally with foreign investors, and where U.S. subsidiaries of foreign investors which invest in the U.S. and U.S. parented companies are treated equally. Further, we believe that tax reform should not create winners and losers among industries or among types of businesses, but should attract investment and enhance job creation throughout U.S. business enterprises and foreign enterprises investing in the United States. In summary:

- The U.S. should adopt U.S. tax rules that will enable, rather than impede, U.S. companies to compete on a level playing field with regard to their foreign business operations. ACC supports the adoption of a territorial system (which is comparable to those of our major trading partners) for the taxation of foreign business income, that would permit competitive treatment for U.S. companies.
- U.S. companies operating in the U.S.—whether U.S. owned or foreign owned-- should be subject to comparable rules, and thus taxed on a level playing field with regard to U.S. business operations. ACC supports U.S. tax rules which would provide parity between U.S.-owned companies and foreign-owned companies.
- Changes that would place the burden of U.S. tax reform on one or more particular industries would not result in a level playing field. For example, when looking at potential base broadeners,

the manufacturing industry (including the chemical industry) should not be disproportionately impacted, unfairly so, vis-à-vis other industries. Otherwise, this would have a significant negative impact on U.S. manufacturing, economic growth, new investment and jobs.