October 13, 2021

The Honorable Ron Wyden
Chairman, Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Richard E. Neal
Chairman, Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20510

Re: Comments regarding proposed changes to the deduction for interest expense, proposed sections 163(n) and (o)

Dear Chairman Wyden and Chairman Neal:

The American Chemistry Council ("ACC"), based in Washington, D.C., 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. A complete listing of our member companies can be found at our website www.americanchemistry.com.

ACC is writing to raise concerns about some of the provisions contained in House tax proposal of the Build Back Better agenda that could also be included in Senate legislation. Specifically, ACC would like to comment on the treatment of deductions for interest expense under proposed sections 163(n) and (o).

Proposed Section 163(n)

The House version of Build Back Better would limit interest by the lower of current section 163(j) or proposed section 163(n). Proposed section 163(n) would limit a US group's interest to its share of the global financial group's net interest expense based on a ratio of US earnings before interest, taxes, depreciation, and amortization (EBTIDA) over global financial group's EBITDA. These limitations apply where the loan is from a third party (e.g., bank or public debt offering), a related party, or a combination of the two.

Over the years, Congress and Treasury have implemented a series of limitations on interest that reduce the amount of interest expense that can be deducted in the United States. For example, the 2017 tax law added two new limitations that apply to interest expense deductions (the base erosion and anti-abuse tax and anti-hybrid rules reduce interest) and significantly modified section 163(j) to align the standard to the OECD Base Erosion and Profit Shifting Project (BEPS) recommendation under Action Item 4. This is on top of preexisting limitations under sections 267, 269, 382, 385, 482, 861 and 864, among others. All of these limitations, at the very least, ensure that a taxpayer's interest deduction is an appropriate/legitimate business expense.

The proposal under consideration by the House would diverge from OECD Action Item 4 by creating a "lower than" test. In so doing, the proposal transforms a taxpayer's interest deduction into a random and unpredictable event. As such, taxpayers will not be able to consider a tax benefit on financing for their planned investments. Thereby reducing the rate of return on US investments and putting the US at a competitive disadvantage. As such, the cost of capital for investment in the United States would be increased. This increased cost of capital will affect investment in the United States, potentially reducing jobs and investment in research, plant, property, and equipment. While businesses can decide to finance with equity, equity financing is more expensive. The switch to equity financing would also likely reduce domestic investment and jobs, while incentivizing investment abroad.

Proposed section 163(n) would penalize businesses during a downturn, either specific to a distressed business or where the US economy is in a recession. US-headquartered businesses generally borrow from third party-lenders in the US. If US business contracts due to a downturn, while the foreign operations increase EBITDA, the US financial group will lose most of its interest expense deductions at a time when it needs access to additional capital. It is difficult for distressed businesses to obtain equity financing, and debt financing is often the only available lifeline. Congress recognized this issue as part of the CARES Act when Congress increased the limitation under section 163(j) to effectively 50% of EBITDA.

There is a perception that a multinational enterprise could engage in self-help by easily moving the location of debt from the United States to a foreign jurisdiction. This is an incorrect assumption. Debt often needs to be located in the jurisdiction where it will be used. If a business borrows in the United States in order to make investments in new plants and equipment in the United States, the debt will reside in the United States. Other countries place limitations on interest expense deductions, as well as limit the push down of debt where there is not a business reason. Further, if the OECD Inclusive Framework becomes law, it is unlikely that global groups will be permitted to place debt outside the United States that could have the effect of modifying Pillar One, Amount A, and could result in additional taxation under a Pillar Two income inclusion rule or undertaxed payment rule. Therefore, there is no real option to self-help.

All interest expense limitations have a measurable negative impact on the US economy. For example, after Congress modified section 163(j) in 2017, businesses limited by section 163(j) reduced their investment rate by 6.8% and their hiring rate by 17.3%.[1] The proposal would have

[1] Ali Sanati, *How Does Removing the Tax Benefits of Debt Affect Firms? Evidence from the 2017 US Tax Reform,* Mimeo (2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3878363.

further negative impact and would put the US out of alignment with the OECD and place US headquartered companies at a competitive disadvantage to foreign competitors when bidding for potential targets. For these reasons, ACC urges Congress to reject additional limitations.

Proposed Section 163(o)

Under current law, section 163(j) provides for an unlimited carryforward of denied interest expense. This carryforward recognizes that some businesses may require a shorter or longer business cycle in order to be able to deduct interest expenses. The House proposal would reduce the carryforward from an unlimited carry forward to five years for interest expense deductions denied under either section 163(j) or proposed section 163(n).

The proposed carry forward limitation is too short in instances where the loan proceeds are used to build a new plant or other facility, or where the business experiences a downturn. In the case of a new facility, it typically takes years to build a new plant or facility. The income generated by such new facility may not generate sufficient earnings to allow a manufacturer to fully deduct the interest expense carried forward within five years. With respect to acquisitions, a business may use a combination of debt and equity to purchase a target. It may take more than five years for the target to generate a sufficient return for the acquiring business to repay the loan. A five year carry forward may not allow the acquirer to deduct all of the interest expense related to the purchase of target. Similarly, in a downturn, businesses borrow from third parties to maintain operations. If the recession is lengthy (e.g., the Great Recession of 2008), then a five year carry forward will be insufficient to recover the interest expenses carried forward. This will result in businesses paying tax on nonexistent income at a time when they cannot afford to do so.

Given the precarious nature of the economy due to COVID-19 and the importance of supporting U.S. investment, ACC urges Congress to retain the unlimited carryforward.

Conclusion

ACC recommends that Congress reject proposed sections 163(n) and 163(o). We welcome the opportunity to meet with your staff to discuss these important issues.

Very truly yours,

Robert B. Flagg
Senior Director, Federal Affairs
American Chemistry Council

cc: Ranking Member Mike Crapo, Senate Committee on Finance
Ranking Member Kevin Brady, House Committee on Ways and Means