

HOW BUSINESS TAX REFORM CAN ENCOURAGE JOB CREATION

HEARING BEFORE THE COMMITTEE ON WAYS AND MEANS U.S. HOUSE OF REPRESENTATIVES ONE HUNDRED TWELFTH CONGRESS FIRST SESSION

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HOW BUSINESS TAX REFORM CAN ENCOURAGE JOB CREATION

THURSDAY, JUNE 2, 2011

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The committee met, pursuant to call, at 10:06 a.m., in Room 1100, Longworth House Office Building, the Honorable Dave Camp [chairman of the committee] presiding.
[The advisory of the hearing follows:]

HEARING ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

Camp Announces Hearing on How Business Tax Reform Can Encourage Job Creation

May 26, 2011

Congressman Dave Camp (R-MI), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing on major business and corporate tax issues and how changes to those aspects of the Tax Code, as part of comprehensive tax reform, might promote job creation and economic growth. Whereas the two most recent Committee hearings on the business aspects of tax reform focused on international taxation, this hearing will address the taxation of domestic business operations. **The hearing will take place on Thursday, June 2, 2011, in Room 1100 of the Longworth House Office Building, beginning at 10:00 A.M.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing. A list of invited witnesses will follow.

BACKGROUND:

At a combined federal-state rate of over 39 percent, the United States has the second-highest corporate income tax rate in the developed world, trailing only Japan. The average for countries in the Organization for Economic Co-operation and Development (OECD) is only 25.5 percent. And as the Committee learned at its May 24, 2011, hearing on foreign tax systems, the Japanese Government intends to reduce its corporate rate by five percentage points, which soon will leave the United States with the highest corporate rate among our major trading partners. Extensive economic research, meanwhile, has found that most of the burden of corporate tax rates is borne by workers. Furthermore, pass-through entities pay tax at the individual income tax rates, and uncertainty surrounding the individual rate structure after 2012 has serious implications for business planning and job creation.

In addition, the Committee must consider a number of issues related to business taxation as part of comprehensive tax reform. These issues include differences between tax accounting and financial accounting, the treatment of inventories and depreciable property, and trade-offs between marginal tax rates and targeted business tax preferences. The Committee must investigate the purposes behind these various rules and provisions, and whether such rules and provisions serve their intended purpose. The fact that the United States is an outlier with respect to the rates at which it taxes business income, combined with the complexity of the rules governing business taxation, make it important for the Committee to explore whether tax reform that broadens the base and lowers marginal rates could benefit the U.S. economy and American workers.

In announcing this hearing, Chairman Camp said, **“While our major trading partners have spent the last two decades reducing their corporate tax rates, the U.S. corporate rate is actually higher than it was 20 years ago, and the rates that apply to small businesses are scheduled to go up in the near future rather than down. At the same time, the Tax Code is full of tax preferences that attempt to pick winners and losers rather than just allowing the most promising business investments to flourish. As the Committee continues to investigate how best to reform the tax system for American families, we also need to take a close look at the major elements of business taxation and evaluate those elements against the principles of simplicity, fairness, stability, and economic growth.”**

FOCUS OF THE HEARING:

The hearing will inquire about the potential benefits to companies and workers of lowering marginal tax rates on business income, and the trade-offs that such companies might be willing to make given current fiscal constraints. The hearing also will examine major elements of business and corporate taxation in anticipation of future efforts to evaluate policy options that might encourage job creation in the United States.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, <http://waysandmeans.house.gov>, select "Hearings." Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Thursday, June 16, 2011**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225-3625 or (202) 225-2610.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone, and fax numbers of each witness.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available on the World Wide Web at <http://www.waysandmeans.house.gov/>.

Chairman CAMP. The hearing will come to order.
Good morning. And thank you for joining us today for another in a series of hearings on comprehensive tax reform.

Whether at the full committee, the subcommittee, or the Joint Committee on Taxation, this committee has been actively engaged in a systemic review of the Tax Code for a very simple reason: Today's Tax Code is preventing, not promoting, job creation. And on the eve of what is widely expected to be a disappointing jobs report, this committee remains focused on what action must be taken to reform our Tax Code and make America a more attractive place to invest and create the jobs we need.

Today's hearing will examine the potential benefits to companies and workers of lowering marginal tax rates on business income. The hearing also will look at major elements of business and corporate taxation to evaluate policy options that can encourage job creation here at home.

The challenges created by the Tax Code for job creators of all sizes are many: high statutory rates, compliance and administrative burdens, the impact of temporary and expiring tax provisions, just to name a few. And pile on top of that a dizzying array of credits, deductions, exemptions, and it is no wonder that the Tax Code is distorting economic behavior.

America's high and uncertain tax rates are barriers to growth and competition. With a combined Federal-State corporate tax rate of 39.1 percent, we are well above the average of the rest of the industrialized world.

Some might find comfort in the fact that the December tax relief package prevented an immediate tax hike on job creators organized as passthroughs, who pay their taxes at the individual rate. These employers are primarily small businesses. But that relief will be fleeting, as they again face higher taxes in less than 2 years unless Congress acts. The uncertainty surrounding their future tax rates makes it even harder for them to plan, invest, and create jobs.

Consider this fact: Over 200 Federal tax provisions are scheduled to expire between 2010 and 2020, whereas in 1998 there were only 50 such expiring provisions. With uncertainty at every turn, it is no wonder that the optimism of small employers remains at recessionary levels, according to NFIB's Small-Business Optimism Index. And, today, through the testimony of both job creators and tax practitioners, we hope to gain insight into how the current structure of taxation affects the ability of businesses to invest, grow, and create jobs.

Before we move to our panel and begin our discussion on tax reform, I want to make one final comment. Tax reform cannot and should not be confused with increasing taxes. It must be done in a revenue-neutral manner. We will not grow if Washington is taking an ever-increasing share of economic output in the form of Federal taxes. We do not have a vibrant economy when we increase taxes on job creators. We have a vibrant economy when we get spending down, keep taxes low, and get Washington out of the way of our entrepreneurs. As we discuss tax reform, I intend to move the dialogue in that direction.

I look forward to the testimony of today's witnesses. Thank you all for being here.

I will now yield to the ranking member, Mr. Levin, for his opening statement.

Mr. LEVIN. Thank you very much, Mr. Chairman.

And thank you, all the witnesses, for coming. Many of you have Michigan roots. In fact, I think that is the majority. And I want to put on the record that this is not a result of a grand conspiracy between Mr. Camp and myself.

Shall I yield to you for a special word?

Chairman CAMP. That is fine.

Mr. LEVIN. Mr. Camp and I join together in welcoming everybody, whether you are from Michigan or not.

In announcing this hearing, Chairman Camp indicated that it would include an examination of, and I quote, “the tradeoffs that companies might be willing to make given current fiscal constraints,” end quote. I think most of us agree that a lower corporate rate is desirable, but—and I emphasize this—the tradeoffs involved in getting there truly matter.

We have learned in our prior hearings that businesses seem generally to agree that tax reform should be revenue-neutral. The inevitable consequence of that would be a shifting of the burden of current level of taxation, and there would be winners and losers. We must now examine the true impact on domestic companies if we repealed important tax benefits that encourage investment in jobs in our country.

Considering that we have spent the last four full committee hearings on tax reform, mostly at a 30,000-foot level, we welcome this opportunity to move beyond generalities and examine the benefits that companies would be willing to give up in order to achieve the goal laid out in the Republican budget of a top corporate and individual tax rate of 25 percent.

We, indeed, need to carefully examine these issues so that we can reform our Tax Code and our corporate Tax Code in a way that encourages economic growth, investment, and job creation.

With that in mind, I join my colleagues in looking forward to your testimony.

If I might, Mr. Chairman, I would like to add just a word. Mr. Neal, our colleague, was surely planning to be here, but he will not be, because he has returned to his district because of the tornado that occurred there in western Massachusetts.

If I might add on another personal note, the father of Allyson Schwartz, who has been a member of this committee, passed away over the weekend. I think she will be here today, and, if so, I think you might want to give her a special hello and a special hug.

Thank you, Mr. Chairman.

Chairman CAMP. Well, thank you.

We are pleased to welcome our panel of experts, all of whom have either extensive experience as tax practitioners or have handled tax matters for American businesses. I believe that their experience and insight will be helpful as we focus on the potential benefits to businesses and workers of lowering statutory income tax rates.

First, I would like to welcome and introduce Ashby Corum, a partner at KPMG in Detroit, Michigan. Mr. Corum is an expert on the relationship between tax and financial accounting. And since joining the Detroit office in 2003, he has been actively involved in resolving accounting-related income tax issues for major corporations.

Second, we will hear from Walter Galvin, the Vice Chairman of the Board at Emerson Electric Company in St. Louis, Missouri. In his current role, he is responsible for Emerson's financial planning and financial services. Until February of last year, Mr. Galvin served as Emerson's chief financial officer, a position he held for 17 years.

Third, we welcome Judy Brown, the Executive Vice President and Chief Financial Officer of Perrigo Company in Allegan, Michigan. Perrigo is the world's largest manufacturer of over-the-counter pharmaceutical products for the store brand market, and Ms. Brown is responsible for all aspects of the company's corporate financial management.

Fourth, we will hear from James Zrust, the Vice President of tax for the Boeing Company in Chicago, Illinois. With 30 years of tax experience, Mr. Zrust has spent considerable time working on all aspects of Federal and State income taxes, as well as major international transactions.

And, fifth, we welcome James Misplon, the Vice President of Tax for Sears Holdings Management Corporation in Hoffman Estates, Illinois. Mr. Misplon is responsible for the design and implementation of comprehensive structural and nonstructural tax strategies for Sears. Today, Mr. Misplon is testifying on behalf of the National Retail Federation and is the chair of the federation's Taxation Committee.

And, finally, we will hear from Mark Stutman, the National Managing Partner of Tax Services for Grant Thornton in Philadelphia, Pennsylvania. In that role, Mr. Stutman has overall responsibility for the quality of services, the profitability of operations, and the welfare of clients for Grant Thornton's core and specialty tax practices.

Thank you all again for your time today.

The committee has received each of your written statements, and they will be made part of the formal hearing record. Each of you will be recognized for 5 minutes for your oral remarks.

And, Mr. Corum, we will begin with you. You are recognized for 5 minutes.

STATEMENT OF ASHBY T. CORUM, PARTNER, KPMG LLP

Mr. CORUM. Good morning, Chairman Camp, Ranking Member Levin, and other Members of the Committee. I appreciate the opportunity to appear before you today as an invited witness to assist the committee in understanding the importance of financial accounting and the relationship between tax and financial accounting, particularly as affected by changes in tax law. The views expressed here are my own and do not necessarily reflect the views of KPMG.

The accounting and reporting of income taxes by corporate enterprises in their financial statements is a critical element of their overall reporting to stakeholders. Income tax expense is often a significant expense for an enterprise, and it can have a major impact on earnings. Accordingly, investors, analysts, and other stakeholders monitor the income tax amounts reported by businesses closely and make assumptions about the long-term trends of the reported amounts.

The Internal Revenue Code specifies how an enterprise's annual Federal current income tax liability is determined. Accounting standards provide for the financial accounting and reporting of the effects of income taxes that result from an enterprise's activities during the current and preceding years.

The objectives of accounting for income taxes are to: recognize the amount of income taxes payable or refundable for the current year; and recognize deferred tax liabilities and assets that reflect the future tax consequences of events that have been recognized in the enterprise's financial statements or tax returns.

Total income tax expense of an enterprise consists of both the current tax expense and the deferred tax expense or benefit associated with changes in the balance of the deferred tax liabilities and assets. The result of dividing total income tax expense by pretax accounting income is commonly known as the "effective tax rate" and may differ substantially from the statutory tax rate of a group's parent company or the rate of current tax paid.

Financial statement pretax income for a global enterprise can differ substantially from taxable income in a particular jurisdiction. Most of these differences are attributable to: when income or expense is recognized for tax purposes versus when it is recognized for financial reporting; items of income or expense that are permanently allowed or disallowed for taxable income purposes; and the allocation of income to different jurisdictions around the world with different statutory tax rates.

Changes to the tax law often produce financial accounting consequences, some of large magnitude. I will read to you a single example of the impact of a change in tax law. My written testimony provides other examples.

If an enterprise were to have a post-retirement obligation for which a pretax book expense of \$100 was recognized in a prior period but for which a tax deduction is not permitted until the liability is settled, the entity would have a deferred tax asset of \$35. If the statutory tax rate were reduced from 35 percent to 25 percent, then the applicable rate used to measure the deferred tax asset would be adjusted downward since the company would now expect to receive a smaller future tax benefit upon settling the liability.

This would result in a reduction of the deferred tax asset from \$35 to \$25 and an income tax expense of \$10 in the period of enactment. In other words, an enterprise's book net income for the period of enactment would be reduced by \$10. The opposite effect would occur in the period of enactment for an enterprise's deferred tax liabilities, where a reduction in tax rates would result in an increase in book net income.

In future periods, that same enterprise may have reduced income tax expense due to the reduced statutory rate—that is, a rate reduction will impact book income for the period of enactment to the extent that existing deferred tax assets and liabilities are remeasured and for the effects of retroactive provisions. That is why the enactment of a rate change for future periods does not necessarily affect the current tax position of the company during the period of enactment and may have a significant effect on reported earnings.

I am happy to answer any questions you may have. Thank you.
[The prepared statement of Mr. Corum follows:]

**Testimony of Ashby T. Corum
Partner, KPMG LLP**

**Before the Committee on Ways and Means
U.S. House of Representatives
June 2, 2011**

Good morning, Chairman Camp, Ranking Member Levin, and other members of the committee. I am Ashby Corum, a tax partner at KPMG LLP. I appreciate the opportunity to appear before you today as an invited witness to assist the Committee in understanding the importance of financial accounting and the relationship between tax and financial accounting, particularly as affected by changes in tax law. The views expressed here are my own and do not necessarily reflect the views of KPMG LLP, its partners, principals and employees, or other KPMG International member firms. KPMG has no position on any of the various tax reform proposals put forth, and no position should be inferred from my testimony.

The accounting and reporting of income taxes by corporate enterprises in their financial statements is a critical element of their overall reporting to stakeholders. Financial statements present the financial position and operating results of the company and are used by analysts, shareholders, lenders and directors. Income tax expense is often a significant expense for an enterprise and it can have a major impact on earnings. Income tax amounts on the balance sheet can also have a significant influence on the financial ratios of a corporate enterprise. Accordingly, investors, analysts and other stakeholders monitor the income tax amounts reported by businesses closely, and make assumptions about the long-term trends of the reported amounts. Changes in tax law can have significant effects on financial statements.

The Internal Revenue Code specifies how an enterprise's annual federal current income tax liability is determined. Accounting standards provide for the financial accounting and reporting of the effects of income taxes that result from an enterprise's activities during the current and preceding years.¹ The objectives of accounting for income taxes are to:

- recognize the amount of taxes payable or refundable for the current year,
- recognize deferred tax liabilities and assets that reflect the future tax consequences of events that have been recognized in an enterprise's financial statements or tax returns, and
- measure current and deferred tax assets and liabilities based on the provisions of enacted tax law.

Total income tax expense of an enterprise consists of both the current tax expense and deferred tax expense or benefit associated with changes in the balance of deferred tax liabilities and assets. The result of dividing total income tax expense by pre-tax accounting income is commonly known as the effective tax rate and may differ substantially from the statutory tax rate of a group's parent company or the rate of current tax paid.

¹ Specifically, for U.S. GAAP reporting, FASB ASC Topic 740, *Income Taxes*.

Financial statement pre-tax income for a global enterprise can differ substantially from taxable income in a particular jurisdiction. Most of these differences are attributable to:

- when income or expense is recognized for tax purposes versus when it is recognized for financial reporting (“temporary differences”),
- items of income or expense that are permanently allowed or disallowed for taxable income purposes (commonly referred to as “permanent differences”), and
- the allocation of income to different jurisdictions around the world with different statutory tax rates (sometimes referred to as “allocation differences”).

Changes to the tax law often produce financial accounting consequences, some of large magnitude. Some common examples of the financial accounting impact of changes in tax laws or rates are as follows:²

- An adjustment to the timing of when an amount is deductible – An example of this would be bonus depreciation on new machinery and equipment purchases. If an enterprise were to purchase an eligible piece of machinery for \$100 while a 100% bonus depreciation incentive was in effect, the enterprise would be able to reduce its current tax expense by \$35. The financial accounting treatment of that purchase is more complicated. For book purposes, while the company has a current tax deduction of \$100 and a current tax benefit of \$35, it must create an account, called a deferred tax liability, to reflect the fact that the immediate deduction of the cost of the asset reduces the enterprise’s tax basis in the asset to zero. As the machinery on the books is depreciated the difference between the book balance and tax basis will be reduced resulting in the deferred tax liability being reduced. If the enterprise were to recover the book value of the asset, it would incur \$35 of additional income tax. Accordingly, a deferred tax liability of \$35 would be recognized.
- An adjustment to the statutory rate – If an enterprise were to have post-retirement obligations for which a pre-tax book expense of \$100 was recognized in a prior period, but for which a tax deduction is not be permitted until the liability is settled, the entity would have a deferred tax asset of \$35³. If the statutory rate were reduced from 35% to 25%, then the applicable rate used to measure the deferred tax asset would be adjusted downward since the company would now expect to receive a smaller future tax benefit upon settling the liability. This would result in a reduction of the deferred tax asset from \$35 to \$25 and an income tax expense of \$10 in the period of enactment. In other words, the enterprise’s book net income for the period of enactment would be reduced by \$10. The opposite effect would occur in the period of enactment for an enterprise’s deferred tax liabilities where a reduction in tax rates would result in an increase in book net income. In future periods, that same enterprise may have a reduced income tax expense due to the reduced statutory rate. That is, a rate reduction will impact book income for the period of enactment to the extent that existing deferred tax assets and liabilities are re-measured and for the effects of retroactive provisions. Thus, while the enactment of a rate change for future periods does not

² All examples are intended to be generic and are not intended to be an interpretation of the application of the Internal Revenue Code.

³ For this example, we will assume the deferred tax asset is not reduced by a valuation allowance.

necessarily affect the current tax position of the company during the period of enactment it may have a significant effect on reported earnings.

- An adjustment to the statutory rate for an enterprise with net operating loss carryforwards – A similar example would be an enterprise that incurs \$100 of operating losses in a prior year and has a \$100 net operating loss carryforward. The enterprise would recognize a \$35 deferred tax asset for the net operating loss carryforward.⁴ The deferred tax asset represents the \$35 of future tax the enterprise would avoid if it earns \$100 in the future during the carryforward period and utilizes the net operating loss carryforward against that income. If the statutory tax rate were reduced from 35% to 25%, then the deferred tax asset for the \$100 net operating loss carryforward would be remeasured to \$25, since it will now only offset \$25 of potential future tax expense. The enterprise would recognize \$10 of deferred tax expense in the period of enactment of the tax rate change.
- An adjustment to the deductibility of a particular item – An example of this would be the recent change to the deductibility of expenses related to Medicare Part D reimbursement rights. For example, assume an enterprise has accrued post-retirement benefits costs of \$100, prior to consideration of the Medicare Part D subsidy. After consideration of the subsidy, the carrying amount of accrued post-retirement benefit costs is \$72. Based on pre-2010 tax law, the enterprise would have anticipated recovering the \$72 accrual through the payment of \$100 of fully deductible expenses, partially offset by a tax-exempt subsidy of \$28.⁵ Accordingly, the enterprise would have recognized a \$35 deferred tax asset related to this accrual. The Patient Protection and Affordable Care Act reduced the amount of health care payments that would be eligible for a deduction. After enactment of the legislation, the enterprise would only be able to deduct \$72 of the accrued post-retirement benefit costs, and would have non-deductible post-retirement benefit costs of \$28 to match the \$28 of tax-exempt subsidy. Accordingly, the enterprise would remeasure its deferred tax asset to \$25 (\$72 x 35%) and would recognize a deferred tax expense of \$10 in the period of enactment of the legislation.
- Change to the tax treatment of distributions from foreign subsidiaries – Currently, many enterprises with foreign operations have a significant amount of foreign earnings that are held offshore. An exception in the literature provides that a deferred tax liability is not recognized for temporary differences related to investments in foreign subsidiaries that are essentially permanent in duration.⁶ Accordingly, an enterprise would not recognize a deferred tax liability for the future tax consequence of repatriating past earnings of a foreign subsidiary, assuming sufficient evidence shows that the subsidiary has invested the undistributed earnings indefinitely. If a reduction of the tax rate applicable to repatriated earnings caused an enterprise to change its intent with respect to those earnings and it decided to repatriate the earnings to the U.S. parent, then a tax expense would be recognized in the financial statements.

The foregoing are just a few examples of the ways tax and financial accounting differ—and the financial reporting consequences of those tax changes. There are, of course, many others that will arise as you deliberate changes to the Code. I am happy to answer any questions you may have.

⁴ For this example, we will assume the deferred tax asset is not reduced by a valuation allowance.

⁵ See Section 139A of the Internal Revenue Code of 1986.

⁶ ASC subparagraph 740-10-25-3(a)(1).

Chairman CAMP. Thank you very much.
Mr. Galvin, your written statement is also part of the record, and you have 5 minutes.

**STATEMENT OF WALTER J. GALVIN, VICE CHAIRMAN OF THE
BOARD, EMERSON ELECTRIC CO.**

Mr. GALVIN. Good morning, Chairman Camp, Ranking Member Levin, and Members of the Committee. I am Walter Galvin, vice chairman and former CFO of Emerson, a \$25 billion global manufacturing company based in St. Louis.

With 57 percent of our sales outside the United States, operations in more than 150 countries, and over 130,000 employees, Emerson is a large U.S. taxpayer. Last year, we paid U.S. income taxes of approximately \$500 million, with an effective tax rate on U.S. profits of 36 percent.

In the words of former Secretary of State Dean Rusk, one-third of the world is asleep at any given time and the other two-thirds is up to something. Indeed, much of the world is up to something. They are reworking their Tax Codes to boost international competitiveness. We need to wake up and join them if we want the U.S. to stay competitive.

There are three specific challenges that place Emerson and American jobs at a substantial disadvantage: The first is our worldwide system of taxation. The second is the high U.S. corporate income tax rate. And the third is the lopsided incentives in our Tax Code, encouraging foreign companies to take a huge amount of debt in the United States.

The first disadvantage is that most of our foreign competitors don't pay a significant second tax on non-U.S. earnings repatriated to their home countries. The U.S., on the other hand, taxes the worldwide profits of American companies at the high 35 percent rate, minus credits to any foreign taxes paid.

I know the committee recently held hearings on this issue, so I would just point out some practical consequences that for Emerson are very real.

In 2006, Emerson sought to buy APC, a Rhode Island-based company that produces high-tech electronic equipment. Over 50 percent of APC's earnings came from outside the United States. We competed against Schneider Electric, a French company, to buy APC. Emerson offered \$5 billion, but Schneider ultimately acquired the company by offering \$6 billion. Why was Schneider willing to pay more? Quite simply, APC profits were worth more to Schneider because, as part of a French company, APC's dividend sent to France would be taxed at under 2 percent.

Another important impact of the worldwide system is the incentive to keep the profits we make in our international locations. Last year, Emerson bought a company in the U.K. called Chloride for approximately \$1.5 billion with cash we had earned abroad and kept abroad. We considered other options for that cash, such as bringing it to the U.S., but the U.S. Tax Code would charge us an extra 10 to 15 cents in taxes on every dollar. Where is our return higher, a dollar invested in the U.K. or 85 cents in the United States?

Secondly, we, as a country, have been tinkering with credits and deductions that, while well-intentioned, have done little more than encourage complex tax planning. Eliminating the bulk of deductions and credits, exchanged for a lower corporate tax rate, will keep U.S. companies competitive and create jobs.

Third, I would like to address the lopsided incentive to debt-load in the United States. In recent years, countries around the world have been tightening tax rules, regulating a company's ability to load up on debt, take huge interest deductions, and lower their tax liabilities. These strict regulations prevent multinational companies, for example, from using excessive leverage financed by debt to acquire other companies.

If Emerson wants to acquire a company in India or China, we must generally come to the table with cash, not debt. If one of their companies or other international companies want to purchase an American company, U.S. tax law encourages them to finance that acquisition with debt. Foreign corporations typically load up on debt in the U.S. and enjoy the interest expense deduction, thereby minimizing U.S. taxes paid to the Federal Government.

America's high corporate tax, worldwide system, and lopsided incentives to debt-load contributed to the 2008 acquisition of Anheuser-Busch by Belgian-based InBev in Emerson's home city of St. Louis. At the time of the acquisition, Anheuser-Busch paid over \$900 million in taxes. InBev loaded up on debt to acquire Anheuser-Busch and are now enjoying huge tax deductions. Based upon my experience, I would suspect InBev won't pay much in income taxes to the Federal Government on the U.S. profits it earns from Anheuser-Busch for at least a decade.

The prospect of tax reform is an opportunity to level the playing field with our international competitors, but I urge the committee to keep two things in mind. First, U.S. tax policy should be equitable so as not to distort business decisions. Equitable tax policy treats all business income equally notwithstanding the industry, how a company is structured, or whether it is headquartered in the U.S. or offshore. Second, tax reform should be revenue-neutral. Our fragile economy would likely react negatively to a large money grab through higher corporate taxes.

In closing, we can't create jobs at home if we punish those who are headquartered here rather than overseas. There is no reason why American companies should not be able to compete and win anywhere in the world, but we need a level playing field.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Galvin follows:]

**Testimony of Mr. Walter J. Galvin
Before the Committee on Ways & Means
U.S. House of Representatives**

**Hearing on
How Business Tax Reform Can Encourage Job Creation**

June 2, 2011

Good morning Chairman Camp, Ranking Member Levin and Members of the Committee.

I am Walter Galvin, Vice Chairman and former Chief Financial Officer of Emerson, a \$25 billion global manufacturing company based in St. Louis with operations in more than 150 countries and over 130,000 employees.

Emerson is a large U.S. taxpayer. Last year we paid U.S. income taxes of approximately \$500 million, with an effective tax rate on U.S. profits of 36 percent.

In the words of former Secretary of State Dean Rusk, "One-third of the world is asleep at any given time and the other two-thirds is up to something." Indeed, much of the world is up to something—they're reworking their tax codes to boost international competitiveness. We need to wake up and join them if we want the U.S. to stay competitive.

There are three specific challenges that have placed Emerson, and American jobs, at a substantial disadvantage. The first is our worldwide system of taxation. The second is the high U.S. corporate tax rate. And the third is the lopsided incentive in our tax code encouraging foreign companies to take on huge amounts of debt in the United States.

1. Reliance on a Worldwide Tax System

The first disadvantage is that most of our foreign-based competitors don't pay a significant second tax on non-U.S. earnings repatriated to their home countries. The U.S., on the other hand, taxes the worldwide profits of American companies at the high 35 percent rate minus credits for any foreign taxes paid.

I know the Committee recently held hearings on this issue, so I will just point out some practical consequences that for Emerson are very real.

In 2006, Emerson sought to buy APC, a Rhode Island-based company that produces high-tech electronic equipment. Over 50 percent of APC's earnings came from outside the United States. We competed against Schneider Electric, a French company, to buy APC. Emerson offered \$5 billion, but Schneider ultimately acquired the company by offering \$6 billion. Why was Schneider willing to offer more? Quite simply, APC's profits were worth more to Schneider because, as part of a French company, APC's dividends sent to France would be taxed at under 2 percent.

Another impact of the worldwide system is the perverse incentive to keep the profits we make in our international operations offshore.

Last year, Emerson bought a company in the U.K. called Chloride for about \$1.5 billion with cash we had earned abroad and kept abroad. We considered other options for that cash, such as bringing it to the U.S., but the U.S. tax code would charge us an extra 10 to 15 cents in taxes on every dollar. Where is our return higher? A dollar invested in the U.K. or 85 cents in the United States?

2. High U.S. Statutory Corporate Income Tax Rates

Second, we as a country have been tinkering with credits and deductions that, while well-intentioned, have done little more than encourage complex tax planning. Eliminating the bulk of deductions and credits in exchange for a lower corporate rate will keep U.S. companies competitive and create jobs.

3. Lopsided Incentive to Debt-Load in the U.S.

Third, I'd like to address the lopsided incentive to debt-load in the United States. In recent years, countries around the world have tightened tax rules regulating a company's ability to load up on debt, take huge interest deductions, and lower their tax liabilities. These strict regulations prevent multinational corporations, for example, from using excessively leveraged financing to acquire other companies.

If Emerson wants to acquire a company in India or China, we must generally come to the table with cash—not debt. If one of their companies, or any international company, wants to purchase an American company, U.S. tax law encourages them to finance that acquisition with debt. Foreign corporations typically load debt in the U.S. and enjoy the interest expense deduction, thereby minimizing U.S. taxes paid to the federal government.

America's high corporate rate, worldwide system, and lopsided incentive to debt-load contributed to the 2008 acquisition of Anheuser-Busch by Belgium-based InBev, in Emerson's home city of St. Louis. At the time of acquisition, Anheuser-Busch paid over \$900 million in taxes. InBev loaded up on debt to acquire Anheuser-Busch and is now enjoying huge tax deductions. Based on my experience, I suspect InBev won't pay much in income taxes to the federal government on the U.S. profits it earns from Anheuser-Busch for at least a decade.

4. Framework for Reform

The prospect of tax reform is an opportunity to level the playing field with our international competitors, but I urge this Committee to keep two things in mind.

First, U.S. tax policy should be equitable so as not to distort business decisions. Equitable tax policy treats all business income equally, notwithstanding the industry, how a company is structured, or whether it is headquartered in the U.S. or offshore.

Second, tax reform should be revenue neutral. Our fragile economy would likely react negatively to a large money-grab through higher corporate taxes.

In closing, we can't create jobs at home if we punish those who headquarter here rather than overseas. There is no reason why American companies should not be able to compete and win anywhere in the world. But we need a level playing field.

Thank you.

Chairman CAMP. Thank you.
And, Ms. Brown, you also have 5 minutes. Thank you, and welcome.

**STATEMENT OF JUDY L. BROWN, EXECUTIVE VICE PRESIDENT
AND CHIEF FINANCIAL OFFICER, PERRIGO COMPANY**

Ms. BROWN. Thank you.

Chairman Camp, Ranking Member Levin, and distinguished Members of the Committee, thank you for this opportunity to share my views on how business tax reform can encourage job creation.

Before doing so, I would like to first provide an overview of Perrigo's business and how we are creating many new jobs today. Then I will address the role that taxes play in our decision-making processes.

Perrigo was founded 124 years ago in the small town of Allegan, Michigan, where we still maintain our global headquarters today. Our mission is to provide quality, affordable health care, and we do so through our unique offering of store-brand pharmaceutical and infant-nutrition products in the over-the-counter, or OTC, space.

Our products are comparable in quality and effectiveness to nationally advertised brand products, but the cost of our products to the retailer is significantly lower, as is the price the consumer pays. Therefore, the retailers are happy and consumers are happy. We estimate that our business model saves consumers approximately \$1.5 billion annually in their health-care spending.

Perrigo is sometimes referred to as the largest health care company you have never heard of. But most Americans have at least some of our products in their cabinets. Each year, we produce over 44 billion tablets and over 350 million liquid doses. Simply stated, this means that every second of every day, 1,400 Perrigo tablets are being taken.

No one has more products requiring FDA approval in the OTC universe than Perrigo. Our more than 450 products are custom labeled and packaged under the names of all major drug, club, and supermarket chains in the U.S., which means we have a tremendously complex supply chain. And, yet, we believe we are one of the most cost-effective health-care manufacturers in the world. We have benchmarked our labor and plant efficiencies against competitors in so-called low-cost countries, like India and China, and still believe that our plants in Michigan, South Carolina, Vermont, Florida, Ohio, New York, and soon Minnesota can compete with anyone, all while maintaining high product quality under strict American standards.

Over 70 percent of our revenues and earnings before tax come from U.S. activity, although we are looking to expand into new markets globally. Although we export some products from the United States and do import others from international operations, the majority of our products are manufactured in the countries in which they are sold to end consumers.

We have grown from approximately \$1 billion in revenue in 2005 to nearly \$3 billion in 2011, an 18 percent compound annual growth rate. In that time, we have invested over \$2 billion in 12 acquisitions, two-thirds of which were in the U.S., adding manufacturing footprint and employee head count along the way. Today, we employ over 8,000 people globally, with more than 5,000 in the U.S. and over 3,500 of them in Michigan.

Through the success of our business model and acquisitions, our total U.S. employment has grown 57 percent over the last 6 years. I would like to note that Perrigo's growing global footprint has increased the need for many well-compensated scientific, managerial, and other white-collar roles at our global headquarters in Michigan.

Now, with that brief background on our business, let me switch to the topic at hand, taxes, which is, without question, an important issue for us. One of the top strategic issues I face as CFO of Perrigo is the increasing disparity of the U.S. corporate tax rate relative to other countries and the impact this disparity has on our long-term decision-making.

Perrigo is currently looking to invest tens, if not hundreds, of millions of dollars in the next few years to build manufacturing capacity to meet the strong demand for our quality, affordable health-care products. We would prefer to invest those dollars in the most optimal place for our supply chain—that is, close to our distribution centers and our customers, which, as I indicated, is mostly in the United States.

When we consider where to make an investment that could be made in either the U.S. or abroad, we model our return on invested capital on an after-tax basis. In such an analysis, for a foreign investment we use the statutory rate imposed by the foreign jurisdiction and assume the earnings will not be repatriated to the United States.

When we model a U.S. investment, we used the statutory Federal income tax rate, plus the applicable State and local tax rates, because they are a real cost and impact cash flow. While Congress cannot change State and local rates, any discussion regarding tax reform should take into account the reality of these other increasing tax burdens, as well.

These models show that the tax rates we have to pay on a U.S. investment are now much higher than what we would pay on a foreign investment. In light of this, our return on invested capital tells us that foreign investments need to be taken ever more seriously, even where our first preference would be to continue investing in the United States. As a CFO, I don't believe that taxes should be the main strategic driver of our next investment dollar.

In summary, I am acutely aware of our national budget situation and the need to make difficult choices on revenue and expenditures. Perrigo believes that increased transparency, simplification, and certainty are desirable and, in fact, worth paying for. We do not need the world's lowest rate to compete, but our increasingly disparate rate is putting us at a disadvantage.

We want our business model to continue to shine on its own accord, as it saves U.S. consumers billions of dollars while, at the same time, providing attractive shareholder returns. We want to continue to compete well in a global economy by being able to bid competitively against foreign players. And, therefore, we support an overall lower corporate rate, combined with a territorial model that would enable better use of global capital, thereby ensuring the continued positive effects of investment and job creation in the U.S.

On behalf of Perrigo, I would like to thank the Ways and Means Committee for the opportunity to provide our views on the impact

of business taxation on job creation, and look forward to working with all of you and other tax policymakers on this and other related issues.

[The prepared statement of Ms. Brown follows:]

**Testimony of
Ms. Judy Brown
Executive Vice President and Chief Financial Officer
Perrigo Company**

**Before the
Committee on Ways and Means
U.S. House of Representatives**

**Hearing on
How Business Tax Reform Can Encourage Job Creation
June 2, 2011**

Chairman Camp, Ranking Member Levin, and distinguished members of the Committee, thank you for this opportunity to share my views on how business tax reform can encourage job creation. Before doing so, I would first like to provide an overview of Perrigo's business and how we are creating many new jobs today. Then I will address the role that taxes play in our decision-making processes.

Perrigo

Perrigo was founded 124 years ago in the small town of Allegan, Michigan, where we still maintain our global headquarters today. Our mission is to provide "quality, affordable healthcare" and we do so through our unique offering of store brand pharmaceutical and infant nutrition products in the over-the-counter, or "OTC" market. Our products are comparable in quality and effectiveness to nationally advertised brand products, but the cost of our products to the retailers is significantly lower, as is the price the consumer pays. Therefore the retailers are happy and consumers are happy. We estimate that our business model saves consumers approximately \$1.5 billion annually in their healthcare spending.

Perrigo is sometimes referred to as "the largest healthcare company you've never heard of," but most Americans have at least some of our products in their medicine cabinet. Each year, we produce over 44 billion tablets and over 350 million liquid

doses. Simply stated, this means that every second of every day, 1,400 Perrigo tablets are being taken.

No one has more products requiring FDA approval in the OTC universe than Perrigo. Our more than 450 products are custom labeled and packaged under the names of all the major drug, club and supermarket chains in the US, which means we have a tremendously complex supply chain. And yet, we believe that we are one of the most cost effective healthcare manufacturers in the world. We have benchmarked our labor and plant efficiencies against competitors in so-called "low cost" countries like India and China and still believe that our plants in Michigan, South Carolina, Vermont, Florida, Ohio, New York (and, soon, Minnesota) can compete with anyone, all while maintaining high product quality under American standards. Over 70% of our revenues and earnings before taxes come from U.S. activity, although we are looking to expand into new markets. Although we export some products from the United States, and do import others from international operations, the majority of our products are manufactured in the countries in which they are sold to end consumers.

We have grown from approximately \$1 billion in revenue in 2005 to nearly \$3B in 2011, an 18% compound annual growth rate. In that time, we invested more than \$2 billion in 12 acquisitions (two-thirds US), adding manufacturing footprint and employee headcount along the way. Today, we employ over 8,000 people globally, with more than 5,000 in the US and over 3,500 of them in Michigan. Through the success of our business model and acquisitions, our total U.S. employment has grown 57% over the last 6 years. I'd like to note that Perrigo's growing global footprint has increased the need for many well compensated scientific, managerial and other white collar roles at our global headquarters in Michigan.

Business Taxation

Now, with that brief background on our business, let me switch to the topic at hand – taxes – which is, without question, an important issue for Perrigo. One of the top strategic issues I face as CFO of Perrigo is the increasing disparity of the U.S. corporate tax rate relative to other countries and the impact this disparity has on our long-term decision-making.

Perrigo is currently looking to invest tens, if not hundreds, of millions of dollars in the next few years to build manufacturing capacity to meet the strong demand for our quality, affordable healthcare products. We prefer to invest those dollars in the most optimal place for our supply chain – that is, close to our distribution centers and our customers, which, as I indicated, are mostly in the United States.

When we consider where to make an investment that could be made in either the United States or abroad we model our returns on an after-tax basis. In such an analysis, for a foreign investment, we use the statutory rate imposed by the foreign jurisdiction and assume the earnings will not be repatriated to the United States. When we model the after-tax return for a U.S. investment, we use the statutory federal income tax rate *plus* the applicable state and local tax rates. We add these because they *are* a real cost and impact cash flow, and while Congress cannot change state and local tax rates, any discussion regarding tax reform should take into account the reality of these other increasing tax burdens as well.

These models show that the tax rates we will have to pay on a U.S. investment are now much higher than what we would pay on a foreign investment. In light of this, foreign investments need to be taken ever more seriously even where our first preference would be to invest in the United States. As a CFO, I do not believe that taxes should be a main strategic driver of our next investment dollar.

Given the reality of the current U.S. corporate tax rate structure, in order for us to be able to compete long-term on an after-tax profit margin basis with global players in our industry, we have no choice but to consider diversification of Perrigo's footprint as part of our strategy. In addition, many of our shareholders frequently ask me why Perrigo does not seem to have a lower long-term tax rate, as many of our competitors do.

So what can the United States do to encourage investment and job creation in the United States? First, lower the corporate tax rate. The United States need not have the lowest corporate tax rate in the world, but we should have a rate comparable to those of our trading partners. When lowering the rate, we will likely need to reduce tax expenditures to broaden the tax base. Although certain tax expenditures, such as the section 199 manufacturing incentive and the R&D credit, are important to Perrigo under the current tax code, even these tax expenditures should be on the table in the current tax reform discussions. We would prefer tax reform that lowers the corporate tax rate in a meaningful way, even if certain current tax expenditures are curtailed.

Second, add more certainty to the corporate tax system. As a CFO, I need long-term visibility to make optimal investment decisions. For example, when the United States enacts a temporary tax incentive, I cannot assume that the tax incentive will be available for future U.S. investments. As a result, I may invest where there is greater certainty about the long-term tax burden on that investment.

Third, make U.S. companies more competitive globally. I am aware that some have suggested that we should remove the disparity between foreign and domestic tax burdens by taxing foreign investment returns as fully as we tax domestic investment returns. Although this hearing is not primarily concerned with international taxation, which you have addressed at prior hearings, I should briefly respond that doing so would move the United States in the wrong direction. Moving towards a territorial tax system will better enable U.S. companies like Perrigo to compete with

our foreign competitors when we do decide to make investments abroad. Perrigo's goal is to be a strong U.S. company, creating good U.S. jobs that support both our domestic and foreign operations. We believe that the path to this goal is lower, not higher, corporate taxes on both domestic and foreign earnings.

Fourth, allow U.S. companies to access their overseas cash at a lower cost. Because our foreign earnings must be "permanently reinvested" to avoid current tax, we may invest earnings abroad that we would rather invest in the United States. We can facilitate access to overseas cash by adopting a territorial system.

In summary, I am acutely aware of our national budget situation and the need to make difficult choices on revenues and expenditures. Perrigo believes that increased transparency, simplification and certainty are desirable and in fact worth paying something for. We do not need the world's lowest rate to compete -- but our increasingly disparate rate is putting us at a disadvantage. We want our business model to continue to shine on its own accord as it saves U.S. consumers billions of dollars while at the same time providing attractive shareholder returns. We want to continue to compete well in a global economy by being able to bid competitively against foreign players. And, therefore we support a lower overall corporate rate, combined with a territorial model that would enable better use of global capital, thereby ensuring the continued positive effects of investment and job creation in the United States.

On behalf of Perrigo, I would like to thank the Ways and Means Committee for the opportunity to provide our views on the impact of business taxation on job creation. I look forward to working with the Committee and other tax policy makers on this and other related issues, and I would be happy to answer any questions you have.

Chairman CAMP. Thank you. Thank you very much.
Mr. Zrust, you have 5 minutes.

**STATEMENT OF JAMES H. ZRUST, VICE PRESIDENT OF TAX,
THE BOEING COMPANY**

Mr. ZRUST. Chairman Camp, Ranking Member Levin, and Members of the Committee, thank you for the opportunity to testify on the need for business tax reform.

I have worked in corporate tax for over 30 years, and I can say unequivocally that the U.S. corporate tax system must be reformed to ensure that U.S. companies are not put at a disadvantage when competing in the global marketplace with our foreign counterparts.

First, I would like to provide a brief overview of The Boeing Company. The Boeing Company is the world's largest aerospace company, the largest U.S. manufacturing exporter, and leading manufacturer of commercial jetliners and defense, space, and security systems. With our corporate headquarters in Chicago, Illinois, Boeing has over 160,000 employees in the U.S., with major operations in 34 States.

Boeing is organized into two business units: Boeing Commercial Airplanes and Boeing Defense, Space, and Security. Importantly, The Boeing Company contributes more than \$1 billion each week into the U.S. economy. In 2010, Boeing paid over \$32 billion to more than 22,000 U.S. businesses, supporting an additional 1.2 million supplier-related jobs across the country.

The Boeing Company is proud to have customers located in more than 90 countries. Historically, 70 percent of the commercial airplane business is derived from outside the United States, and we are rapidly growing our defense business outside the U.S.

Although a significant portion of our customers are outside of the United States, our employees, manufacturing and support operations, research and development activities, and intellectual property are predominantly located in the U.S. Over 95 percent of our net income is attributable to these domestic activities. Unlike other large multinational companies, almost all of our current worldwide income is subject to U.S. tax, and our effective rate is generally between 31 and 33 percent.

In addition to a significant percentage of our customers being outside the U.S., many of our competitors are, as well. It is well-known that our largest competitor is located in Europe, and new competition is rapidly emerging from China, Canada, Brazil, and Russia, all with lower combined Federal and local statutory rates than the U.S.

Everyone here today is well-aware that the combined U.S. statutory tax rate is almost 15 percentage points higher than the average combined rate of other OECD member countries. It is our view that significantly reducing the corporate tax rate will improve U.S. competitiveness. We believe lowering the corporate rate would dramatically reduce tax policy pressure and rhetoric by ensuring that U.S. companies are competitive and, importantly, would not tip the scale in favor of foreign production.

Recently, a commercial aircraft customer located in the Middle East approached Boeing with a concern regarding the lack of U.S. companies willing to bid on a contract in that region. The general sentiment is that price bids received from companies based in Asia, Europe, and Australia are consistently lower than those made by

U.S. aerospace companies due to our tax system and high corporate rate.

This is not the outcome we should want. We believe that a concerted effort to enact a corporate rate reduction to ensure that the U.S. remains competitive and an attractive place to do business in the global marketplace needs to be made now.

We appreciate the current deficit position and are not asking Congress to ignore the costs associated with a meaningful rate reduction. Like many of the bipartisan proposals outlined recently, we agree that tax expenditures should be on the table if a meaningful rate reduction is considered. It is our position that we could support eliminating tax expenditures in order to obtain a meaningful lower corporate tax rate.

Turning toward the issue of the complexity, I often tell my team, "Complexity breeds opportunity." This is not an ideal situation for either the government or the taxpayer. The complexity of our present tax system leads to considerable uncertainty with regard to issue resolutions and is burdensome in terms of the cost of compliance.

Each year, we spend millions of dollars to comply with the complexities of the U.S. tax system. This entails detailed analysis of the over 500 book tax accounting differences in our Federal income tax return. In addition, the determination of the R&D credit, the domestic manufacturing deduction, and the U.S. taxation of foreign activities involve incredible degrees of complexity.

Our compliance obligations not only include the filing of our Federal tax return but also the continuous audit by the Internal Revenue Service. The IRS has over 30 agents assigned to our case and maintains permanent offices in 3 of our locations. Our most recent case to be resolved covered the years 1998 to 2003 and was only concluded in December of last year.

Compliance is built in to Boeing's business culture. While compliance is and should be a crucial element to all businesses, a less complicated system will inherently increase transparency and result in improved productivity.

In conclusion, over the course of several decades, U.S. competitors, both new and old, have lowered their corporate tax rate, but the U.S. corporate tax rate has remained virtually unchanged. In today's global economy, now is the time to act to ensure that the U.S. is a place where companies want to do business from as well as in. We believe a meaningful lower rate and a less complex system would make U.S. companies like Boeing more competitive with the rest of the world.

[The prepared statement of Mr. Zrust follows:]

**Testimony of
Mr. James Zrust
Vice President of Tax
The Boeing Company
Chicago, Illinois**

**Before the
Committee on Ways and Means
U.S. House of Representatives**

**Hearing on
How Business Tax Reform Can Encourage Job Creation**

June 2, 2011

Chairman Camp, Ranking Member Levin, and Members of the Committee, thank you for the opportunity to testify on the need for business tax reform. I have worked in corporate tax for over thirty years, and I can say unequivocally that the U.S. corporate income tax system must be reformed to ensure that U. S. companies are not put at a disadvantage when competing in the global market place with our foreign counterparts.

Background on the Boeing Company

First, I would like to provide a brief overview of the Boeing Company. The Boeing Company is the world's largest aerospace company, the largest U.S. manufacturing exporter and leading manufacturer of commercial jetliners and defense, space and security systems. With our corporate headquarters in Chicago, Illinois, Boeing has over 160,000 employees in the US with major operations in 34 states. More than 123,000 employees hold college degrees -- including nearly 32,000 advanced degrees -- in virtually every business and technical field from approximately 2,700 colleges and universities worldwide.

Boeing is organized into two business units: Boeing Commercial Airplanes and Boeing Defense, Space & Security. Supporting these units are Boeing Capital Corporation, a global provider of financing solutions; the Shared Services Group, which provides a broad range of services to Boeing; and Boeing Engineering, Operations & Technology, which helps develop, acquire, apply and protect innovative technologies and processes.

Boeing products and tailored services include commercial and military aircraft, satellites, weapons, electronic and defense systems, launch systems, advanced

information and communication systems, and performance-based logistics and training.

Importantly, the Boeing Company contributes more than \$1 billion each week into the U.S. economy. In 2010, Boeing paid over \$32 billion to more than 22,000 U.S. businesses, supporting an additional 1.2 million supplier-related jobs across the country. In the past year, the Boeing Company contributed over \$89 million to U.S. nonprofit organizations. In addition, Boeing employees contributed \$51 million to their Employees Community Fund, which is the world's largest employee-operated charitable fund.

Competitiveness- Lower Statutory Tax Rate is Needed

The Boeing Company is proud to have customers located in more than 90 countries. Historically, 70 percent of the commercial airplane business is derived from outside of the United States and we are rapidly growing our defense business outside of the U.S. In fact, developing and emerging markets account for a significant portion of the forecasted growth in the aerospace and defense sector.

Although a significant portion of our customers are outside of the United States, our employees, manufacturing and support operations, research and development activities and intellectual property are predominantly located in the United States. Historically, over 95 percent of our net income is attributable to these domestic activities. Unlike other large multinational companies, almost all of our current worldwide income is subject to U.S. tax, and our effective rate is generally between 31-33 percent. The tax incentives that have the most impact on our effective rate are primarily the research and development tax credit ("R&D credit") and, to a lesser extent, the domestic manufacturing deduction. Last year Boeing spent over \$4 billion on research and development, primarily on our two major commercial development programs.

In addition to a significant percentage of our customers being outside of the U.S., many of our competitors are as well. It is well known that our largest commercial competitor is located in Europe, and new competition is rapidly emerging from China, Canada, Brazil, and Russia-all with lower combined federal and local statutory tax rates than the United States.

Everyone here today is well aware that the combined US statutory tax rate is almost 15 percentage points higher than the average combined rate of other

OECD member countries. It is our view that significantly reducing the corporate tax rate will improve U.S. competitiveness. We believe lowering the corporate rate would dramatically reduce tax policy pressure and rhetoric by ensuring that U.S. companies are competitive, and importantly, would not tip the scale in favor of foreign production.

A 2005 study by the Congressional Joint Committee on Taxation concluded that a reduction in the corporate income tax had the greatest impact on increasing long-term economic growth due to increased capital investment and labor productivity.¹ We can no longer deny that capital is mobile. However, a workforce generally is not. Manufacturing in particular is capital intensive, so a higher corporate tax rate results in less investment in not only our facilities but also in our workforce.

Recently, a commercial aircraft customer located in the Middle East approached Boeing with a concern regarding the lack of US companies willing to bid on a contract in that region. The general sentiment is that price bids received from companies based in Asia, Europe and Australia are consistently lower than those made by US aerospace companies due to our tax system and high corporate rate. This is not the outcome we should want. We believe that a concerted effort to enact a corporate rate reduction to ensure that the US remains competitive and an attractive place to do business in the global marketplace needs to be made now.

The statutory tax rate can impact where a company makes new capital investments. The U.S. corporate tax rate is inherently built into the price of our products. We are committed to bricks and mortar here in the U.S. and are proud to be the largest U.S. manufacturing exporter. However, in order to continue to grow, we need a level playing field with our competitors. Lower combined corporate tax rates in the countries where our competitors are located make the price of their products less expensive for the global customers for which we compete. Our Chairman and CEO, Jim McNerney, recently noted that Boeing consistently wins contracts globally through innovation, which has always kept us ahead of our competitors. However, as the rest of the world attempts to gain market share and compete with us, a significantly lower corporate tax rate will become crucial to our continued success.

Revenue Concerns

¹ (JCX-4-05)

We appreciate the current deficit position and are not asking Congress to ignore the cost associated with a meaningful rate reduction. Like many of the bipartisan proposals outlined recently, we agree that tax expenditures should be on the table if a meaningful rate reduction is considered. It is our position that we could support eliminating tax expenditures in order to obtain a meaningful lower corporate tax rate. Making U.S. businesses more competitive by reducing the rate could, from our perspective, address some of the long-term fiscal issues we face today.²

Complexity

Turning towards the issue of complexity, I often tell my team that complexity breeds opportunity. This is not an ideal situation for either the government or the taxpayer. The complexity of our present tax system leads to considerable uncertainty with regard to issue resolutions and is burdensome in terms of the cost of compliance. For example, President Obama's Economic Recovery Advisory Board estimated the total compliance costs for U.S. companies at \$40 billion annually, or more than 12 percent of the revenues collected.³

Each year we spend millions of dollars to comply with the complexities of the US tax system. This entails detailed analysis of the over 500 book/tax accounting differences in our federal income tax return. In addition, the determination of the R&D credit, the Domestic Manufacturing Deduction and the U.S. taxation of foreign activities involve incredible degrees of complexity. Our compliance obligations not only include the filing of our federal tax return but also the continuous audit by the Internal Revenue Service ("IRS"). The IRS has over 30 IRS agents assigned to our case and maintains permanent offices in three of our locations. Our most recent case to be resolved covered the years 1998-2003, and it was only concluded in December of last year. One of the major issues during the 1998-2003 audit cycle was the R&D credit which was fully disallowed at the initial audit stage. Only after more than a year of meetings were we able to settle the issue at the Appeals level. This inefficiency brought on by the complexities of the current tax system was costly and unnecessary for both Boeing and the government.

² Johanson, Heady, Arnold, Brys, and Varita, "Tax and Economic Growth", OECD Economics working paper No. 620., July 11, 2008.

³ PERAB, "The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation", August 2010.

Compliance is built into Boeing's business culture. While compliance is and should be a crucial element to all businesses, a less complicated system will inherently increase transparency and result in improved productivity.

Conclusion

Over the course of several decades, U.S. competitors, both new and old, have lowered their corporate tax rate, but the U.S. corporate tax rate has remained virtually unchanged. In today's global economy, now is the time to act to ensure that the U.S. is a place where companies want to do business from as well as in. We believe a substantially lower rate and a less complex system would make U.S. companies like Boeing more competitive with the rest of the world.

Chairman CAMP. Thank you very much.
Mr. Mispelon, you have 5 minutes.

**STATEMENT OF JAMES MISPLON, VICE PRESIDENT, TAX,
SEARS HOLDINGS CORPORATION, TESTIFYING ON BEHALF
OF THE NATIONAL RETAIL FEDERATION**

Mr. MISPLON. Chairman Camp, Ranking Member Levin, and Members of the Committee, my name is Jim Misplon. I am vice president of tax for Sears Holdings Corporation, parent company of Sears, Roebuck and Co., Kmart and Lands' End.

Sears Holdings has 280,000 employees and over 3,500 stores in the United States. We have stores in all 50 States, as well as Puerto Rico, U.S. territories, and Canada. Like most retailers, the vast majority of our operations are domestic.

I am the chair of the National Retail Federation's Taxation Committee and am testifying today on behalf of the National Retail Federation. Accompanying me today is Rachelle Bernstein, vice president and tax counsel for the NRF. We appreciate the opportunity to present the views of the retail industry on the subject of corporate tax reform.

The NRF supports business tax reform that will lower corporate tax rates and broaden the tax base. We believe this type of income tax reform will be good for the retail industry and good for the economy as a whole.

Sears Holdings and other members of NRF believe that the most important aspect of any tax reform measure is its impact on the economy and jobs. We believe that the reform of the income tax, by providing a broad base and lower rates, will bring the greatest economic efficiency to the Federal tax system. These changes will lead to greater investment, more jobs, and greater economic growth.

Tax reform must be applicable to all businesses, not just C corporations. The retail industry has one of the highest Federal effective tax rates of any industry. Because their industry is so competitive, NRF believes that most of the tax rate reduction will be passed forward to consumers through lower prices. As a result of this price cut to consumers, retailers will increase sales, hire more employees, and purchase more inventory, all of which will increase investments and jobs.

Lower tax rates will create more investment opportunity. If the corporate tax rate is lowered, investment proposals will more likely meet a company's required internal rate of return, and a decision to invest will more likely be made. These investments, like building or improving stores and distribution centers, the investment in on-line and mobile shopping platforms, create jobs both within and outside the retail industry.

In addition, lower tax rates reduce incentives for entering into tax-motivated business strategies. This will also eliminate much of the tax complexities from the business tax system and reduce controversy between the taxpayer and the IRS.

Any new tax system will need to provide for the recovery of the cost of capital assets and inventories. We recognize and support the tax reform goal of substituting lower tax rates for tax incentives. However, the new tax system should also not burden investments by extending the tax write-off of an asset beyond its economic life.

These rules must be applied fairly so that similarly situated taxpayers are not treated differently. Thus, any new tax system

should eliminate the current tax law bias that provides more favorable depreciation rules for taxpayers that lease their property than for taxpayers in the same industry that own their own property.

In the retail industry, tax rules relating to inventories and depreciation create the greatest compliance burdens. If the rules are to be changed, we urge that every effort be made to keep the new system as simple as possible. We recognize that the specifics of inventory and depreciation reform are not the subject of today's hearings; however, because these issues are so important to the retail industry, we respectfully request the opportunity to offer our views on these issues when the committee considers them in more detail.

Finally, one of the most harmful things that could be done to our economy at this time would be to place a direct Federal tax on consumption. A recent study performed for the NRF by Ernst & Young and Tax Policy Advisors found that if a VAT were adopted in addition to income tax, economic growth would decline for several years. It would cause a loss of 850,000 jobs in the first year and 700,000 fewer jobs over the long term.

In conclusion, the NRF urges the committee to move forward with business income tax reform. This will encourage investment, create jobs, and simplify administration of the tax system.

Mr. Chairman, thank you for the opportunity to express NRF's views on business tax reform, and we would be pleased to answer any questions.

[The prepared statement of Mr. Mispion follows:]



Testimony
of
James Misloun
Vice President, Tax
Sears Holdings Corporation
on behalf of
The National Retail Federation

Hearing on How Business Tax Reform Can Encourage Job Creation

before the
House Ways and Means Committee
June 2, 2011

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Chairman Camp, Ranking Member Levin, and Members of the Committee, my name is Jim Misplon. I am Vice President of Tax for Sears Holdings Corporation, parent company of Sears, Roebuck and Co; Kmart and Lands' End, headquartered in Hoffman Estates, Illinois. Sears Holdings has 280,000 employees and over 3500 stores in the United States. Like most retailers, we have partnerships with multinational suppliers and we have some employees outside of the US including those at Sears Canada, a 92% owned subsidiary, however, the vast majority of our operations are domestic. I am the Chair of the National Retail Federation's Taxation Committee, and am testifying today on behalf of the National Retail Federation (NRF).

As the world's largest retail trade association, the NRF's global membership includes retailers of all sizes, formats and channels of distribution as well as chain restaurants and industry partners from the U.S. and more than 45 countries abroad. In the U.S., NRF represents the breadth and diversity of an industry with more than 1.6 million American companies that employ nearly 25 million workers and generated 2010 sales of \$2.4 trillion.

Summary of Comments

Sears Holdings and other members of NRF believe that the most important aspect of any tax reform measure is its impact on the economy and jobs. The U.S. economy is coming out of the worst recession since the Great Depression, but economists predict that economic growth may continue to be slow because of high unemployment, which will also continue to depress consumer spending. It is vitally important that any tax reform measure do no harm to our economy, which is likely to remain fragile for several years to come.

We believe that a reform of the income tax, by providing a broad base and low rates, will bring the greatest economic efficiency to the federal tax system. These changes will lead to greater investment, more jobs and greater economic growth. In making these reforms, it is important that the tax code not place different tax burdens on taxpayers in similar economic circumstances. For this reason, tax reform must be applicable to all businesses, not just "C corporations."

Reforms of the income tax could be designed to eliminate some of the major complications in the current Internal Revenue Code, which cause companies like Sears Holdings to spend tens of thousands of man-hours each year on tax compliance issues that do not assist the company with its business objectives. Reduction in complexity would also eliminate a lot of controversy with the IRS, making the government's tax collection process far more efficient.

Finally, one of the most harmful things that could be done to our economy at this time would be to place a direct federal tax on consumption. A recent study performed for the NRF by Ernst & Young and Tax Policy Advisors found that if a VAT were adopted in addition to the income tax,

economic growth would decline for several years. It would cause a loss of 850,000 jobs in the first year and 700,000 fewer jobs over the longer term. The study also found that most Americans alive today would be worse off under a VAT. An earlier study conducted for the NRF by PricewaterhouseCoopers found that if a consumption tax were adopted to replace the current income tax system, there would be harmful economic results for a period of three to eight years, with employment dropping for a period of four to five years.

Impact of Tax Reform on Business

Sears Holdings and other members of the NRF support income tax reform that would broaden the income tax base and lower the income tax rates. The elimination of many special deductions and credits in exchange for lower rates will bring about a more economically efficient tax system that is simpler for taxpayers and will ease enforcement.

Most importantly, we believe that business tax reform will result in greater economic growth. The retail industry may have the highest *federal* effective tax rate of any industry, typically between 33 and 35%. With state and foreign taxes included, our industry's corporate effective tax rate is even higher. Business tax reform would most likely lower the effective tax rate of the retail industry. The NRF believes that most of that tax rate reduction will be passed forward to the consumer through lower prices. Because our industry is so competitive, once one retailer reduces prices, others are forced to follow if they want to maintain their sales. As a result of this price cut to consumers, retailers will have the ability to sell greater volume, which will create the need for more employees in stores and distribution centers. In addition, retailers will purchase more inventory, which will increase investment and jobs throughout the supply chain.

Lower tax rates will create more business investment. NRF members, like most companies, evaluate investments based on metrics such as "return on investment" (ROI). If the corporate tax rate is lowered, investment proposals will be more likely to achieve the needed hurdle rate, and a decision to invest is more likely to be made. For our member companies, some of the types of investment that would be typically considered are improvements to stores, building new distribution centers, and improvements to internal systems. These types of investments lead to higher employment both within and outside of the retail industry.

In addition, lower tax rates reduce the incentives for entering into tax motivated business strategies. Lower rates combined with the elimination of various tax preferences will cause businesses to structure transactions to their most productive use, rather than spending inordinate amounts of resources on tax planning. This will also eliminate a lot of complexity from the business tax system and reduce controversy between taxpayers and the IRS.

Finally, in a global economy, high U.S. corporate tax rates serve as a disincentive for investment in the United States and make U.S. companies less competitive in the global marketplace.

In the context of business income tax reform that lowers the rates and broadens the base, a new tax system will still need to include provisions that provide recovery of costs for capital assets and inventories. We recognize and support the tax reform goal of substituting lower tax rates for tax *incentives*. However, the new tax system also should not burden investments by extending the tax write-off of an asset beyond its economic life. These rules must be applied fairly so that similarly situated taxpayers are not treated differently. Thus, any new system should eliminate the current tax law bias that provides more favorable depreciation rules for taxpayers that lease their property than for taxpayers in the same industry that own their property.

Tracking inventories can be extremely difficult. If current law rules are to be changed, we urge that every effort be made to keep the new systems as simple as possible.

For both depreciation and inventory accounting, reform must include necessary transition rules to mitigate the economic disruptions of moving to a new tax system. We recognize that the specifics of inventory reform or depreciation reform are not the subject of today's hearing; however, because inventory accounting represents such a large issue for the retail industry, we respectfully request the opportunity to offer our views on this issue when the Committee considers it in more detail.

Problems with Complexity, Uncertainty and Biases in the Current Tax System

The complexity of the tax code creates a huge and unnecessary burden for both businesses and the IRS. NRF members spend tens of thousands of man hours per year on tax compliance issues. The complexity of tax issues relating to inventories and depreciation account for a lot of these compliance hours. In addition, members of the industry typically spend hundreds of thousands of dollars each year on outside tax consultants to assist with the complexity in the code and the additional compliance burdens that it creates.

The complexity as well as the temporary nature of many provisions in the tax code also present difficulties in making investment decisions. Earlier in the testimony, I discussed the ROI metric that many companies use. However, because there is so much uncertainty with respect to the interpretation of certain tax provisions or whether certain expiring tax provisions will be extended for the time period for which the investment is planned, many alternative scenarios may need to be evaluated. This is very frustrating when management is trying to make an investment decision. At times, these tax uncertainties could either delay an investment or cause the investment not to be made. Replacing targeted provisions within the tax code and all of the associated complexities, as

well as the temporary nature of many of these provisions, with a permanent lower corporate tax rate will greatly improve this process and should result in more investment.

The current tax system also includes biases that may discriminate between taxpayers in the same industry and cause competitive disadvantages. Because of the haphazard approach that Congress has taken to depreciation, improvements to stores that are owned by a retailer are treated worse than improvements made to stores that are leased by a retailer. This is because the owners of stores are denied the opportunity to elect bonus depreciation for their improvements, but lessees are permitted to have bonus depreciation. This not only hurts the NRF's larger member companies like Sears Holdings, which own a significant portion of our stores, but it also hurts the traditional small Main Street retailer that tends to own its retail store building. Another depreciation bias impacting retailers is the fact that a shorter depreciable life is applied to improvements to all leased space, whether storefront or warehouse. If a retailer owns its buildings, improvements to non-public space (i.e. backroom or warehousing) have a longer depreciable life. In the context of business tax reform, we believe the tax base needs to be defined more comprehensively, so that taxpayers within the same industry are not treated differently.

Another way in which the current tax system discriminates against taxpayers in the same industry is through the tax treatment of internet sales. Because Sears Holdings and other national retailers have stores in most, if not all 50 states, when we sell an item into any state that has a sales tax, either through a store located in that state or over the internet, we must collect sales tax on the sale. If the same item is sold to a customer in that state by an e-retailer that has no store in the state, they do not have to collect sales tax. This issue creates a competitive disadvantage to the retailers that are actually providing jobs and paying taxes in your states, and, again, applies to the larger companies like Sears Holdings, as well as the traditional Main Street retailers. Although this tax discrimination does not arise out of the Internal Revenue Code, it can be resolved through federal legislation.¹

Consumption Taxes

Whenever fundamental tax reform is considered, policy debates generally turn to whether the United States should move from its current income-based tax system to a consumption-based tax system or to a hybrid tax system, which would impose a value added tax (VAT) in addition to the income tax, similar to the European model. NRF opposes the adoption of a consumption tax because it would have a chilling effect on our already weak economy.

¹ *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) made clear that Congress has the power to resolve this issue and is better qualified than the courts to resolve this issue. "Accordingly, Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with the duty to collect use taxes." *Quill* at 318.

Consumption taxes can be imposed in various ways including a National Retail Sales Tax (NRST), Value Added Tax (VAT), Flat Tax, and consumed income tax. Economists generally agree that the economic impact of various forms of consumption taxes is similar, although the application of the taxes may differ.

In 2010, Ernst & Young and Tax Policy Advisors conducted a study for NRF on the Macroeconomic Effects of an Add-on VAT enacted for deficit reduction. The study found that following the enactment of a VAT, the economy would lose 850,000 jobs, GDP would decline and retail spending would decline. By contrast, the study found that following the enactment of a comparable deficit reduction through a reduction in government spending, the economy would add 250,000 jobs, GDP would increase and there would be a much smaller drop in retail spending. A copy of the NRF study can be found at www.nrf.com/VAT.

An earlier study,² prepared for the NRF Foundation by PricewaterhouseCoopers, examined the impacts of *replacing* the income tax with a consumption tax (either an NRST or a Flat Tax). The study concluded that although replacing the income tax with a consumption tax *might* bring *long-term* economic growth, there could be very harmful short-term and mid-term economic results.³ The study also found that the economic growth that occurred during the ten-year modeling period was relatively modest compared to the disruptions to the economy during the transition years. Specifically, the study found that following the enactment of an NRST, the economy would decline for three years, employment would decline for four years, and consumer spending would decline for eight years. The study found that following the enactment of a Flat Tax, the economy would decline for five years, employment would decline for five years and consumer spending would decline for six years. Given the fragile state of the current economy, the United States cannot afford to see further declines in consumer spending for several more years.

In addition to the overall impact of consumption taxes on the economy, retailers are particularly concerned with the impact of consumption taxes on our customers. Consumption taxes are highly regressive and will raise the tax burden on lower and middle-income Americans. This occurs because lower-income households tend to spend a higher portion of their incomes, so they will pay a higher tax relative to income level under a consumption tax than will upper income households.

Consumption taxes also impose an unfair tax increase on senior citizens, who are living on fixed incomes. Senior citizens generally live off of previously-taxed earnings that they have saved

²PricewaterhouseCoopers LLP, *Fundamental Tax Reform: Implications for Retailers, Consumers, and the Economy*, April 2000. A copy of the study can be found at: http://nrf.com/modules.php?name=Documents&op=viewlive&sp_id=3965

³ The PwC model was developed specifically to analyze tax reform plans. It combined microsimulation models for individual and corporate income taxes with a macro-economic forecasting model, which allowed it to provide short-term transition results on an annual basis. Id at p. 119.

from their working years. They now are at a stage where they consume far more than they earn. An increase in the tax burden on consumption would be extremely difficult for seniors.

A consumption tax, whether as a replacement to the current income tax system or as an addition to the income tax system, will not meet President Obama's goal to not impose higher taxes on Americans with less than \$250,000 a year of income. The E&Y/Tax Policy Advisors study showed that enactment of a VAT would mean that most Americans alive at the time the VAT was enacted would have a lower standard of living for their entire lifetime. Even if exemptions were provided to alleviate the impact of a VAT on lower income households, most families with household income over \$40,000 a year would have a lower standard of living if a VAT were enacted.

A federal consumption tax will also wreak havoc with state budgets. Forty-five out of fifty states depend on sales taxes as a major source of revenue. In fact, much of the current short fall in state budgets is as a result of the sharp decline in consumer spending, and hence sales tax collections, during this weak economic period. If a consumption tax is added at the federal level, it will be far more difficult for the states to increase sales taxes to address budget short falls.

Enforcement issues are likely to increase if the federal government adopts a consumption tax either in addition to the current income tax or as a replacement to the current income tax. When the rate of tax on consumption exceeds certain levels, tax evasion grows.⁴ The level of tax on consumption that would be imposed if a federal tax were added to state and local sales taxes would probably exceed these levels. They certainly would be exceeded if a federal consumption tax were to replace the income tax.

Adding a bureaucracy within the Internal Revenue Service to enforce a federal consumption tax will necessitate large start up costs, as well as additional ongoing costs to operate.


Adding a federal consumption tax to the income tax will also greatly increase the overall level of complexity of our tax system. A World Bank Study found that the hours needed to comply with a VAT exceeded the hours needed to comply with the corporate income tax by 26%.⁵ Complications will result because of the differences between the federal sales tax base and state and local tax bases. The dual tax system may be particularly burdensome for small businesses, which have enough trouble meeting the burdens of collecting and remitting payroll and income tax withholdings.

⁴ President's Advisory Panel on Federal Tax Reform, *Simple, Fair & Pro-Growth: Proposals to Fix America's Tax System*, November, 2005.

⁵ World Bank, *Paying Taxes 2010* (November 2009). The compliance hours are presented in Appendix 1.3.

Conclusion

The NRF supports business tax reform that will lower corporate tax rates and broaden the tax base. We believe this type of income tax reform will be good for the retail industry and good for the economy as a whole. The NRF urges the Committee to move forward with corporate income tax reform, and we offer whatever assistance we may provide in meeting this goal. Corporate income tax reform will encourage investment, create jobs and simplify administration of the tax system without shifting the burden to those that can least afford to pay.



Chairman CAMP. Thank you very much.
Mr. Stutman, you have 5 minutes.

**STATEMENT OF MARK STUTMAN, NATIONAL MANAGING
PARTNER OF TAX SERVICES, GRANT THORNTON**

Mr. STUTMAN. Thank you.

Mr. Chairman, Mr. Ranking Member, and other members of this distinguished committee, it is an honor to appear before you and participate in this hearing on comprehensive tax reform and the role it can play in promoting job creation and economic growth.

My name is Mark Stutman, and I am the tax practice leader for Grant Thornton LLP, the U.S. member firm of Grant Thornton International, one of the six global accounting tax and business advisory organizations. Grant Thornton helps thousands of the most dynamic and entrepreneurial businesses in America to budget and plan their business activities, report their earnings to creditors and shareholders, and fulfill their Federal, State, and local tax obligations.

Grant Thornton supports tax reform aimed at lowering effective business tax rates in order to promote global competitiveness for U.S. businesses. Low effective tax rates encourage investment and business activity, spur job creation, and, ultimately, increase national wealth.

Tax reform should benefit the dynamic businesses that are the backbone of American economic growth and the driving force behind expanding employment. Included in this category are many privately held businesses, the Russell 2,000, and similar groups.

I urge Members of the Committee to make their highest priority those tax reform proposals that will lower effective business tax rates, will preserve valuable incentives for domestic business activity, and will not disproportionately burden any one segment of the business community.

It is important for policymakers to focus on effective business tax rates, not just the statutory corporate tax rate. The effective tax rate measures how much tax is actually paid and is a true measure of the burden taxes place on business activity.

Much has been made of the fact that the U.S. has a higher statutory corporate tax rate than many of our trading partners. The statutory corporate tax rate is an important factor in determining the effective rate a business must pay, but it is by no means the only factor. Rules that produce an unintended or inappropriate result are properly called "loopholes." Where these rules serve a specific and intended policy goal, they are better described as "tax expenditures."

It is also important to consider the presence of other taxes that apply to business activity. Virtually every country with a statutory corporate tax rate lower than the U.S. also burdens business activity with some form of a value-added tax. The effective business tax rate can only be measured by considering all of these factors, not just the statutory corporate tax rate.

Many reform proposals envision going significantly beyond loopholes to cover some or all of the costs of a statutory corporate tax rate reduction by eliminating existing business tax expenditures. This may result in a lower statutory corporate tax rate but will not necessarily improve effective business tax rates. If the committee chooses to reduce or eliminate tax expenditures, caution should be exercised so as not to unduly burden domestic business activity.

Existing business tax expenditures are predominantly directed at encouraging investment, production, and research in the U.S. According to a December 2007 Treasury Department report, the three largest business tax expenditures in the Internal Revenue Code are accelerated depreciation, the domestic production activity deduction, and the research credit. Each of these is an incentive to domestic economic activity. The tax benefits realized by dynamic organizations through these incentives are significant drivers of domestic economic growth and job creation. A reduction in these tax expenditures, even if combined with a reduction in statutory rates, could result in an increase in the effective rate on a domestic business activity.

In a recent Grant Thornton national survey of 318 U.S. CFOs and senior comptrollers, over 60 percent of respondents said they would prefer to retain their existing tax benefits unless the statutory corporate tax rate was reduced to 25 percent or lower, and 17 percent preferred keeping their incentives regardless of the size of the rate cut.

I also urge the Members of the Committee not to consider tax reform proposals that would disproportionately burden any one segment of the business community. Dynamic organizations, frequently organized as passthrough entities, are the backbone of American economic activity and a driving force behind expanding American employment. Passthrough businesses represent an ever-increasing share of the U.S. economy and are responsible for an increasing proportion of all business receipts, rising from 7 percent in 1980 to over 30 percent in 2007.

The earnings of passthrough businesses, such as S corporations and partnerships, are generally taxed at individual rates. Any tax reform proposal that eliminates business tax benefits but provides only a statutory corporate tax rate reduction would significantly increase the effective tax rate on many dynamic passthrough companies.

In conclusion, Grant Thornton supports tax reform efforts that seek to reduce effective business tax rates. Low effective business tax rates encourage investment and business activity, spur job creation, and, ultimately, increase national wealth.

Reducing statutory corporate tax rates can be an important part of reducing effective business tax rates. However, it is important to remember that other factors contribute to determining the effective tax rate of any business. I urge the Members of the Committee to support tax reform proposals that will lower effective business tax rates, preserve valuable incentives for domestic business activity, and not disproportionately burden any one segment of the business community.

Thank you for giving me the opportunity to share this information with the committee, and I am pleased to answer any questions.

[The prepared statement of Mr. Stutman follows:]

Testimony before the Committee on Ways and Means
United States House of Representatives
Washington, DC
June 2, 2011

Hearing on How Business Tax Reform Can Encourage Job Creation

Statement of Mark Stutman, Grant Thornton LLP

Mr. Chairman, Mr. Ranking Member and other members of this distinguished committee, it is an honor to appear before you and participate in this hearing on comprehensive tax reform and the role it can play in promoting job creation and economic growth. My name is Mark Stutman, and I am the tax practice leader for Grant Thornton LLP, the U.S. member firm of Grant Thornton International, one of the six global accounting, tax and business advisory organizations. Through our 49 offices in the United States, Grant Thornton helps thousands of the most dynamic and entrepreneurial businesses in America to budget and plan their business activities, report their earnings to creditors and shareholders, and fulfill their Federal, state and local tax obligations.

Grant Thornton supports tax reform aimed at lowering effective business tax rates in order to promote global competitiveness for U.S. businesses. Low effective tax rates encourage investment and business activity, spur job creation, and ultimately increase national wealth. Tax reform should benefit the dynamic businesses that are the backbone of American economic growth and the driving force behind expanding employment. Included in this category are many privately held businesses, the Russell 2000 and similar groups. I urge members of the Committee to make their highest priority those tax reform proposals that:

- Will lower effective business tax rates;
- Will preserve valuable incentives for domestic business activity; and
- Will not disproportionately burden any one segment of the business community.

It is important for policy makers to focus on effective business tax rates, not just the statutory corporate tax rate. The effective tax rate measures how much tax is actually paid and is the true measure of the burden taxes place on business activity.

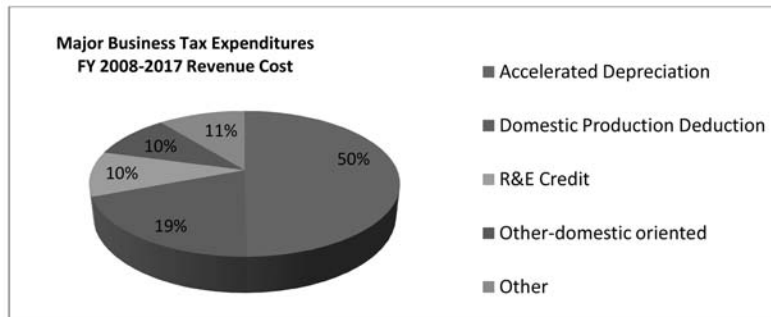
Much has been made of the fact that the United States has a higher statutory corporate tax than many of our trading partners. The statutory corporate tax rate is an important factor in determining the effective rate a business must pay, but it is by no means the only factor. Equally important are the rules for calculating income tax liability. Where these rules produce an unintended or inappropriate result, they are properly called "loopholes." Where these rules serve a specific and intended policy goal, they are better described as "tax expenditures." It is also important to consider the presence of other taxes

that apply to business activity. Virtually every country with a statutory corporate tax rate lower than the United States also burdens business activity with some form of a value-added tax. The effective business tax rate can only be measured by considering all of these factors, not just the statutory corporate tax rate.

There is little opposition to closing tax “loopholes.” However, most reform proposals envision going significantly beyond “loopholes” to cover some or all of the cost of a statutory corporate tax rate reduction by eliminating existing business tax expenditures. This may result in a lower statutory corporate tax rate, but will not necessarily improve effective business tax rates. If the Committee chooses to reduce or eliminate tax expenditures, caution should be exercised so as not to unduly burden domestic business activity.

Existing business tax expenditures are predominantly directed at encouraging investment, production and research in the United States. According to the December 2007 Treasury Department report, “Approaches to Improve the Competitiveness of the U.S. Business Tax System for the 21st Century,” the three largest business tax expenditures in the Internal Revenue Code are accelerated depreciation, the domestic production activity deduction and the research credit. Each of these is an incentive to domestic economic activity. Accelerated depreciation requires property to be placed in service in the United States. The domestic production activities deduction is only for domestic production. The research credit is dependent on the research performed in the United States.

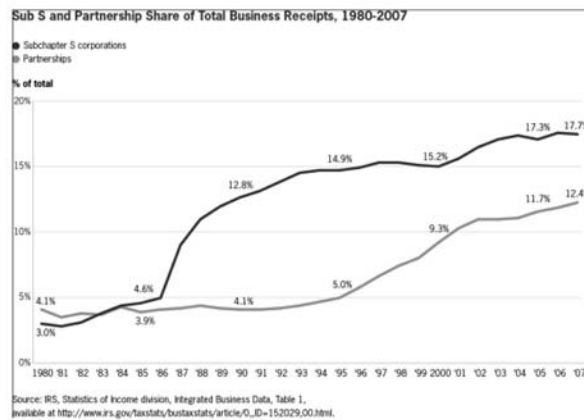
The tax benefits realized by dynamic organizations through these incentives are significant drivers of domestic economic growth and job creation. A reduction in these tax expenditures, even if combined with a reduction in statutory rates, could result in an increase in the effective rate on domestic business activity.



Business leaders appear keenly aware of the role that tax benefits play in determining their effective tax rate. In a recent Grant Thornton national survey of 318 U.S. CFOs and senior comptrollers, over 60% of

respondents said they would prefer to retain their existing tax benefits unless the statutory corporate tax rate was reduced to 25% or lower, and 17% preferred keeping their incentives regardless of the size of the rate cut.

I also urge the members of the Committee not to consider tax reform proposals that would disproportionately burden any one segment of the business community. Dynamic organizations are frequently organized as pass-through entities and have become part of the backbone of American economic activity and a driving force behind expanding American employment. Pass-through businesses represent an ever-increasing share of the U.S. economy and are responsible for an increasing proportion of all business receipts, rising from 7% in 1980 to over 30% in 2007.



The earnings of pass-through businesses, such as S corporations and partnerships, are generally taxed at individual rates. Any tax reform proposal that eliminates business tax benefits but provides only a statutory corporate tax rate reduction would significantly increase the effective tax rate on many dynamic pass-through companies.

In conclusion, Grant Thornton supports tax reform efforts that seek to reduce effective business tax rates. Low effective business tax rates encourage investment and business activity, spur job creation and ultimately increase national wealth. Reducing statutory corporate tax rates can be an important part of reducing effective business tax rates; however, it is important to remember that other factors contribute to determining the effective tax rate of any business. I urge the members of the Committee to support tax reform proposals that will lower effective business tax rates, preserve valuable incentives for domestic business activity, and not disproportionately burden any one segment of the business community.

Thank you for giving me the opportunity to share this information with committee. I am pleased to answer any questions.

Mr. Stutman is the National Managing Partner of Tax Services and a member of the firm's Senior Leadership. In this role, Mark has overall responsibility for the quality of services, the profitable operations and the welfare of the clients and employees of the core and specialty tax practices. Over the course of his career with Grant Thornton, he has built a reputation for value-added, attentive service to entrepreneurial companies and their management teams. Mark specialized in entity planning and structuring, cost classification, mergers and acquisitions, and operational issues for both public and private clients predominantly in the manufacturing, distribution, service and real estate industries.

During his thirty-seven year career with Grant Thornton, Mr. Stutman has served in many leadership positions, including as a member of the firm's governing body, the Partnership Board; as Managing Partner of the Washington National Tax Office; and as a member of the National Real Estate Committee. Mark also served on the AICPA Partnership Committee, a national technical task force that monitors legislative and regulatory developments and works with the U.S. Department of Treasury to provide feedback on proposed guidelines, as well as creates working tools for use by AICPA members.

Chairman CAMP. Well, thank you very much, Mr. Stutman.

I want to thank all of our witnesses for their testimony.

Now, we will move into the question period, and each Member will have 5 minutes to ask questions. I will begin.

I have a question really for Mr. Galvin, Ms. Brown, Mr. Zrust, and Mr. Misplon, if you would all give me an answer down the line.

We heard from several of you that the U.S. has a high corporate tax rate, the second highest in the world except for Japan, and Japan is in the process of lowering their rate. We will be the highest after that occurs. In this world of increasingly mobile capital—and I think everyone would agree that capital is mobile—how does this high rate, this high U.S. corporate tax rate, make business investment and job creation decisions in the U.S. more difficult for your companies?

And if you could each just comment on that, I would appreciate it.

Mr. Galvin, why don't we start with you?

Mr. GALVIN. Well, certainly, the high corporate U.S. tax rate makes us less competitive with competing companies around the world. And, in that context, Emerson's major competitors are large companies based in Germany and Switzerland. And the risk you have, if the U.S. is not put on a level playing field, is that more and more smaller-cap U.S. companies will be acquired, perhaps, by large international companies in Europe and probably, in a few years, by Asian-domiciled companies.

When you have those acquisitions made, you tend to lose a significant number of jobs, as we have seen in St. Louis as Anheuser-Busch was acquired or in the acquisition of APC. Generally, when a company is acquired, the headquarters staff jobs are lost. So not having a competitive tax rate with the rest of the world causes more and more jobs to be lost.

Chairman CAMP. All right. Thank you.

Ms. Brown.

Ms. BROWN. Certainly.

For the committee to understand, as a CFO I spend a lot of time meeting with the investment community. And, interestingly enough, I spend about half of my time in many conversations talking about our tax rate.

Our business model has been very successful, and our income statement is very attractive to investors, all the way through operating margins. So we have been very good at delivering profitability for shareholders, and, as I mentioned, adding a considerable amount of jobs—57 percent employment growth in the last 5 years.

However, the one area where we are not competitive versus our Swiss, Israeli, Canadian, European—I can go down the list—competitors is on the tax line. And so we get questioned very frequently on why can't we be more like them, to which I have to respond that we have a different tax rate because we compete in different jurisdictions and are heavily U.S.-focused today. Our business model is focused there, too.

And combined with the fact that, as we are making investment decisions, our investment decisions are based on where we need to be to serve our customers, where our global supply chain is based. And that means that, today, as we go through a portfolio of investment decisions, we want to make decisions based on the talented people that we can get to work in our factories, the supply chain and marketing expertise that we need to run our business. And we think that that can be done very, very well right here in the U.S. We have great people doing that.

However, when the model gets run and we look at a return on invested capital, the tradeoff between making the next dollar investment in the U.S. versus somewhere else, unfortunately, many times comes back to the beneficial tax impact that we would have as a company and for our shareholders and owners by being in a more multi-jurisdictional footprint globally.

So it very much comes into play as we talk about decisions with our analysts.

Chairman CAMP. Thank you.

Mr. Zrust.

Mr. ZRUST. As I mentioned before, we are facing new competition from countries like China, Canada, Brazil, and Russia in the single-aisle space. And all of those countries have considerably lower tax rates than the U.S.

And so, one of the decisions we are going to have to make, or our businesses are going to have to make, and they have publicly talked about, is a decision as to when they are going to build a new airplane in the single-aisle space. And to the extent that the U.S. lowers the tax rate and is competitive with countries like that, down into the mid-20s, I think that is going to make that decision easier and allow us to be more competitive going forward.

Chairman CAMP. Mr. Misplon.

Mr. MISPLON. As you know, the National Retail Federation and the companies that it represents are predominantly domestic. Sears Holdings' effective tax rate averages between 38 and 36 percent, which is an extremely high effective tax rate, which really is a barrier to additional investment.

To the extent that we would need a return on investment of a certain percentage to build a new store, build a new distribution

center, the impact of a 38 percent effective tax rate on that decision makes many of the investment decisions decline, in that they just are not returning the sufficient amount of income.

Chairman CAMP. Some have suggested, Mr. Misplon, that the U.S. should adopt a national consumption tax or a VAT to either bring additional revenue to the Federal Government or to pay for corporate rate reduction.

You mentioned in your testimony the impact that a consumption tax would have on the U.S. economy and, particularly, jobs. And I wondered if you could just explain in more detail why, from your perspective, the consumption tax would be problematic and what its potential impact on the U.S. economy would be.

Mr. MISPLON. Well, first off, we certainly think that a VAT tax is a regressive tax and puts more of the tax burden on the low- to middle-income families.

But, that said, the studies show that, since it is a direct impact on consumers, which really is the engine that drives our economy, and that higher prices resulting from the VAT tax would lower consumer spending, which is going to put a real dampening effect on our economy—there is actually a very close example of what happens with a VAT, and that is up in Canada, where, 10 or 15 years ago, a VAT was instituted in Canada, and Sears Canada, from that day forward, for the next 5 years, lost money, and the Canadian economy did very poorly over that same period of time.

Chairman CAMP. All right.

And I have one just last question for the four of you, Mr. Galvin, starting with you.

There has been some testimony today about the positive impact on your companies and your employees from a lower corporate tax rate in exchange for specific tax preferences being given up. Can you explain how this kind of tradeoff might benefit your company, if it did not necessarily reduce your effective tax rate?

Mr. GALVIN. Well, certainly, Emerson is at a competitive disadvantage with our worldwide competitors who have a much lower tax rates. We would be in favor of eliminating all or substantially all tax credits and deductions, including the manufacturing and R&D tax credits. I do favor the 199 section.

But, clearly, because of the complexity of the current Tax Code and system, you have a lot of unintended consequences. A lot of money is spent, that is not necessarily productive, on tax lawyers, tax planning, and other factors.

Get rid of as many as you can, lower the rate, and keep the revenue across all corporate America revenue-neutral. We would then be more competitive with our international competitors, and this country would be much better off in preserving jobs.

Having a noncompetitive tax rate hurts U.S.-headquartered companies.

Chairman CAMP. All right.

Ms. Brown.

Ms. BROWN. Certainly. I will answer this building off of my earlier statement, which is, for us, we would be open to eliminating expenditures. We utilize today the R&D credit and the 199 manufacturing credit. But to make the tradeoff to reduce our overall tax burden and to make our system, our tax rate more comparable to

the international competitors that our analysts are comparing us to today anyway, have a lower overall tax burden, reduce the complexity, as my colleague just noted as well, and be able to then make investment decision much more elegantly based on the real returns of the business decision, as opposed to defaulting so much—or placing so much weight on financial matters like tax.

Chairman CAMP. Thank you.

Mr. Zrust.

Mr. ZRUST. As I mentioned in my statement, there is incredible complexity associated with putting together the information to comply with respect to the R&D credit, the domestic manufacturing deduction, and with the U.S. taxation of foreign income tax, in particular.

And so, from our standpoint, though we spent last year \$4 billion in R&D, given the way the R&D credit is administered right now and the fact that the renewal is constantly in question, we would certainly, in return for a significantly lower rate, give up the R&D credit, even given the magnitude of our spend. We would certainly, given the fact we are a large manufacturer—and we would also give up the domestic manufacturing deduction.

And I think, though the complexity is not in the same arena, I think another thing that could go on the table is something along the lines of bonus depreciation. So, I mean, in return for complexity—or, in return for simplicity, we would like to get rid of the complexity.

Chairman CAMP. All right. Thank you.

And, finally, Mr. Misplon.

Mr. MISPLON. As I mentioned, the retailers traditionally have a very high effective tax rate to start with. So, certainly, in the spirit of tax reform and the lowering of rates, we understand that other tax preferences to be subject to change, as well, and we would welcome that.

The other panelists also mentioned simplicity and the lack of complexity, and that really is another important issue, in that it is such an adversarial relationship between the taxpayer and the IRS. And to eliminate much of the complexity and have, actually, the IRS and the taxpayer work together for a change, as opposed to oppose one another, would be welcome change.

Chairman CAMP. Thank you.

Mr. Levin may inquire.

Mr. LEVIN. Let me just ask a few questions. Time is limited. I don't want to only ask questions of the witness we invited. I think it is useful to have as much back and forth as possible. So I want to try to do that.

I just want to say to Mr. Misplon, it is true that the retail industry has the highest effective tax rate generally. But remember, in countries that have a lower effective tax rate, they have a value-added tax. And that has been, more or less, the tradeoff.

And as we talk about lowering tax rates, we have to look at the tradeoff. And I think you would not trade off a lower tax rate for a value-added tax, would you?

Mr. MISPLON. We believe that the problem is going to be that the dampening effect on the economy for the first 10 years, in the present state of our economy, would be extremely damaging and

that our economy could not support the increase in prices that would go along with a VAT tax.

Mr. LEVIN. All right. So I think your answer is "no." And I think that is understandable.

Let me just ask Ms. Brown, what is the effective tax rate for your company?

Ms. BROWN. Our global effective tax rate today is approximately 30 percent, excluding one-off items.

Mr. LEVIN. Excluding what?

Ms. BROWN. Any one-off items.

Mr. LEVIN. But you can't exclude.

Ms. BROWN. Okay. So last year's rate was approximately 30 percent. We paid 38 percent in the United States.

Mr. LEVIN. Okay. I think we need to look at that, because the information we have is quite different. So I think all of us should take a look at effective tax rates, and our information is that yours was considerably lower.

You are a Michigan company. I want to treat you gently.

Ms. BROWN. Yes. We are a Michigan company. So we have approximately 70 percent of our earnings before tax are in the U.S., heavily domiciled in Michigan. Our U.S. rate, again, is approximately 38 percent, including State and local, and then less the, give or take, about 2-percentage-point credit we get between the R&D credit and manufacturing credit. The remaining 30 percent of our earnings before tax are from international locations.

So the weighted average rate over the last several years for our company has been high 20 percent or approximately 30 percent. So that is the basket of overall tax rates that we are paying globally.

Mr. LEVIN. Uh-huh. Okay. And so we will talk about that further.

Mr. Galvin, let me just ask you about your statement. At the end, you say, "U.S. tax policy should be equitable so as not to distort business decisions. Equitable tax policy treats all business income equally notwithstanding the industry, how a company is structured, or whether it is headquartered in the U.S. or offshore."

So let me just ask you, if you can operate overseas and bring back the income without paying any tax, why wouldn't that be an incentive to move operations overseas?

Mr. GALVIN. The major reason that our operations are overseas are, in fact, because 57 percent of our sales are overseas.

And as you look at Emerson today and also for the last 3 years, if you look at Emerson's U.S. exports to third parties and to our subsidiaries overseas and compare that to our international subsidiaries' imports into the United States and what they ship to third parties into the U.S., we, in fact, export more than we import from our subsidiaries.

And we look at things according to our after-tax return on investment. And while tax needs to give us a level playing field with our competitors——

Mr. LEVIN. You say "level playing field," but consider your competitors who are domestic. If you can operate overseas and bring back the income without any taxation, how does that effect the competition between you and somebody who is domestic?

Chairman CAMP. And if you could just answer briefly, because time has expired.

Mr. GALVIN. Fine.

We would be quite competitive, yes, if the repatriation rate were similar to the international companies of 2 percent, yes.

Mr. LEVIN. I am asking about your domestic competitors.

Chairman CAMP. Time has expired.

Mr. Herger is recognized for 5 minutes.

Mr. HERGER. Thank you, Mr. Chairman.

I have a question I would like to address to Mr. Galvin, Ms. Brown, Mr. Zrust, and Mr. Misplon.

The United States will soon have the highest corporate tax rate among the OECD countries. Most analysts would agree that that is a problem for U.S. competitiveness. However, some have argued that the key factor is the average or effective tax rate, not the marginal rate. They contend that the effective rate for U.S. companies is comparatively low.

I assume that as you try to expand your company, multiple investments opportunities are competing for the same resources. When you are deciding to build a plant or make an acquisition, do you factor taxes into your analysis, and if so, do you look more at your marginal rate or your overall average tax rate and why?

And Mr. Galvin, beginning with you, please.

Mr. GALVIN. Thank you.

Yes, we look at the marginal rate and we also look at our effective rate. For Emerson, for the last 3 years, our U.S. effective rate has varied between 35 and 37 percent, so it is not a big difference. As we look at our return on where we decide our plants should be, we first determine where manufacturing locations are closest to the customer.

We also have to consider that while taxes are important, if you look at Emerson's P&L in round numbers and \$100 of sales, 35 percent of our costs are material costs. Often having the locations closer, and the competitiveness on material costs dictates where the production goes.

Secondly important is compensation costs. About 25 percent of sales dollars is in compensation, about 20 percent is in other expenses, in manufacturing, administrative costs, marketing costs, et cetera. Our taxes represented as a percent of sales, even being a large taxpayer, is 4 percent. Where we have a problem is taxes, we can be competitive with our competitors on material, on compensation, other expenses—freight is also a factor, we spend 3 percent of sales on freight, being closer to our customers reduces our rate costs. With taxes, we can't be competitive at the current time with the U.S. corporate tax rate.

Mr. HERGER. Ms. Brown.

Ms. BROWN. In Perrigo, as I mentioned, we do a vast majority of our manufacturing in the United States. And we also believe having benchmarked globally that our operations are absolutely unequivocally competitive, if not lower cost, because of the tremendous labor force we have, our people and the technology that we have invested in the United States.

That being said, we have gotten to a place because when we model, we model on a return on investment capital, and we are in

fact right now live in the process of looking at investing in additional manufacturing capacity because the tremendous success of our business model. What does that mean?

We have to now consider, where do we place that plant, and we have to think about the return after tax in reference to the comments already made, which are where ending cash flows are going to be generated. So we take into consideration the rate in each jurisdiction that we would be looking at. The effective rate is great on a global basis. It is a general rate for us, and we look at the competitiveness of that line. But we are really looking at the after-tax return against the different plants.

So we will start first with the supply chain, and that has got to be the key driver. But that marginal rate that we would have to pay at each location comes into play, and right now, we are pulling the tax rate into our consideration because it is just not competitive for us in the U.S. on that line item.

Mr. HERGER. Mr. Zrust.

Mr. ZRUST. When we make additional investments, we also look at the marginal tax rate, and thus we look at things on an after-tax basis.

And so from a competitive standpoint, I mean, the high U.S. rate puts us at a disadvantage against some of our competitors. As I mentioned, the new competition that we are facing on the single aisle is a good example of that.

Mr. MISPLON. For a retailer, the marginal tax rate and the effective tax rate are virtually the same and any ROI calculation would use either one of those in the comparison of whether it will meet the threshold.

Mr. HERGER. Thank you.

Chairman CAMP. Thank you.

Mr. Johnson may inquire.

Mr. JOHNSON. Thank you, Mr. Chairman.

Mr. Zrust, in your testimony you say each year Boeing spends millions of dollars to comply with the complexities of our tax system. And you mentioned you are continuously under audit by the IRS. I was amazed by the number of people you have there. As you know, many of our corporate structures have to provide office space for the IRS. And then the IRS turns around and sues you, don't they? So, first of all, can you quantify what your company spends just to comply with the corporate Tax Code?

Mr. ZRUST. We haven't quantified that in terms of a hard number, but I think it is certainly safe to say it is well into the millions of dollars, if not maybe—I can say it is well into the millions of dollars in terms of wages of Boeing employees, both in the tax area and then within the business units in the finance area. And then to deal with the complexity of the law, we also have, we also have a high degree of spend with tax consultants as well to help us wade through the complexities of the existing law.

Mr. JOHNSON. So the guys sitting in your building don't help you, the tax guys?

Mr. ZRUST. The in-house guys do. The IRS guys, no, they don't help us.

Mr. JOHNSON. Thank you. I am aware of the companies in Dallas griping at me about that, too. It is a shame you all didn't move there. You know you had the opportunity.

As a matter of curiosity, do you know what your expense is to house those IRS agents.

Mr. ZRUST. I am sorry, could you repeat that?

Mr. JOHNSON. Yeah. Do you know what your cost is to house the IRS guys?

Mr. ZRUST. I don't.

Mr. JOHNSON. But it is significant?

Mr. ZRUST. Typically, as I said, we have IRS agents in three locations. And there, depending upon the given day, there is in excess of 30 agents in the aggregate at the three locations.

Mr. JOHNSON. Maybe we ought to cut the IRS by about 20 percent. What do you think?

Second, can you tell me, the committee, what the impact the cost of compliance has had on your bottom line or your ability to grow?

Mr. ZRUST. Well, again, on an annual basis, we spend millions of dollars in order to comply.

And I think that those funds, to the extent that we could reduce the complexity associated with the compliance effort, would be better put to investment in new products and jobs.

Mr. JOHNSON. I know. Sell airplanes. So you talk about battling the IRS over the R&D tax credit. I know you have had some problems with that. Has your experience made the company more cautious toward using that tax credit?

Mr. ZRUST. I can't say that we are going to be more cautious in using it. I can say that since it is less certain as to what the incentive is, because of the complexity and because of the—let's call it the ongoing battle with regard to quantifying that credit, and so it does have an impact. And the ongoing complexity is considerable.

Mr. JOHNSON. Does it hamper your R&D work?

Mr. ZRUST. I don't think it has a direct impact on the engineering or anything, no.

Mr. JOHNSON. Okay. In the context of reform, do you have any suggestions of what we can do to ease the compliance burden associated with the R&D tax credit, and would you consider doing away with the credit in return for a lower rate?

Mr. ZRUST. Well, if you we look at our, at our competing countries, I mean, many of these countries, in addition to having lower rates, do incentivize research and development. Because of the way the R&D is presently structured, I think we would be in a position, and because of the lack of certainty associated with the ongoing legislation of that credit, we would be willing to take a rate reduction and in return give up the R&D credit, given the way it is presently structured.

Mr. JOHNSON. Thank you, sir.

Thank you, Mr. Chairman. I yield back.

Chairman CAMP. Thank you.

Mr. McDermott may inquire.

Mr. MCDERMOTT. Thank you, Mr. Chairman, for gathering this panel together.

Mr. Galvin, I want to understand, if we lower the tax rate to 25 percent, will you stop laying off people in the United States? Will

that make you competitive so you don't have to lay off anybody here? Because everybody here is worried about jobs.

I have been waiting for six months for a jobs bill, and they keep saying if we lower the tax rate to the corporations, somehow we will get jobs in this country. So I want to hear you tell me that you will stop laying people off in Alabama and other places.

Mr. GALVIN. Certainly the issue is very complex, as you understand, and we have no crystal ball on the economic outcome. And the unfortunate situation that occurred in 2008 with the financial crisis, when our underlying sales declined 13 percent between 2008 and the middle of 2009, we had to reduce our employment in the U.S., in Europe, in Asia. In fact, the reductions actually are higher in Asia because of the commodity.

So I have no crystal ball as to the sales revenue we will have with the state of the economy.

I can say this: If the state of the U.S. economy improves and there is higher growth in the U.S., we will obviously grow, but I have no crystal ball as to that.

You said Alabama. I assume it is in Huntsville.

Mr. MCDERMOTT. Yes.

Mr. GALVIN. That is a difficult market with a lot more incoming products, and that acquisition we made about a year and a half ago.

Mr. MCDERMOTT. Well, the reason I ask the question is because today's Washington Post says: "U.S. Economy: Manufacturing Slowdown the Latest Sign Recovery is Faltering."

So lowering the tax rate is not going to stop the faltering of the manufacturing in this country, is it? Or do you think if we lowered it quickly down to 25 we would have no loss in jobs.

Mr. GALVIN. I think there are many factors that need to be considered, and there is not one single silver bullet that will help.

Mr. MCDERMOTT. I get that, because you gave me some data that I thought was very interesting, and I appreciate your candor, 25 percent for material.

Mr. GALVIN. No. I think what I said was 35 percent is material costs; about 25 percent is compensation costs.

Mr. MCDERMOTT. That is 60 percent.

Mr. GALVIN. Yes.

Mr. MCDERMOTT. And then 4 percent was taxes?

Mr. GALVIN. Yes.

Mr. MCDERMOTT. So we are talking about the tail wagging the dog here, aren't we?

Mr. GALVIN. No. The reason is when you look at material costs in a competitive environment, we can be competitive with any country, any competitor around the world on material purchases of buying from suppliers in a competitive fashion. We can be competitive on compensation with companies like Germany and others by basing it in the same locations as they do.

But we cannot be competitive against the Chinese, which have a much lower tax rate, and Germany, Switzerland and other countries that are not competitive.

Mr. MCDERMOTT. Let me ask you a question. You said that—I mean, everybody graciously has said we want to have revenue-neutral. I like that idea. I like that idea that somebody else is

going to pay it, because you are going to get a 5 percent reduction or a 10 percent reduction. Whose taxes are going to go up in this process?

Mr. GALVIN. Well, certainly. You as Members have often talked about the effective tax rate of U.S. companies being much lower than our current rate.

Mr. MCDERMOTT. But tell me who is going to pay more taxes if we take away those.

Mr. Stutman, can you give me an idea who is going to pay more taxes? Who is it shifted to if it is a zero-sum game here?

Mr. STUTMAN. Well, if it is a zero-sum game, you are absolutely right that you don't get to zero sum by everybody having the same result.

But in fact, when we look at Grant Thornton and our client base, and we have what I would call not just a horse in this race but 10,000 horses in this race relative to our client base, we know that they are each in different places. The tradeoffs that are made affect each taxpayer differently.

So the only thing that we can urge the committee on is to be fair and equitable relative to how you balance and measure.

Mr. MCDERMOTT. I want to stop you there because my time is almost up.

I hope the chairman will have another hearing where we get a hearing from the squealing ones who have gotten bit by this new getting rid of all the tax credits and lowering the rates. There is going to be somebody in this country who is going to squeal, and I want to hear from them as well, Mr. Chairman.

I hope we will have that. Thank you.

Chairman CAMP. Mr. Tiberi is recognized.

Mr. TIBERI. Thank you, Mr. Chairman. Thank you for your leadership. Great witnesses. Little time, so much to talk about.

Thank you for your testimony. Mr. Levin may have missed last week with respect to the VAT issue. Clearly, at our most recent hearing there were witnesses from other countries who said that the VAT issue and the corporate tax reduction were two separate issues, so I just want to remind everybody of the testimony from last week's hearing.

Mr. Stutman, your testimony on pass-through entities is right on. I hope you have some influence at Treasury and can talk to them about their thoughts on pass-through entities. In Ohio, we have lost a ton of jobs, 400,000 jobs, 600,000 jobs in the last 4 years. We have lost corporate headquarters in Ohio. The new Governor has stopped that. We are open for business again. So we are not only competing against India; we are competing against Indiana.

And by the way, for the two of you from Illinois, we are open for business. You can come look at Ohio to headquarter as well. Don't just look at Dallas.

Mr. Galvin, what great testimony, all of you. But I want to follow up on what Mr. McDermott said. Because the bumper sticker, the bumper sticker, the easy issue out there that everyone kind of points to is you go overseas because you want to avoid taxes.

And that is so far from the truth in terms of the policy. And you talked about that today. In fact, our Tax Code and I want you to

expand upon this, because you are a U.S. company and your major competitors from what I understand, are foreign competitors, when you had an opportunity to acquire a U.S. company, it was acquired ultimately by a foreign company, and you were at a competitive disadvantage because of the double taxation issue.

Can you expand upon that quickly for the members of this committee: How the Tax Code actually hurt a U.S. company from acquiring another U.S. company?

Mr. GALVIN. In my testimony, I talked about the acquisition of a company formally headquartered in Providence, Rhode Island-APC in 2006. In that year, or in the previous 3 years, in excess of 50 percent of APC's earnings -because it is an electronics company -was outside the United States.

When Emerson looks at acquisitions, we look at the after-tax cash flows as the money comes back eventually to the U.S. So even though their tax rate was much lower, in our discounted cash flows, we assumed that that cash eventually would come to the U.S. and be taxed at the 35 percent rate, even though the Asian taxes were much lower. And we priced that out. We bid up into the \$5.2 billion, \$5.3 billion. Schneider, the French company, paid in excess of \$6 billion range. We looked at the difference in the cash flows of the international earnings in perpetuity from our estimate, and it would have exceeded \$800 million. Because if you have a 10 percent tax rate in Asia, we would have been paying an additional 25 percent tax rate, bringing the cash back to the U.S.

Mr. TIBERI. Because of repatriation.

Mr. GALVIN. Because of repatriation. We assume in all transactions cash eventually comes back to the U.S.

Mr. TIBERI. The French company didn't have that issue?

Mr. GALVIN. The French company, you are correct, didn't have that issue. The French tax law exempts 95 percent of dividends, and so the effective tax rate in France is about 1.5 percent.

Mr. TIBERI. So that company that you looked at acquiring is now a French company?

Mr. GALVIN. Correct.

Mr. TIBERI. So the headquartered corporate jobs that were in Rhode Island are now in—

Mr. GALVIN. In France. And the engineering R&D also shifted to consolidation within France.

Mr. TIBERI. All those jobs are gone. So you in St. Louis, where are your best jobs for Emerson, that is your 130,000 jobs?

Mr. GALVIN. As you know, we employ a lot of people in Ohio.

Mr. TIBERI. Your best jobs?

Mr. GALVIN. Our best jobs are—

Mr. TIBERI. Are they in France?

Mr. GALVIN. No.

Mr. TIBERI. Where are they?

Mr. GALVIN. Our best jobs would probably be in the U.S. with the competitiveness of high-tech areas.

Mr. TIBERI. So when a corporate headquarters leaves, their best jobs leave. Have you seen that in St. Louis?

Mr. GALVIN. We have seen that in spades in St. Louis. Somebody can just look at what has happened; when a company is acquired the headquarters jobs are lost.

Mr. TIBERI. If the Federal Government, if we, Congress, don't do something about the current Tax Code, is Emerson, are your three companies, at risk from a foreign competitor at some point in time?

Mr. GALVIN. At some point in time, but I would certainly think smaller companies would be acquired first. Our market cap currently exceeds \$40 billion.

Ms. BROWN. I would say any company is always at risk of takeover. You always have to worry about that. But because of the comparative disadvantage that the American bidders in an acquisition would go through because of the net after-tax cash flow, certainly we would be at risk. We would all be thinking about that.

Chairman CAMP. Thank you. Your time has expired.

Mr. Reichert is recognized.

Mr. REICHERT. Thank you, Mr. Chairman.

Well, you know, what we are all trying to do and I have said this as an opening part of my statement each hearing we have is we are all trying to work hard to make American companies successful and create jobs for people here in the United States.

And part of that process is listening to all of you and trying not to make this a partisan issue where some are intent upon doing that.

So I really appreciate the presence of all of you here, and I thank the chairman for his, and the ranking member, for putting this hearing together. I represent a district that has 22,000 Boeing workers, so you can see where my focus might be going this morning.

It is a pleasure to have you and see you again, Mr. Zrust. And I want to ask the question about your future competition and how you plan to face that, because you and I have talked about that future competition for Boeing in connection with the tax structure. How do you plan to face that competition if the structure essentially stays the same?

Mr. ZRUST. Well, historically, our European competitor in Boeing have dominated the single-aisle airplane space at 100 passengers or greater. And a number of companies—a number of countries have built airplanes at the size of less than 100 passengers. And what is happening, as I mentioned, the Canadians, the Russians, the Chinese and the Brazilians are starting to move up into and have indicated that they are moving up into, let's say, into the space that has historically been dominated by both our European competitor in Boeing.

And as I mentioned in my statement, all of those new competitors reside in countries where the tax rate there is considerably less than the U.S. rate, and so that is going to present an issue for us in terms of competition. Because the decision we are going to have to make at some point is, what are we going to do to face that new competition and where are we going to get the capital in order to compete with that new competition. And to the extent that we are put on a level playing field with that new competition in terms of tax, that is going to free up capital and allow us to put more jobs in the U.S. and potentially more bricks and mortar, because as you know, all of our manufacturing facilities are in the

U.S., and the vast majority of our jobs are in the U.S. as well. And the intention is to keep it that way for now.

Mr. REICHERT. So freeing up capital—

Mr. ZRUST. That is right.

Mr. REICHERT [continuing]. With a different tax structure is what you are hoping?

Mr. ZRUST. That is right.

Mr. REICHERT. And to follow up on Mr. Tiberi's questioning, could you explain how Boeing might face foreign companies or competition even in the U.S. markets and how the tax laws affect you and your ability to compete against foreign companies right here in the United States? So your major competitor—

Mr. ZRUST. Well, our major competitor, obviously, is in France. I mean, the rate with France is slightly less than that of the U.S. I think to the extent that they are putting bricks and mortar in the U.S., I think we are probably on a level playing field. But if we look at right now who is buying airplanes, the customers for the most part are outside the U.S., and so we are dealing with issues, you know, the interaction of the U.S. tax laws with the income that we are driving outside the U.S.

So I think so long as our competition would stay with our one European competitor, let's say, in the twin aisle planes—

Mr. REICHERT. Last week, for example, I flew on an Airbus—usually Boeing.

Mr. ZRUST. I mean, the bottom line is, it goes to freeing up capital and keeping—trying to get the U.S. rate down to a level that is consistent with where our competition is.

Mr. REICHERT. I yield back. Thank you.

Chairman CAMP. Thank you.

Mr. Becerra is recognized.

Mr. BECERRA. Thank you, Mr. Chairman.

And thank you all for your testimony, I appreciate it. And hopefully, we are able to use some of your testimony in the future as we try to move forward on a reform of the Tax Code.

I thought, Mr. Galvin, you made a statement that I think perhaps encapsulates this entire discussion and, quite honestly, this entire debate about how we reform the code. And you said something, I caught just this part of it where you said, in response to Mr.—I think it was Mr. McDermott, who was asking questions about jobs, because there is no easy yes or no answer to anything, and you said, there are many factors that need to be considered. You went on to say other things.

But again, if we lower rates tomorrow, will you be able to retain employees tomorrow. Lots of things have to be considered beyond the code. And so as we go about trying to figure out what to do, lots of things have to be considered, not just the rates, the corporate rates.

You mentioned—you used two very good examples of the competition you lost with a French company for a particular firm you were looking to buy. And you mentioned how their territorial rates make it easier for them to compete with you and prices that we would have to pay under our worldwide rates of corporate taxation. Lots of things have to be considered.

That French company takes advantage of their corporate rates, their territorial rates. France has a 19 percent VAT, a VAT. Would you ask us to have a 19 percent tax on every product that the end stream for Americans to pay on top of what they pay today for milk, clothes and the rest?

Mr. GALVIN. That is also, again, unfortunately, a multifaceted question. I think for the short-term, overall corporate tax reform needs to be addressed.

Mr. BECERRA. Let me hold you there because I am going to run out of time, and we will keep talking, but my point is this: Lots of things have to be considered.

The French are able to charge a lower rate on corporations for work and business that is done abroad through their territorial rates because they probably have done other things to make up for that.

Mr. GALVIN. Correct.

Mr. BECERRA. One of those is the VAT, which—the value added tax—which a French citizen will pay at some point, in this case, it is about 19 percent. They also have income tax rates that are in the 40s, high 40s. I imagine if I asked you, would you want Americans to have income tax rates that go up into the high 40s, you would probably say lots of things have to be considered, but you probably wouldn't be all that excited about having Americans' income tax rates go up as well.

Mr. GALVIN. I would say, again, in the short-term this committee is on the corporate tax side. A VAT or a national sales tax is a later discussion.

Mr. BECERRA. Let me stop you there because, see, we won't have an opportunity if we don't deal with this entire subject matter together, we may push one side and not realize the pull on the other, and we have to take all those things into consideration. So, in reforming the code, obviously, we are talking today about corporate rates.

Mr. GALVIN. Right.

Mr. BECERRA. But whatever we do on corporate rates may have an impact, as I think Mr. Stutman tried to make the case, on individual rates, whether it is because of these pass-through entities and otherwise. And so we will have to have a fuller discussion.

But your points are all very well taken that we have to figure out a way to reduce the rates and let you be more competitive.

I think the operative word here is competitive. Because most American companies, I think you will all agree, are still able to compete with anyone so long as the playing field is equal, and I think that is what you all would like.

Let me move on. I would love to let you have more time, but I need to move on because I am going to run out of time. One of the other issues that affects Americans' perception of what we are doing is they get the sense that we are not doing this for them but for others. For example, today we are giving oil companies tax breaks to go search for oil and drill for oil. And they wonder what the heck do we need to do that for when they are making tens of billions of dollars in profits and charging us over \$4 a gallon in some places for gasoline? But we do that.

The second thing they see is that in the 1990s, we were creating jobs in America at the same time that a lot of our companies were also creating jobs in other parts of the world outside of the U.S. But in the 2000s, the first decade of the 21st century, we created more jobs, our American companies created more jobs abroad than were created in the U.S. Essentially, there was a flight of jobs by American companies.

So it is all an issue of how the American people perceive what we are trying to do. I appreciate your testimony, and I hope what we can do is be able to incorporate everything you said to come up with that solution that deals with the whole mix of things.

Mr. Chairman, I appreciate the time, and I thank the witnesses for coming.

Chairman CAMP. Thank you.

Mr. Buchanan is recognized.

Mr. BUCHANAN. Thank you, Mr. Chairman, for holding this important hearing. I also would like to thank all of our panelists today for being here.

I would like to, Mr. Stutman, talk to you on some of your testimony you gave today. It is basically about pass-through entities. I represent the Tampa Bay area, the Sarasota community. But also being the only member of Ways and Means from Florida, I look at it in terms of the impact on pass-through entities. In Florida alone, there are 600,000 S corps, and I am sure a lot of LLCs and partnerships. Would you agree that we need to keep these small businesses in mind when we do any kind of tax reform?

Mr. STUTMAN. Well, as I mentioned in my testimony, the proliferation of pass-throughs over the course of the last 15 to 25 years has been dramatic and significant. And they are more a part of the business community than ever before. And I tend to stay away from classifying pass-throughs by reference to size, because we have some small, as you referenced. But we have some really significant and large partnerships and S corporations that would rival some of the companies perhaps that have testified here today and before.

And it is pretty clear that they are drivers of the economy. They are drivers of jobs, and therefore, they need to be included in the debate. And therefore, if we are talking simply corporate rate reduction, there is an element for which then caution needs to be exercised around how we handle pass-throughs. They will continue, I believe, to grow in size and numbers as we continue to have alternate structural entities that allow for corporate liability protection at the same time being able to accommodate the pass-through nature of the tax laws.

Mr. BUCHANAN. My understanding in terms of flow-through or pass-through entity businesses compared to C corporations, is that they employ more workers in 48 out of 50 States in our country. But yet there is some discussion of the possibility, even within the Administration—the President mentioned it yesterday at our conference that he is interested in lowering corporate rates, which I think we need to do, whether that number is 25 percent or another number. But there is, at the same time, a sense of increasing taxes on individuals, and a lot of them that make over \$250,000 are job providers. Are you concerned also about the impact that would

have if you raised individual rates and lowered corporate rates, what that would do to jobs?

Mr. STUTMAN. Well, certainly in the context of pass-through entities, you know, as long as you follow the current construct of the Internal Revenue Code, they are taxed at individual rates in terms of the owners of those entities. And so if you have a pure corporate rate reduction and either neutrality or rate increase for individuals or do not somehow cover pass-throughs as businesses within the context of a corporate rate reduction, then yes, there is a high level of concern, especially in terms of our client base.

Mr. BUCHANAN. Again, as a past chairman of the Chamber in Florida, 99 percent of businesses that are registered in the State of Florida are small- and medium-size businesses. They create probably 70 percent of the jobs, probably not just in Florida but around the country. So that is why I am concerned. I would love to see us deal with the C corp rate, but I don't know how you deal with the C corp rate without dealing with also the pass-through entities. It all has to be looked at.

And that is why if you raise the personal income tax rate and lower the corporate rate, you are going to have a lot of people in the same industries that are going to have a huge advantage over another business. Because I just recall back in the 1980s, everybody had a C corp. Then it went to an S corp. Then everybody was doing LLCs. But all this has to be taken into consideration, don't you agree?

Mr. STUTMAN. Yes. I think in terms of the testimony that I presented is about there are multiple moving parts relative to this issue. And we have talked about the various components, including corporate rate, including tax expenditures, including the impact of the burdensome reference to the possibility of any particular segment of our taxpaying business community, and right now in terms of certainly what you are saying would go to the pass-throughs.

Mr. BUCHANAN. And Mr. Corum, do you want to add something to that as a tax specialist?

Mr. CORUM. I am here really to look at the financial accounting impacts of that. Those pass-through entities don't necessarily reflect taxes in their own separate financial statements because the taxes are borne by the owners and the shareholders of it. So therefore, a corporate rate change affects corporate financial statements primarily.

Mr. BUCHANAN. Thank you, Mr. Chairman.

I yield back.

Chairman CAMP. Mr. Smith is recognized.

Mr. SMITH. Thank you, Mr. Chairman.

And thank you to our panel for sharing their expertise. We have been reading more and more about companies with either a zero effective tax rate or close to it. And I was wondering if any of you would care to speculate on what would be in it for companies such as those with the currently low effective tax rate, if they would perhaps see their effective tax rate go up, could there still be some benefit to public policy in a bigger picture? Maybe no one wants to answer that, but Mr. Galvin.

Mr. GALVIN. With a high effective tax rate, I guess I am a safe person to answer. In the newspapers, and it has been on a lot of

different shows on TV, certainly one thing to consider is that sometimes the press stories are rather one-sided and misleading.

So while they might be technically correct, they are definitely misleading when you look at the complexity of the Tax Code and the fact that the effective tax rate was negative over the last 3 years. It goes to show why we need U.S. corporate tax reform, because you have all these complexities, unintended consequences. And I am sure all of them, from what I have heard from the companies, fully comply with the U.S. tax law. It is an example that U.S. tax reform on the corporate side is needed so we don't have these unintended consequences.

And there is added complexity with getting refunds over a 3-year period. Some of the staffers in the back could be paying more in taxes than the corporations. I mean, it is a very unfortunate situation. It just proves that corporate tax reform for simplification is needed.

Mr. SMITH. And I will let anyone else who—

Mr. ZRUST. I might comment on that. As I mentioned in my statement, at the Boeing company, we have over 500 differences between how we account for items in our financial—in our annual report for financial reporting and then how we reflect those same items on our tax return.

And many of these items result in differences of recognition of income and expense, differences in just periods; it is timing, not permanent. So when we talk about effective tax rates from a tax standpoint, people look at things of a permanent nature; R&D credit, how you affect States, State income taxes, the interaction of U.S. income and foreign income. Those things—domestic manufacturing deduction—those things are of a permanent nature. But there are distortions in cash taxes paid, and it is a difference in periods.

For instance, funding a pension in a given year results in a current tax deduction and may result with the drop in the markets the last few years in a large current deduction, but yet for financial reporting, that does not result in a current reduction in book income. And so there is an appearance that something is wrong because there might be a large amount of book income but yet there are no taxes paid when it is simply due to the differences in tax accounting between what happens for GAAP, Generally Accepted Accounting Principles, and then what the Internal Revenue Code mandates.

Mr. SMITH. Thank you.

Shifting gears just a bit, we heard earlier that it is oftentimes wise that the manufacturing be done close to the customers. That makes sense. In fact, we are already seeing a lot of that type of policy taking shape in terms of energy conservation and even incentives.

And we know that a good portion of the world's population lives and works outside of the borders of the United States. We have seen companies obviously from overseas locate here in America and hiring Americans. I see that as a positive thing as well.

But I was wondering, Mr. Stutman, if a company that is based in the U.S. hires people overseas, or opens a plant that is closer to their customers, would you characterize that as jobs fleeing the shores of America.

Mr. STUTMAN. In terms of answering the question, if in fact we have a global economy and we know that some of what we do is capable of being done in the U.S. and some of which is capable of being done across border, you know, it is really a function of, you know, in terms of your question, whether or not there are skills or reasons, such as being closer to your customers, or other factors that will come into play relative to ultimately making the determination of where to create those jobs.

As I think most of the panelists talked about, there is a return-on-investment calculation that they all go through that relates to making those determinations. I would not suggest that automatically you come to a conclusion that by going overseas that you are taking jobs away from America.

Mr. SMITH. Okay. Thank you.

Chairman CAMP. Mr. Stark is recognized.

Mr. STARK. Thank you, Mr. Chairman.

And thank the panel for their input to this hearing. I am going to ask the chair to insert in the record the Citizens for Tax Justice initial report on 12 corporations that pay a tax rate of a negative 1.5 percent on \$171 billion in profits and got \$62 billion in tax subsidies, which does happen to include Boeing. And in the report, it says that Boeing made a profit of almost \$4.5 billion in 2010 and had negative Federal taxes. The same held true for 2009 and 2008. And over those 3 years, Boeing made almost \$10 billion and had a negative tax rate of 1.8 percent.

And I think in testimony that I heard earlier from Mr. Zrust that Boeing would like a lower tax rate. So how much lower a tax rate should we give Boeing and why?

Mr. ZRUST. So Mr. Stark, let me address that. Over the last 3 years, we have not paid a—

Mr. STARK. How much lower rate do you need now to survive?

Mr. ZRUST. Well, let me talk about what that is attributable to.

Mr. STARK. I know what it is attributable to.

Mr. ZRUST. Well, it is attributable to new products and it is investments in our workforce, so there are three things: One is contributions to our pension plan. As we know, there are two major development programs.

Mr. STARK. All companies do that. That is not unusual. But how much lower rate do you need to survive?

Mr. ZRUST. Well, what will happen with those items, as I mentioned before, there are things of a permanent nature and there are things that are temporary. So those same things that gave rise to low tax payments in the last 3 years are going to reverse in the next few years and result in considerable tax payments.

Mr. STARK. Oh, yeah? We are going to get more from Boeing in the next few years?

Did you know that, Mr. McDermott?

Mr. MCDERMOTT. I didn't know that.

Mr. STARK. I didn't know that either. How much more do you think Boeing is going to pay us in the next few years?

Mr. ZRUST. Well, sir, as we start delivering airplanes, the 787, for instance, that is going to result in a reversal of the inventory accounting differences that are reflected in the last 3 years that resulted in current tax deductions. It is going to result in book tax

deductions, but yet not a corresponding deduction on the tax return, so that difference is going to be reflected in increased tax payments.

Depending upon the magnitude of the deliveries, it is possible that the company could be paying a rate of tax in excess of the statutory rate of 35 percent. So this is a function of the differences in tax accounting between the Internal Revenue Code and what is mandated under Generally Accepted Accounting Principles.

Mr. STARK. You pay your taxes based on the Internal Revenue Code, don't you?

Mr. ZRUST. That is correct.

Mr. STARK. Mr. Chairman, I would just like to submit for the record the Citizens for Tax Justice analysis of 12 corporations that pay an effective tax rate of negative 1.5 percent, and a further report will be coming later, and it illustrates that Boeing over the last few years has had a negative 1.8 percent rate. It paid a Federal tax of—a rebate of \$178 million on profits of almost \$10 billion, so that it just gives us the example of what many of these corporations are able to do and does illustrate why we should make some changes in the Tax Code.

I thank the gentleman for yielding.

Chairman CAMP. Without objection, the document will be placed in the record.

[The information follows:]



June 1, 2011

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**Analysis: 12 Corporations Pay Effective Tax Rate of Negative 1.5%
on \$171 Billion in Profits; Reap \$62.4 Billion in Tax Subsidies
Exxon Mobil, Boeing, Verizon, Others Illustrate Why Revenue-Raising Reform is Needed**

Washington, DC – To better inform the public and lawmakers about how successful many American corporations have been in reducing or eliminating their federal income taxes, Citizens for Tax Justice is releasing a preview of its forthcoming major study of Fortune 500 companies and the taxes they paid — or failed to pay — over the 2008-10 period. Today's release details the pretax U.S. profits, federal taxes paid and effective tax rates of (in alphabetical order): American Electric Power, Boeing, Dupont, Exxon Mobil, FedEx, General Electric, Honeywell International, IBM, United Technologies, Verizon Communications, Wells Fargo and Yahoo. CTJ's full corporate report is scheduled for release this summer.¹

The analysis serves to illuminate the current corporate tax debate in Washington, DC, and demonstrates that real corporate tax reform is long overdue. President Obama has indicated that he wants to reduce or eliminate corporate tax subsidies, but use all the increased revenue to lower the statutory corporate tax rate. Lobbyists for big business, along with many Republican political leaders, reject this "revenue-neutral" approach, and call for changes that would *reduce* corporate tax payments by trillions of dollars over the upcoming decade.

In contrast, Citizens for Tax Justice and many others take the position that at a time when our country faces huge long-term deficit problems, corporate tax reform should be significantly *revenue-positive*, as it was under President Ronald Reagan in 1986.² Since then, the corporate tax code has once again become overburdened with loopholes, shelters and special tax breaks.

Citizens for Tax Justice and 250 organizations from all 50 states with constituencies across America have signed a letter to Congress stating that "most, if not all, of the revenue saved from eliminating corporate tax subsidies should go towards deficit reduction and towards creating the healthy, educated workforce and sound infrastructure that will make our nation more competitive."³

The 12 corporations analyzed are major, nationally recognized companies in a range of industries, including manufacturing, energy, services, transportation, high tech and finance. They all made significant profits in 2010 and over the 2008-10 period.

¹CTJ's comprehensive corporate tax reports in the 1980s played a key role in the enactment of the Tax Reform Act of 1986. See, e.g., *Corporate Taxpayers & Corporate Freeloaders, Four Years of Continuing, Legalized Tax Avoidance by America's Largest Corporations, 1981-84*, www.ctj.org/pdf/corp0885.pdf.

²Reagan's Tax Reform Act of 1986 was designed to increase corporate income tax payments by 34 percent.

³"Corporate Tax Reform: Consumer Groups, Labor Unions, Faith-Based Groups at Odds with Obama on Goals," www.ctj.org/taxjusticedigest/archive/2011/05/corporate_tax_reform_consumer.php.

- From 2008 through 2010, these 12 companies reported \$171 billion in pretax U.S. profits. But as a group, their federal income taxes were negative: -\$2.5 billion.
- All but two of the dozen companies enjoyed at least one no-tax year over the 2008-10 period, despite reporting substantial pretax U.S. profits in those no-tax years.
- Eight of the twelve companies reported net tax benefits over the full three-year period.

The table that follows shows the results of our analysis. It includes General Electric, whose tax-avoiding ways have been widely reported.⁴ Over the 2008-10 period, GE enjoyed \$4.7 billion in tax benefits on top of its \$7.7 billion in pretax U.S. profits.

Not a single one of the companies paid anything close to the 35 percent statutory tax rate. In fact, the "highest tax" company on our list, Exxon Mobil, paid an effective three-year tax rate of only 14.2 percent. That's 60 percent below the 35 percent rate that companies are supposed to pay. And over the past *two* years, Exxon Mobil's net tax on its \$9.9 billion in U.S. pretax profits was a minuscule \$39 million, an effective tax rate of only 0.4 percent.

Had these 12 companies paid the full 35 percent corporate tax, their federal income taxes over the three years would have totaled \$59.9 billion. Instead, they enjoyed so many tax subsidies that they paid \$62.4 billion *less* than that.

If just these 12 companies had paid at a 35 percent tax rate over the past three years, total federal revenues from corporate taxes would have been 12 percent higher than they actually were.

"These 12 companies are just the tip of an iceberg of widespread corporate tax avoidance," said Bob McIntyre, director of Citizens for Tax Justice. "Our elected officials have a duty to the American public to make reducing or eliminating the vast array of corporate tax subsidies the centerpiece of any deficit-reduction strategy."

Here is the information on the 12 illustrative companies. Technical notes follow on page 3.

Twelve Corporations: Their U.S. Pretax Profits and Their Federal Income Taxes, 2008-2010

\$-millions	2010			2009			2008			3 year totals		
Company	US Profit	FedTax	FedRate	US Profit	FedTax	FedRate	US Profit	FedTax	FedRate	US Profit	FedTax	FedRate
General Electric	5,079	-3,253	-64.0%	-305	-833	nm	2,948	-651	-22.1%	7,722	-4,737	-61.3%
American Electric Power	1,869	-134	-7.2%	2,014	-575	-28.6%	2,016	164	8.1%	5,899	-545	-9.2%
Dupont	949	-109	-11.5%	180	23	12.8%	995	14	1.4%	2,124	-72	-3.4%
Verizon Communications	11,963	-705	-5.9%	12,261	-611	-5.0%	8,294	365	4.4%	32,518	-951	-2.9%
Boeing	4,450	-3	-0.1%	1,494	-136	-9.1%	3,791	-39	-1.0%	9,735	-178	-1.8%
Wells Fargo	16,486	1,345	8.2%	21,797	-3,967	-18.2%	11,087	1,941	17.5%	49,370	-681	-1.4%
FedEx	not available yet*			2,138	15	0.7%	885	-38	-4.3%	3,023	-23	-0.8%
Honeywell International	1,243	-482	-38.7%	1,723	-28	-1.6%	1,937	476	24.6%	4,903	-34	-0.7%
IBM	8,861	190	2.1%	9,404	473	5.0%	8,208	338	4.1%	26,473	1,001	3.8%
Yahoo	855	-82	-9.6%	354	102	28.8%	453	125	27.5%	1,663	145	8.7%
United Technologies	2,543	44	1.7%	2,539	198	7.8%	2,854	550	19.3%	7,935	791	10.0%
Exxon Mobil	7,419	992	13.4%	2,490	-954	-38.3%	9,745	2,744	28.2%	19,655	2,783	14.2%
These 12 companies	61,719	-2,196	-3.6%	56,090	-6,293	-11.2%	53,213	5,989	11.3%	171,021	-2,500	-1.5%

NOTES: Negative taxes and rates reflect tax benefits received rather than taxes paid. "nm" = not meaningful.

*FedEx's fiscal year ends 5/31. Its 10-K for June 1, 2010 to May 31, 2011 will be filed in mid-July of 2011.

⁴"G.E.'s Strategies Let It Avoid Taxes Altogether," David Kocieniewski, *The New York Times*, Mar 24, 2011, p. 1.

Technical notes:

Pretax profits are generally reported pretax U.S. profits as reported in the companies 10-K reports to shareholders and the SEC, less state income taxes paid.⁵ The notes below describe any adjustments we made to reported pretax U.S. profits for specific companies.

Federal income taxes are the "current" U.S. federal taxes reported by the companies,⁶ less any "excess tax benefits from employee exercise of stock options," which are not taken into account in the "current" tax line, but are instead reported as additions to shareholders' equity (and/or in the cash flow statement). We assigned part of the excess stock option benefit to state income taxes, and the rest to federal income taxes. The notes below report the amounts of any federal stock option tax benefits.

Specific company notes:

Boeing: Income taxes are net of \$19 million, \$5 million and \$100 million in excess stock option federal tax benefits in 2010, 2009 and 2008, respectively.

Exxon Mobil: Income taxes are net of \$232 million, \$116 million and \$61 million in excess stock option federal tax benefits in 2010, 2009 and 2008, respectively.

FedEx: FedEx's fiscal year ends on May 31. Its 10-K for June 1, 2010 to May 31, 2011 (which we classify as "2010") will be filed in mid-July of 2011. Pretax income was adjusted upward by \$810 million in 2009 and \$367 million in 2008 to ignore non-deductible, non-cash "goodwill impairment" book charges. Income taxes are net of \$21 million and \$3 million in excess stock option federal tax benefits in 2009 and 2008, respectively.

⁵The pretax profit figures do not include foreign profits, since these are rarely if ever taxed by the United States.

⁶"Deferred" taxes are not included until and if they are actually paid, at which time they will show up in the "current" tax line in the companies' 10-Ks.

Honeywell International: In its 2010 report, the company changed its accounting method for pensions, and retroactively restated its pretax profits for 2009 and 2008. The profit figures shown in our report use the profits actually reported in the company's 2009 and 2008 reports. Income taxes are net of \$11 million, \$1 million and \$17 million in excess stock option federal tax benefits in 2010, 2009 and 2008, respectively.

United Technologies: Income taxes are net of \$78 million, \$41 million and \$26 million in excess stock option federal tax benefits in 2010, 2009 and 2008, respectively.

Verizon Communications: In its 2010 report, the company changed its accounting method for pensions, and retroactively restated its pretax profits for 2009 and 2008. The restatement had little effect for 2009. For 2008, our report uses the profits actually reported in the company's 2008 report.

Wells Fargo: Pretax income was adjusted by replacing the company's non-cash "provision for loan losses" with actual "charge-offs, net of recoveries." This adjustment reduced pretax profits in 2010 and increased them in 2009 and 2008. Income taxes are net of \$80 million, \$15 million and \$102 million in excess stock option federal tax benefits in 2010, 2009 and 2008, respectively.

Yahoo: Income taxes are net of \$108 million, \$90 million and \$103 million in excess stock option federal tax benefits in 2010, 2009 and 2008, respectively.

Note: More details on how specific companies reduced their federal income tax bills will be included in CTJ's upcoming major report on Fortune 500 companies.

Chairman CAMP. Ms. Jenkins is recognized.
Ms. JENKINS. Thank you, Mr. Chairman.

Thank you all for being here today. I want to share with you an excerpt from a recent article in the New York Times entitled "The Logic of Cutting Corporate Taxes" by Laura D'Andrea Tyson. She is a professor at Haas School of Business at the University of California, Berkeley, also a former chair of the Council of Economic Advisors under President Clinton.

She said this: "Shouldn't the government raise the corporate tax rate to require corporations to contribute their fair share to deficit reduction and to enhance the progressivity of the tax system? The answer is no."

And she goes on to say, in today's world of mobile capital, increasing the corporate tax rate would be a bad way to generate revenues for deficit reduction, a bad way to increase the progressivity of the Tax Code and a bad way to help American workers and their families.

For many years, I think the conventional wisdom has been that the corporate income tax is principally borne by owners of capital in the form of lower returns. Now with more mobile capital, workers are bearing more of the burden in the form of lower wages and productivity as investments move around the world in search of better tax treatment and higher returns.

In this environment a high corporate tax rate, not only undermines the growth and competitiveness of American companies, but it also increasingly is ineffective as a tool to achieve more progressive outcomes in the taxation of capital and labor.

There appears to be an emerging consensus that the corporate tax burdens workers in the form of lower wages, and higher retail prices are a reflection of this as well. So I just wanted for you all to comment, if you would, and elaborate on how a high corporate tax rate is reflected in terms of prices, wages and productivity.

Mr. Galvin.

Mr. GALVIN. Certainly the issue, in my opinion, is not just a high corporate tax rate but the noncompetitiveness, which I have said before, and the consequences are an additional loss of jobs. Fifty years ago, the U.S. economy was so large, we could do whatever we wanted. Now we are much more competitive with emerging countries in Asia, and that forces us to be competitive with the rest of the world. And I would hope that while initially our study, at this hearing, is over the corporate tax rate longer term, intermediate term, whatever, in several years, I think the committee might consider looking at overall U.S. tax reform and the issues that were raised about the VAT and others to be competitive with the rest of the world, and the impact we would have if we choose a tax system that is isolated from the rest of the world as we currently have it. So I agree with the comments, and we need to study more economically the issues on a value added tax, not for the short-term, but intermediate term.

Ms. JENKINS. Ms. Brown.

Ms. BROWN. In our universe, it is interesting because in terms of productivity, employment growth, we have been continually providing wage increases, becoming more productive, adding a tremendous amount of head count. I just checked my statistics. We added 450 new jobs in Michigan since just July. So, in our universe, that is a big number.

But I think about, to your point, how does higher income tax affect the big basket of what we are thinking about long-term? The strategic landscape for us has changed. There has been massive consolidation in our industry. And the players who are the most active in buying up companies, many with U.S. footprints, and consolidating out the higher-paying jobs, consolidating out the headquarters, are foreign players in many instances who are taking advantage of that better after-tax return that they are able to utilize because of our, again, relatively higher corporate tax rate.

So we haven't seen necessarily on a day-to-day basis higher taxes pushing through price changes of our product. We have been able to manage that entire process through our own productivity, but we look at the bigger-term, long-term strategic landscape of what is going to impact our long-term growth and what we can share

with our shareholders and add new jobs, and that is where it really becomes problematic for us long term.

Chairman CAMP. All right. Thank you very much.

Mr. Berg is recognized.

Mr. BERG. Thank you, Mr. Chairman.

I, first of all, want to thank the panelists for being here today. This is an extremely important matter. I look back at my home State of North Dakota, and we have reformed the Tax Code. We lowered the property tax. We lowered the income tax. We lowered the corporate income tax. And North Dakota business understood that. What we have heard from you today is not rocket science. It is pretty simple, pretty straightforward. Our business knew when we did that that we were not going to change the rules. We were going to set the Tax Code, and they can make investments that they are expecting a 10-year return on or a 15-year return. And when times got tough, we weren't going to just change the Tax Code and take away their return.

In fact, it is that stability, quite frankly, that has made North Dakota one of the top job creators in the Nation. We have a 3.5 percent unemployment rate. This is what happens when you encourage business and have stability. You know, there is no question that what we have heard today and we have heard from the past several months is how our Tax Code, the uncertainty of it, has a cloud over business, you don't know what the rules are. I have been stunned by all the changes in the Tax Code, the size of the Tax Code and the difficulty in anticipating commonsense business decisions for your company, what that really means after you filter it through a very complicated Tax Code.

So, from my perspective, also being at the end of the questioning here, what I would like to do is kind of get back to what brought us here in the beginning. And maybe if we could real simply just go through the panelists, and again, at a high level, I want to ask two questions. The first question is what does it mean to your company and your job creation if we simplify the Tax Code and have a competitive Tax Code? And so again, Mr. Corum, if you could start.

Mr. CORUM. I might pass that down the aisle since I am not really representing a company.

Mr. GALVIN. It would certainly help us, because at the current time, certain jobs that we have historically had in the U.S., where we could afford a 5 percent or less overall product differential against our competitors in Asia, with the way the Tax Code is working and the way different incentives are given in Asia, reform might reduce the impact of a loss of further jobs. We have been, as I said, a very large exporter, not as large as Boeing, but we export more than we import. And the noncompetitiveness hurts us on doing that because we need to be competitive with our competitors. It is very simple. In the tax line, we are not competitive.

Ms. BROWN. A very simple example. Right now, we are going through a process of evaluating investment and manufacturing footprint. And certainty of tax rate, long-term certainty, take out one-offs and anomalies, but that long-term certainty as we go through this process right now, if I know, and I am very pleased to be sitting here on this panel and knowing that you are all talk-

ing about this and taking it very seriously, because if we know that that rate will be lower in the U.S. longer term, the decision of are we going to put it in the U.S. or are we going to put that manufacturing footprint ex-U.S. becomes much easier. And we know that the comparable rates will be closer; it makes a decision easier because we like to keep that manufacturing close to where our customers are. Very simple.

Mr. BERG. A great example.

Mr. ZRUST. On the airplane side of the business, our manufacturing is in the U.S. Our competition is outside the U.S., and for the most part, our customers are outside the U.S. And so what we need to do is come up with a way if we lower the rate and free up capital that allows us to invest in innovation, in a new product line to better compete with the emerging competition that we are facing from other competitors with significantly lower tax rates.

Mr. MISPLON. Well, certainly we believe that simplifying the Tax Code and reducing the income tax rate, that reduction in the tax rate will be passed down to the consumer, which will equate to increased sales. It will allow us to hire more employees and allow us to purchase more inventory to keep the economy going.

Mr. BERG. Thank you.

Mr. STUTMAN. Well, certainly, as to Grant Thornton being a service provider, I am sure the question isn't aimed at us directly but at our client base.

Mr. BERG. Absolutely.

Mr. STUTMAN. We would recognize that, again, of the thousands of clients we have, many of them would appreciate simplicity, uniformity.

But at the same time, you mentioned the fact that in North Dakota there is now a consistency and uniformity about the decisions you are making and how they play out. And it is the moving parts here as to how you get there, because people have already made those decisions based upon the complexity, and then how do you wind them through the process as you move forward towards getting that consistency and uniformity in the Internal Revenue Code.

Mr. BERG. Thank you.

Chairman CAMP. All right. Thank you.

Mr. Rangel is recognized.

Mr. RANGEL. Thank you so much, Mr. Chairman.

Thank the panel for their patience. Basically when it gets to the later questions, everything that has to be answered has already been answered. Everyone is seeing from the same page, and it sounds like the American thing to do, paying this equity, lower taxes, eliminate unfair preferences, competition, job creation, give the corporations a break, and they will do the right thing by America and their stockholders.

There is something wrong with this picture. If we are all in agreement where is the Chamber of Commerce in all of this? I put out a bill, and they thought it would be great. I talked with the Secretary of Treasury, and he said, there is any number, there are billions of wasteful provisions in the bill. There are waivers, exemptions, credits that shouldn't be there. So we should have a more equal playing field. Something is wrong with this picture.

And there are liberals and conservatives, Republicans, Democrats agreeing with you; we should do it, and we should do it fast.

I kind of believe everyone in business doesn't agree with you. I think that those people that we describe as having unfair preferential tax treatment are the guys behind the tree. Do you remember Senator Long, don't tax me, don't tax me, tax the guy behind the tree? Somebody has got to pay to make this revenue neutral, right? Right. Somebody who is getting unfair tax breaks is going to lose them, right? Right. Are they speaking out? Do we know who they are? Do they come to meetings like this and say, hey, I like it the way it is? I don't want any changes, I love R&D, rapid depreciation, all of those gimmicks will be a gimmick for you, but it is okay for me. Now, where do we go from here? We all are reading from the same page. We are your public servants; reform, reform, reform, competition, jobs creation.

Mr. RANGEL. What is the problem? Mr. Corum, what is our problem? I mean, why don't we do these things? Why are people afraid to say—is there an elephant—strike that—is there a big animal in the room that we don't want to talk about? Come on, who is the lead—come on. I know, once you get your books straight, you want to pay more taxes, you want to do the fair things, and it just looks bad for you. Who is it that we have to drag to this table? Something is wrong with this picture.

Boeing?

No. Okay, gang.

If the answer is not here, Mr. Chairman, there is something wrong with this equation.

The last time I ventured on this very thin ice, the people that were talking about reform started saying that Rangel is increasing taxes. I said, how could that be? Said, well, we don't pay taxes now, and he is talking about reform; that is increasing taxes. Who would want to increase taxes at a time that we are in today? Wow. You have heard that one before, right?

So this thing is not on the level. And I just don't know why I hear such deafening silence since—I don't remember the last time everybody has been on the same page. So here I am, a liberal, progressive, left-wing, saying, "Let's lower the corporate rates. What is going to stop us from doing this together?" And no one is going to help me out? You are going to sit there and say, "I have said what I had to say"?

What do you want us to do? Any volunteers that have any recommendations or suggestions about what we do? How come the chairman says he has solidarity with the committee, that we ought to do these fair, equitable things to create jobs, and now he is being asked—we are asking you, what is the next move? Can anyone of you bring us the support of the United States Chamber of Commerce? Any one of you? Have you discussed it with them?

Mr. Galvin, you are biting at the bit.

Mr. GALVIN. Well, I would generally be first on the list. What I have said before is that I think the Chamber—and I am a member of the U.S. Chamber, as you saw in my biography—But you need overall corporate tax reform, because the last time you had massive tax reform I believe was in 1986. And other countries have now substantially reduced their taxes.

A simple thing that I think most corporations would say, simplify the tax system, lower the rate, make it revenue-neutral.

Mr. RANGEL. Why aren't we doing this? How long have you been with this Chamber? Because I don't ever remember getting any notices from them, "When are you guys going to reform the system so we can be competitive again?"

Mr. GALVIN. Well, I would think the Chamber would answer, "Lower the rate." And I will see about getting you something.

Mr. RANGEL. Thank you for your great contribution.

Chairman CAMP. Thanks.

Mrs. BLACK. is recognized.

Mrs. BLACK. Thank you, Mr. Chairman.

First, I want to thank the panel for being here to testify. And I apologize for being out briefly, but I had another committee where we were talking about Fannie, Freddie, and FHA, so another important subject.

I want to go to the picking winners and losers, because I have heard this as I have traveled throughout my district in the last 4 or 5 months, in talking to various businesses, all the way from very small businesses to the larger businesses—and, of course, there is a different tax structure; some are corporate, and some are using the passthrough—but winners and losers in the different business activities or sectors.

So there are numerous provisions in the Tax Code that have an effect of preferential treatment to a particular business behavior or to a particular sector of the economy. Do you agree that the objective of tax reform should be to address these kinds of disparities in the tax law? Is that one of the areas we should focus on, these disparities?

And any of the panel members can certainly pick up and speak to that.

Ms. BROWN. I would say, certainly. And I am assuming, and from what I have read, that this is exactly what the committee is planning to talk about, is look at the interlocking parts of tax reform and how it would affect the overall economy and job creation. And, today, obviously, we are talking about corporate rates, but how that all fits together.

And, you know, my role, as CFO of a corporation—we are formed as a corporation. We also depend very heavily on a complex ecosystem of smaller businesses, be they the local shop that makes sandwiches for the folks in our corporate headquarters or if it is folks who supply raw materials and plastic bottles to put our product into. It is a very complex web of different companies that have different structures.

And simplifying the rates, simplifying the code, it may mean that some of the smaller businesses choose to form themselves as a corporation, a small corporation but a corporation nonetheless. But as long as you are encouraging each of the different players in our supply chain to be able to compete with their other competition locally, or if they in their universe have foreign players, it would make a lot of sense to us, looking at it all together.

Mr. ZRUST. I think if we are going to look at comprehensive tax reform, we need to put everything on the table and review it. And I think our system is perceived to be based on fairness, or at least

that is what should be—there should be equity in the system. And in doing so—you know, if we talk about changing the status quo now and there is winners and losers, but that is just based upon where the tax system sits right now, and it doesn't necessarily mean the tax system is perceived as equitable and fair right now. I mean, it is in the eyes of the beholder.

And so I think what we need to do, in terms of comprehensive tax reform, is put everything on the table and go back and review and determine what creates a fair, simple, and equitable system.

Mrs. BLACK. Thank you.

Mr. Galvin.

Mr. GALVIN. Yes. I would also think, as you look at corporate tax reform, you certainly have to address the transition rules as you look at passthrough entities. Because, certainly, I surmise that one of the significant reasons of the growth of passthrough entities is you get a tax advantage, vis-à-vis paying the complex corporate tax rate and then either a dividend tax or a capital gains tax rate to your shareholders.

So if the passthrough entities are hurt with a higher personal rate, to allow them appropriate transition rules to go to a corporate structure, especially the larger ones—because a lot of passthrough entities are not necessarily small entities.

Mrs. BLACK. Right.

Mr. GALVIN [continuing]. Have them go to a C structure, and then have the double taxation that currently exists, so they are competitive with the rest of the businesses that they compete with.

But you have to address those things, as well, and not just automatically switch off passthrough entities because of the tax advantages they get.

Mr. STUTMAN. Yeah, I would add on that, you know, as I mentioned in my testimony, there are a significant number of moving parts. And the winners and losers ultimately are determined by effective tax rate, not statutory tax rates.

But we have the issue of passthroughs versus corporates. We have the tax expenditures. We have other issues on the table that, you know, the panel has addressed that all need to be measured, all need to be factored in. And, you know, I understand that is the responsibility of the committee, to take this information and work through what would be a reasonable approach to how business could be impacted, to create jobs, and to move the economy forward.

Mrs. BLACK. Thank you, Mr. Chairman. I yield back my time. Chairman CAMP. Thank you.

Mr. SCHOCK. is recognized.

Mr. SCHOCK. Thank you, Mr. Chairman. I really appreciate this hearing. It has been fantastic.

First, I want to address the outrage expressed by many in this committee about, apparently, some businesses in this country paying zero effective tax and what I perceive to be a little disingenuous demagoguery on their part.

You know, it is one thing to say you don't like the rules; it is another thing to write the rules and then criticize people for following the rules.

I went through my neighborhood McDonald's a couple months ago. It was a brand-new building. Now, the hamburger didn't taste any better. The fries were pretty much the same. And I happened to meet the proprietor of the restaurant—true story. And I asked him, I said, why would you tear down what I thought was a perfectly good building, close your business, and rebuild this building from scratch? And he looked at me and he said, well, thanks to you and the Obama administration, I can write off the entire cost of this building this year. And he said, as a result, I won't pay any taxes this year.

Now, I know that my local franchisee of McDonald's is not the only business doing this. In fact, the Obama administration was quite proud of pushing for this initiative last fall—actually, in August. I have a copy of the press release from the White House where it says, "The President is proud to push for targeted tax cuts and has been a long proponent of expanding the accelerated depreciation and the bonus depreciation."

So I think it is important to point out the fact that this is something that was passed under a Democratic House, Democratic Senate, and signed into law by a Democratic President. I would also say that I supported it, given our economic times, to further encourage investment. However, we should not demagogue those companies, then, who practice exactly the type of investment and business practices that, in fact, we were incentivizing and asking for.

To that end, I also have a copy of the latest Citizens for Tax Justice news release that just came out, criticizing 12 corporations for paying, effectively, a negative tax rate. One of them, of course, is one of my home State companies, Boeing.

And I just thought I would give Mr. Zrust the opportunity to respond to this criticism and perhaps maybe address the issue I raised about bonus depreciation and perhaps other tax methodologies that have played into a very low effective rate today and maybe next year, and what effect that will have, if any, by taking 100 percent of the depreciation this year on further years' tax liabilities.

Obviously, if you don't depreciate something over 5 years or 7 years or 30 years, you get that depreciation this year, but now your effective tax rate could be higher later on.

So I guess my question to Mr. Zrust would be, what will be Boeing's effective tax rate, not for 2008 and 2010, but perhaps from 2008 to 2018, over a 10-year period, as a result of you implementing these type of tax methodologies?

Mr. ZRUST. Well, first of all, as I mentioned in my statement, our effective tax rate—and, again, I talk in an accounting sense—is 31 to 33 percent.

Now, given that—over the last few years, that is true, we have paid a relatively low amount of tax. Now, that is cash taxes, as opposed to effective rate. And the reason for that is principally three things.

One is the investment in our new products, so we have two large development programs, the 787 and the 747-8. And there have been well-documented issues associated with those programs. And the inventory accounting method that we are on allows us to de-

duct certain items for tax purposes that are not currently deductible for book purposes.

However, as we start delivering those airplanes, it flips. So, in other words, in the future, we will have lower book income but higher taxable income. So we are going to pay tax, and this is a timing difference.

Mr. SCHOCK. So, basically, the short answer is your effective tax rate will go up? It will be higher in later years?

Mr. ZRUST. Our cash payments will go up higher than you would expect in future years as this difference reverses.

Mr. SCHOCK. Okay. My time is almost up, so I apologize.

Real quickly, given all of that, my understanding is everyone at this table still would put everything on the table in exchange for a lower effective tax rate. Is that the case? And if you could all quickly respond. And, if not, what is not on the table, in your perspective?

Mr. GALVIN. Yes. Everything is on the table.

Mr. SCHOCK. So even with all these loopholes and gimmies and, you know, all the things we have heard about here today, you are willing to put it all on the table to lower the effective rate?

Mr. GALVIN. Drop everything, lower the rate, make it corporate revenue neutral.

Ms. BROWN. Agreed. Drop everything, lower the rate, lower the tax burden net overall.

Mr. ZRUST. We are in agreement, as well.

Mr. MISPLON. Agreed.

Mr. STUTMAN. Everything needs to be considered. I am not suggesting that when you consider everything you get to an ultimate conclusion that you would trade off everything, for our client base, relative to a lower rate.

Mr. SCHOCK. All right. Thank you all.

Chairman CAMP. Thank you, Mr. Schock.

And, again, I want to thank all of the witnesses for participating in this hearing on corporate tax issues in light of comprehensive tax reform. This will conclude the fifth—

Mr. LEVIN. Mr. Chairman.

Chairman CAMP [continuing]. Full committee hearing on tax reform; six Ways and Means Committee hearings on this issue.

And Mr. Levin.

Mr. LEVIN. For the record, because the effective tax rate that we obtained from your filings is different than you indicated today, I am not saying you are wrong; there may be an explanation, I would ask each of you, for the record, to indicate how you calculated your effective tax rates. We will send you the question. I want to be sure that it is precise.

Chairman CAMP. If the witnesses would accommodate the committee in responding to any written requests that they may receive, we would certainly appreciate that. Obviously not conveying any proprietary information in any answer—

Mr. LEVIN. No.

Chairman CAMP [continuing]. But that might help clarify an issue.

Thank you very much.

This hearing is now adjourned.

[Whereupon, at 12:19 p.m., the committee was adjourned.]
 [Questions for the Record follow:]

June 7, 2011

To: Walter Galvin, Emerson
 Jim Zrust, Boeing
 Judy Brown, Perrigo
 Jim Mispelon, Sears

From: Rep. Sander Levin
 Ranking Member

Re: Question for the record

Several of you referenced in your testimony or during questioning a “US effective tax rate” for your firm that differed from the effective income tax rate you are required to report in your financial statements. If you did so, please describe the derivation of the rate referenced at the hearing, and explain how it compares to the worldwide book effective tax rate you are required to report to your shareholders.

Submitted by Walter Galvin
 August 19, 2011

Question for the Record

Question: “Several of you referenced in your testimony or during questioning a ‘US effective tax rate’ for your firm that differed from the effective income tax rate you are required to report in your financial statements. If you did so, please describe the derivation of the rate referenced at the hearing, and explain how it compares to the worldwide book effective tax rate you are required to report to your shareholders.”

Answer: As I mentioned in my testimony before the Ways and Means Committee on June 2, 2011, “Last year we [Emerson] paid U.S. income taxes of approximately \$500 million, with an effective tax rate on U.S. profits of 36 percent.” The U.S. income tax expense and reported effective tax rate numbers are reflected in the table below. That table also shows that Emerson reported an effective income tax rate of 23.8 percent on non-U.S. income—income tax of \$375 million on pretax income of \$1.576 billion. Combining U.S. and non-U.S. income into a blended total, Emerson reported income tax expense of \$848 million on pretax income of \$2,879 million for an effective rate of 29.4 percent.

	United States	Non-U.S.	TOTAL
Pretax Earnings from Continuing Operations	\$1,303 million	\$1,576 million	\$2,879 million
Current Income Tax Expense*	\$529	\$413	\$942
Deferred Income Tax Expense*	(\$56)	(\$38)	(\$94)
Total Income Tax Expense*	\$473	\$375	\$848
Effective Tax Rate	36.3%	23.8%	29.4%

* Federal, state, and local

Source: 2010 Emerson Annual Report, footnote #13



JUDY BROWN
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August 31, 2011

The Honorable Dave Camp
Chairman
Committee on Ways and Means
US House of Representatives
Washington, DC 20515

The Honorable Sander Levin
Ranking Member
Committee on Ways and Means
US House of Representatives
Washington, DC 20515

Dear Chairman Camp and Ranking Member Levin,

Thank you again for the opportunity to testify before the Committee as it considers fundamental tax reform and thank you for this opportunity to discuss Perrigo's effective tax rate. As I said before the Committee in June, Perrigo's worldwide effective tax rate, excluding unusual items, was just below 30% and Perrigo's US-based effective rate is between 36-38%. In order to give you the most detailed answer possible, I have worked up an analysis of Perrigo's US GAAP tax rate and included the relevant pages from Perrigo's 10K filings with the Securities and Exchange Commission.

In the attached documents, you will find our domestic tax rate, which aggregates the rate paid in federal taxes – both current and deferred – and the rate paid to the states in which we do business – both current and deferred. This rate in fiscal years 2008, 2009, and 2010 was between 36-38%.

Finally, you will find a calculation for Perrigo's worldwide effective tax rate, which combines all of the taxes the company paid with all of the benefits it received in all jurisdictions. As a result of doing business in other countries with lower rates and some benefits, Perrigo's worldwide effective rate is lower than our US rate. In fiscal years 2008-2010, this rate ranged between a low of 21% to a high of almost 31%. In 2009, Perrigo's worldwide effective rate was 30.8%. In fiscal year 2010, the rate was 27.3%.

The answers I provided at the Committee are consistent with the accounting shown in these attachments. Thank you for the opportunity to clarify my testimony. I look forward to working with you and the other members of the committee as you work toward comprehensive tax reform. Please feel free to contact me if I can provide any further information.

Sincerely,

Judy Brown
Executive Vice President and Chief Financial Officer
Perrigo

515 Eastern Avenue
Allegan, Michigan 49010
(269) 673-8451

Perrigo Company & Subsidiaries
Tax Rate Reconciliation per SEC Form 10K

	Fiscal years ended on/about June 30,				Averages	
	2010	2009	2008	2007	3 Year	4 Year
Domestic						
Pre-Tax Domestic Income before Tax (A)	\$ 190,104	\$ 137,839	\$ 101,865	\$ 19,298	429,808	449,106
Provision for Income taxes:						
Federal - Current	63,992	49,692	38,769	1,311	152,453	153,764
Federal - Deferred	261	(4,474)	(4,209)	3,498	(8,422)	(4,924)
Total Federal Provision (1)	64,253	45,218	34,560	4,809	144,031	148,840
Federal Rate	33.8%	32.8%	33.9%	24.9%	33.5%	33.1%
State - Current	7,042	4,892	3,924	550	15,858	16,408
State - Deferred	(554)	488	140	464	74	538
Total State Provision (2)	6,488	5,380	4,064	1,014	15,932	16,946
State Rate	3.4%	3.9%	4.0%	5.3%	3.7%	3.8%
Total Provision for Income Taxes (1)+(2)=(B)	\$ 70,741	\$ 50,598	\$ 38,624	\$ 5,823	159,963	165,786
Domestic Tax Rate - (B)/(A)	37.2%	36.7%	37.9%	30.2%	37.2%	36.9%
International						
Pre-Tax Income (C)	\$ 118,082	\$ 65,941	\$ 76,081	\$ 67,834	260,104	327,938
Provision for Income taxes:						
International - Current	29,128	11,416	2,112	14,005	42,656	56,661
International - Deferred	(15,780)	668	(2,987)	(5,530)	(18,099)	(23,629)
Total Provision for Income Taxes (D)	\$ 13,348	\$ 12,084	\$ (875)	\$ 8,475	24,557	33,032
International Tax Rate - (D)/(C)	11.3%	18.3%	-1.2%	12.5%	9.4%	10.1%
Worldwide						
Pre-Tax Income (E)	\$ 308,186	\$ 203,780	\$ 177,946	\$ 87,132	689,912	777,044
Provision for Income taxes:						
Federal - Current	63,992	49,692	38,769	1,311	152,453	153,764
Federal - Deferred	261	(4,474)	(4,209)	3,498	(8,422)	(4,924)
State - Current	7,042	4,892	3,924	550	15,858	16,408
State - Deferred	(554)	488	140	464	74	538
International - Current	29,128	11,416	2,112	14,005	42,656	56,661
International - Deferred	(15,780)	668	(2,987)	(5,530)	(18,099)	(23,629)
Total Provision for Income Taxes (F)	\$ 84,089	\$ 62,682	\$ 37,749	\$ 14,298	184,520	198,818
Worldwide Tax Rate - (F)/(E)	27.3%	30.8%	21.2%	16.4%	26.7%	25.6%

PER FORM 10-K

NOTE 14 - INCOME TAXES

Pre-tax income and the provision for income taxes from continuing operations are summarized as follows:

	Fiscal Year		
	2010	2009	2008
Pre-tax income:			
U.S.	\$190,104	\$137,839	\$101,865
Foreign	118,082	65,941	76,081
Total	<u>\$308,186</u>	<u>\$203,780</u>	<u>\$177,946</u>
Provision for income taxes:			
Current:			
Federal	\$63,992	\$49,692	\$38,769
State	7,042	4,892	3,924
Foreign	29,128	11,416	2,112
Subtotal	<u>100,162</u>	<u>66,000</u>	<u>44,805</u>
Deferred:			
Federal	261	(4,474)	(4,209)
State	(554)	488	140
Foreign	(15,780)	668	(2,987)
Subtotal	<u>(16,073)</u>	<u>(3,318)</u>	<u>(7,056)</u>
Total	<u>\$84,089</u>	<u>\$62,682</u>	<u>\$37,749</u>

A reconciliation of the provision based on the Federal statutory income tax rate to the Company's effective income tax rate is as follows:

	Fiscal Year		
	2010	2009	2008
	<u>%</u>	<u>%</u>	<u>%</u>
Provision at Federal statutory rate	35.0	35.0	35.0
State income taxes, net of Federal benefit	2.1	2.7	1.3
Foreign tax rate differences	(4.1)	(5.9)	(9.6)
Expenses not deductible for tax purposes/ deductions not expensed for book, net	(1.7)	(0.7)	(2.2)
Approved enterprise benefit	(3.3)	(2.4)	(3.6)
Israeli statutory tax rate change	(1.5)	-	-
Israeli tax ruling	-	-	(2.4)
Non-deductible write-off of in-process research and development	-	-	0.8
International capital loss	-	2.0	-
API restructuring - Germany	0.4	1.1	-
Foreign tax credit	(1.6)	-	-
Research and development credit	(0.3)	(1.4)	(0.5)
Other	2.3	0.4	2.4
Effective income tax rate	<u>27.3</u>	<u>30.8</u>	<u>21.2</u>

NOTE 14 - INCOME TAXES

Pre-tax income and the provision for income taxes from continuing operations are summarized as follows:

	Fiscal Year		
	2009	2008	2007
Pre-tax income:			
U.S.	\$137,839	\$101,865	\$19,298
Foreign	65,941	76,081	67,834
Total	<u>\$203,780</u>	<u>\$177,946</u>	<u>\$87,132</u>
Provision for income taxes:			
Current:			
Federal	\$49,692	\$38,769	\$ 1,311
State	4,892	3,924	550
Foreign	11,416	2,112	14,005
Subtotal	<u>66,000</u>	<u>44,805</u>	<u>15,866</u>
Deferred:			
Federal	(4,474)	(4,209)	3,498
State	488	140	464
Foreign	668	(2,987)	(5,530)
Subtotal	<u>(3,318)</u>	<u>(7,056)</u>	<u>(1,568)</u>
Total	<u>\$62,682</u>	<u>\$37,749</u>	<u>\$14,298</u>

A reconciliation of the provision based on the Federal statutory income tax rate to the Company's effective income tax rate is as follows:

	Fiscal Year		
	2009	2008	2007
	%	%	%
Provision at Federal statutory rate	35.0	35.0	35.0
State income taxes, net of Federal benefit	2.7	1.3	0.8
Foreign tax rate differences	(5.9)	(9.6)	(5.3)
Expenses not deductible for tax purposes/ deductions not expensed for book, net	(0.7)	(2.2)	(0.5)
Approved enterprise benefit	(2.4)	(3.6)	(11.8)
Israeli tax ruling	-	(2.4)	-
Non-deductible write-off of in-process research and development	-	0.8	-
International capital loss	2.0	-	-
API restructuring - Germany	1.1	-	-
Research and development credit	(1.4)	(0.5)	(3.3)
Other	0.4	2.4	1.5
Effective income tax rate	<u>30.8</u>	<u>21.2</u>	<u>16.4</u>

James H. Zrust
Vice President - Tax

The Boeing Company
100 N Riverside MC 5003-4027
Chicago, IL 60606-1596

August 29, 2011



The Honorable Dave Camp
Chairman, House Ways and Means Committee
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515-6348

Dear Chairman Camp:

In response to your inquiry of August 17, 2011, regarding "Question for the Record" (attached), we submit the following additional information.

Your question asks if in our testimony or during the questioning we referenced a "US effective rate" which differed from that which is reported to shareholders to describe such deviation.

In our testimony we stated "Unlike other large multinational companies, almost all of our current worldwide income is subject to U.S. tax, and our effective rate is generally between 31-33 percent". The reference to the "effective rate" above is the same as what is reported to our shareholders in our Annual Report and to the Securities and Exchange Commission in our 10K.

Attached please find a schedule summarizing the Company's effective income tax rate for years 2007 - 2010 as disclosed in our Annual Report and 10K. It should be noted that for years 2009 and 2010 the effective rate was distorted due to large one-time unusual events that are non-recurring in nature. These events are not considered part of the Company's normal operations and are specifically discussed as such in the Annual Report and 10K.

We respectfully submit this information for your review.

Sincerely,

A handwritten signature in black ink, appearing to read 'James H. Zrust', written over a horizontal line.

**The Boeing Company
Attachment**

Years ended December 31,	2010	2009	2008	2007
Effective income tax rate per 10K	26.50%	22.90%	33.60%	33.70%
Adjusting Items:				
Medicare Part D law change (Note 1)	-3.3%			
Federal audit settlement (Note 2)	8.2%			
2009 test airplane charge (Note 3)		7.4%		
Effective tax rate as adjusted	31.40%	30.30%	33.60%	33.70%

Note 1:

One-time income tax charge recorded during 2010 as a result of the Patient Protection and Affordable Care Act, as modified by the Health Care and Education Reconciliation Act of 2010 as disclosed in the 2010 10K page 70.

Note 2:

One-time income tax benefit recorded during 2010 as a result of settling the 1998-2003 federal audit as disclosed on page 70 of the 2010 10K.

Note 3:

Unique pre-tax charge of \$2,693 million recorded during 2009 had the effect of reducing the income tax provision by 7.4%. As discussed in the 2009 10K (see pages 18, 23, 26, 27 and 73), the company concluded that the first three flight-test 787 aircraft could not be sold as previously anticipated due to the inordinate amount of rework and unique and extensive modifications made to those aircraft. As a result, costs associated with these aircraft were expensed and reduced 2009 earnings.

Representative Levin, in answer to your question of June 7, 2011 regarding the "US effective tax rate" that differed from the effective tax rate you are required to report in your financial statements, let me first say that we did not give specific rates for members of the National Retail Federation (NRF) but that since most of the NRF members operate predominately in the US, there would be no difference.

In Sears Holdings Corporation's (SHC) case, our consolidated financial statement effective rate for the year ending 1/2011 was 19.4%. However, SHC had a loss from domestic operations of \$137 million for that year but had income from foreign operations (predominantly Canada) of \$323 million for combined income of \$186 million. For US purposes SHC would record a tax benefit from that loss of 35% and would have also received a financial statement benefit from certain employment tax credits (WOTC) that would have increased the domestic effective tax rate **benefit** to approximately 45%. This tax benefit will partially offset the US tax cost of the Canadian income which will be repatriated to the US in the future, leaving a combine effective tax rate cost of 19.4%.

The other point I would like to make is that at the hearing there appeared to be considerable confusion around the difference between a company's effective tax rate and its cash tax paid rate. Over time and sometimes that means a very long time, those rates will be the same. However, in the short term those rates could and do differ dramatically. As an example, if a company's financial statement pretax income is \$100 in each of two years with no permanent tax benefits, its effective tax rate will be 35% each year. However, if that company elects 100% bonus depreciation for tax purposes on an asset costing \$100, its cash tax paid rate for that year will be 0. In year two the effective tax rate and the cash tax paid rate will both be 35%. If in year 3 the

company earns another \$100 from operations but also writes off the \$100 asset, its effective tax rate will be 0 but the cash tax paid rate will be 35%. Accounting rules will require the difference between the company's effective tax rate and its cash tax paid rate be keep track of as deferred tax assets and deferred tax liabilities. Therefore, it is almost certain that there will be a difference between the effective tax rate and the cash tax paid rate with the difference being recorded to deferred taxes.

Accounting for income taxes is a confusing area and I would welcome any other questions or clarifications you may have.

JAMES MISPLON
Vice President Tax
Sears Holdings Management Corporation

[Submissions for the Record follow:]

STATEMENT OF THE R&D CREDIT COALITION
ON
RESEARCH AND DEVELOPMENT INCENTIVES IN THE U.S. AND ABROAD
SUBMITTED FOR THE RECORD OF THE HEARING
ON
“HOW BUSINESS TAX REFORM CAN ENCOURAGE JOB CREATION”
BEFORE
THE COMMITTEE ON WAYS AND MEANS
ON
JUNE 2, 2011

Introduction

The R&D Credit Coalition welcomes the opportunity to provide comments for the record of the June 2, 2011 Committee on Ways and Means (“Committee”) hearing to examine “major business and corporate tax issues and how changes to those aspects of the tax code, as part of comprehensive tax reform, might promote job creation and economic growth.”¹

The R&D Credit Coalition is a group of more than 100 trade and professional associations along with small, medium and large companies that collectively represent millions of American workers engaged in U.S.-based research throughout major sectors of the U.S. economy, including aerospace, agriculture, biotechnology, chemicals, electronics, energy, information technology, manufacturing, medical technology, pharmaceuticals, software and telecommunications.

Although the make-up of the R&D Credit Coalition is diverse, the member companies generally share a major characteristic— they collectively spend billions of dollars annually on research and development (“R&D”), which provides for high-wage and highly-skilled jobs. Companies must decide where they are going to invest their research dollars— here in the U.S. or abroad. The high U.S. corporate tax rate and the temporary nature of the U.S. R&D tax credit, compared to the lower corporate tax rates and more attractive research incentives in most other countries, are key factors that companies consider in determining where they are going to create R&D jobs. Today, the average company that claims the U.S. R&D credit only realizes a credit rate of 6%. In addition, the U.S. requires that the deduction for R&D expenses be reduced by the amount of any R&D credit.

¹ <http://waysandmeans.house.gov/News/DocumentSingle.aspx?DocumentID=242048> (Hearing Advisory)

Thus, corporate tax reform proposals limiting or eliminating research and development tax incentives could have a dramatic impact on both the number and location of R&D jobs in the U.S., as well as the ability of our companies to compete effectively in the global marketplace. Given the Committee's focus on "policy options that might encourage job creation in the United States,"² the R&D Credit Coalition would like to share our preliminary views regarding the impact of the R&D tax credit on job creation in the U.S., and the implications of regimes found in other countries that were designed to provide more competitive R&D incentives abroad.

Discussion

The R&D tax credit was originally enacted in 1981 and has provided an important incentive to spur private sector investment in innovative research by companies of all sizes and in a variety of industries. The enactment of this incentive helped establish the U.S. as a leader in innovative research. In fact, during the 1980s, the U.S. was the leader among OECD countries in providing the best R&D incentives for companies. However, many of our foreign competitors have since instituted more generous R&D incentives in the decades following, causing the U.S. to drop below the top 10, and today ranks 24th in research incentives among industrialized countries. The temporary nature of U.S. R&D incentives is a strain on U.S. companies. Providing the certainty of a permanent credit, especially in a tax reform environment, is critical to maintaining U.S. leadership in innovative research and ensuring that U.S. companies will continue to do their R&D here in the U.S.

As was highlighted in oral testimony provided during the June 2nd hearing, **many other countries offer both lower tax rates and more attractive R&D incentives, proving that the U.S. should not engage in an "either/or" debate with respect to lower marginal rates and boosting U.S. job creation through R&D incentives, when looking at options to reform the corporate tax code.**

The R&D credit is a *jobs* credit—with seventy percent of credit dollars used for salaries of high skilled R&D workers. A study by the Information Technology and Innovation Foundation (ITIF), "estimates that expanding the Alternative Simplified Credit (ASC) from 14 percent to 20 percent would spur the creation of 162,000 jobs in the short term and an additional, but unspecified, number of jobs in the longer run."³ The U.S. must ensure that our tax system supports high-skilled, high-paying jobs, here in the U.S. We cannot let our tax system put these jobs at risk of moving abroad.

International R&D Tax Incentives

The number of OECD countries offering some sort of incentive for research has grown dramatically in recent years as countries attempt to become leaders in research. The U.S. share of global R&D fell from 39 percent in 1999 to 33 percent in 2007.⁴ In addition, the following OECD chart shows that in 2009, the United States ranked 24 among 38 industrialized countries offering R&D tax incentives.⁵

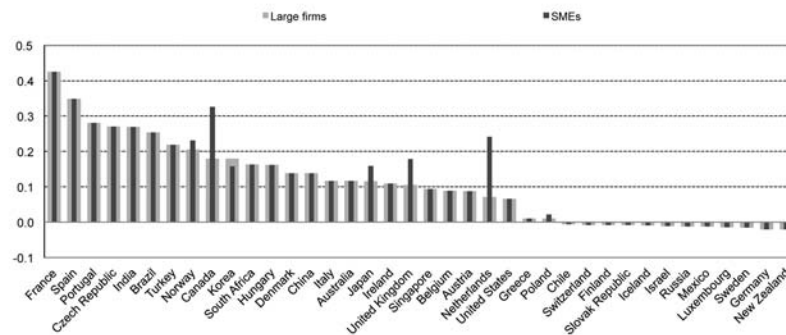
² *Id.*

³ Information and Technology Innovation Foundation, "Create Jobs by Expanding the R&D Tax Credit," by Robert D. Atkinson. January 26, 2010 (page 1)

⁴ OECD, Ministerial Report on the OECD Innovation Strategy, May 2010, p. 8.

⁵ OECD, "Science, Technology and Industry Scorecard," December 2009, p 79.

OECD Science, Technology and Industry Scoreboard 2009 - OECD © 2009 - ISBN 9789264063716
Tax subsidy rate for USD 1 of R&D, large firms and SMEs, 2008



Bipartisan Support for a Strengthened, Permanent Research & Development Incentive

Every Administration has supported the R&D tax credit since its enactment. More recently, a March 25, 2011 Treasury Department study stated, "Two years ago, the President set an ambitious goal of achieving a level of research and development that is the highest share of the economy since the space race of the 1960's – 3 percent of GDP – a commitment he re-emphasized in his State of the Union address in 2011. The R&E tax credit is a vital component of achieving this goal and helping us out-innovate our competition. This is why, in addition to making it permanent, the President proposed on September 8, 2010 to expand and simplify the credit, making it easier and more attractive for businesses to claim this credit for their research investments. This proposal was subsequently included in the President's FY 2012 Budget and should be part of the reform of our corporate tax system currently under consideration."⁶

Moreover, Congress has extended the credit 14 times since it was first adopted in 1981. Earlier this year, Ways and Means Committee members Kevin Brady (R-TX), John Larson (D-CT) and many others introduced H.R. 942, The American Research and Competitiveness Act of 2011. This legislation would

⁶ "Investing in U.S. Competitiveness: The benefits of Enhancing the Research and Experimentation (R&E) Tax Credit," U.S. Department of the Treasury, March 25, 2011, page 1.

provide important certainty for U.S.-based research spending by making the R&D tax credit permanent as well as simplifying and strengthening it, thereby increasing its effectiveness. We urge Congress to pass this legislation before the credit expires on December 31, 2011.

Conclusion

It is vitally important that U.S. policy makers support a strengthened and permanent research and development incentive as part of any tax reform measure. A robust and permanent research and development tax credit is critical to competitiveness, innovation and U.S. jobs. Congress must recognize, that in the global economy, companies have a choice as to where they are going to do their research—and with many other countries offering *both* lower corporate income tax rates and more robust R&D incentives, the U.S. must ensure that R&D incentives are included as part of any tax reform package. The R&D Credit Coalition looks forward to assisting members of the Committee and their staffs to gain a more detailed understanding of the research and development tax credit and its impact on U.S. jobs.



**Marion C. Blakey
President and CEO
Aerospace Industries Association**

Before the

**Committee on Ways and Means
U.S. House of Representatives**

**Hearing on
How Business Tax Reform Can Encourage Job Creation**

June 2, 2011

Remarks Prepared for Submission to the Record

Chairman Camp, Ranking Member Levin, and distinguished members of the Committee: it is a pleasure to submit the following testimony for the record on a very important topic – business tax reform. The Aerospace Industries Association is an organization of more than 300 member companies and an industry of 624,000 highly skilled employees who make the aircraft, avionics, and air navigation equipment that allow aircraft to fly safely in our airspace every day.

The U.S. aerospace industry accounts for at least three percent of the country's gross domestic product and every aerospace dollar yields an extra \$1.50 to \$3 in further economic activity.¹ The U.S. aerospace and defense manufacturing industry remains the single largest positive contributor to the nation's balance of trade. In 2010, the industry exported \$80.5 billion and imported \$27.2 billion, providing a net surplus of \$53.3 billion, the largest of any manufacturing sector. As the U.S. economy moves through uncertain times, America's aerospace industry remains a powerful, reliable engine of employment, innovation and export income. Given the priority to create and sustain jobs, the contribution of our industry to the economy and maintaining our trade strength cannot be overestimated.

The workforce brings a diverse set of skills and capabilities to their jobs: scientists and engineers on the cutting edge of advanced materials, structures, and information technology; machinists fabricating complex shapes and structures; and technicians from almost every degree field testing, applying and integrating the latest technologies. Most of these positions are high-skill, quality jobs, paying above average wages. Production workers average \$32.27 an hour;² entry-level engineers average more than \$56,000 a year, and more senior engineers salaries run well into six figures.³ And employment levels have remained fairly consistent for years.

In short, aerospace products and services are pillars of our national security and competitiveness. In this challenging economic environment, the aerospace industry is a solid and reliable contributor to the national economy and to the lives of millions of Americans. We strongly believe that keeping this economic engine on track is in America's best interest and that a simple, efficient tax code will enable the high-tech aerospace workforce to continue to drive this powerful engine of the U.S. economy.

Tax Policy and the Economy

The U.S. economy is globally competitive, which magnifies the importance of our tax policy. Higher tax rates and complex tax regulations in the United States have produced a competitive disadvantage for the United States and U.S.-based business activities. This disadvantage leads to fewer companies doing business in the United States, which results in a falloff in jobs and lower economic growth.

The United States, which once was home to one of the lowest corporate tax rates among major industrialized economies, is now home to one of the highest.⁴ The

¹ AIA Estimate.

² Bureau of Labor Statistics, Current Employment Statistics survey, Dec. 2008.

³ Aviation Week Workforce Study, 2008.

⁴ Congressional Budget Office, Corporate Income Taxes: International Comparisons November 2005.

current corporate tax rate leads to economic distortions and, in 2002, resulted in compliance costs of \$22 billion. With a corporate and indirect tax rate of 40 percent, companies operating in the United States face a much larger tax burden than they would in other nations.⁷

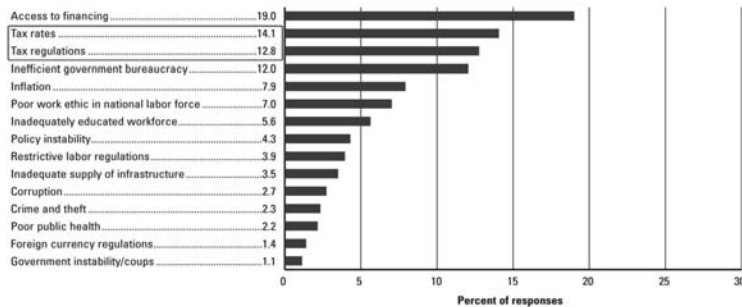
From 1988 through 2009, nations around the world decreased their corporate tax rates, while the United States' remained largely unchanged. Adding to the problem, the U.S. tax code has become increasingly complex and unpredictable. To advance our nation's manufacturing base into the 21st century and increase the number of high-wage jobs in the United States, the government must develop and implement tax policies that will eliminate global disadvantages and allow the aerospace industry to grow.

Aerospace and Defense Industry Tax Principles

The U.S. Tax Code must foster competitiveness, rather than produce disincentives for U.S.-based investment and job creation. As shown below, the World Economic Forum lists tax rates and tax regulations as two of the top three problematic factors of doing business in the United States.⁸

Global Competitiveness Index

The most problematic factors for doing business



Note: From a list of 15 factors, respondents were asked to select the five most problematic for doing business in their country/economy and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings.

The U.S. Tax Code must foster innovation

While the Research and Development tax credit has been instrumental in fostering innovation in American industry, uncertainty over the passage of year-by-year

⁷ Åsa Johansson, Christopher Heady, Jens Arnold, Bert Brys and Laura Vartia Tax and Economic Growth: Economics Department Working Paper No. 620, Organization for Economic Co-operation and Development, 11-July-2008.

⁸ Chart sourced from KPMG Corporate Indirect Tax Rate Survey 2009, pp. 14-15. Available at <http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/>

⁹ KPMG Corporate Indirect Tax Rate Survey 2009, ibid

¹⁰ World Economic Forum, The Global Competitiveness Report 2009-2010, p. 320. Available at <http://www.weforum.org/documents/GCR09/index.html>. Access to financing was the third factor cited.

extensions of the credit hinders business investment. The credit should be made a permanent provision of the Tax Code, providing companies with the certainty and stability necessary for planning long term R&D investment. In addition, Congress and the administration should strengthen the alternative simplified credit rate from 14 to 20 percent to spur innovation and competition and act as an incentive to locate more R&D jobs in the United States.

The U.S. Tax Code must be efficient

Those provisions of the tax code that do not meet this requirement should be eliminated or modified. For example, the three percent withholding tax on all government payments is estimated to increase tax payments by \$11 billion through 2019,⁹ but the Defense Department has estimated that implementation of the tax would cost this agency alone \$17 billion over just five years because of increased contract costs, technology upgrades and administrative overhead.¹⁰

The U.S. tax code must be simple

In general, simplicity within a tax system enhances the public's understanding of, respect for, and compliance with its provisions. We recognize, however, that at times protection of the tax base and simplicity are at odds. In such cases, we believe that a principle of proportionality should be applied: The benefits to the government of proposed complexity, reporting, and enforcement provisions should be weighed against the costs (to taxpayers and the economy in general) of complying with the proposal.

Conclusion

Adopting a tax code that adheres to the principles of efficiency, innovation, competitiveness, and simplicity will pay dividends across the board. U.S. companies will have more business, there will be more jobs for Americans, and the nation will experience more economic growth. Congressional action on repealing the three percent withholding tax, making the research and development tax credit permanent, and lowering corporate tax rates would be an excellent first step forward.

⁹ In January 2009, the Joint Committee on Taxation (JCT-14-09) estimated the "increased revenue" to the U.S. Treasury at \$10.95 billion from 2009 to 2019; however, \$6 billion was simply an acceleration of tax receipts during 2011, the original transition year, and not an actual revenue increase. The 3% withholding requirement was scored to only generate \$575 million in 2012, increasing slightly in each of the next seven years. Thus the bulk of the \$11 billion in increased revenue is merely due to the timing of revenue payable to the Government.

¹⁰ Letter and report sent by Deputy Secretary of Defense James Finley to the Chairmen of the Senate and House Armed Services committees, April 14, 2009

Statement for the Record
Of
The Depreciation Fairness Coalition
For The Hearing On
“How Business Tax Reform Can Encourage Job Creation”
Before
The U.S. House of Representatives
Committee on Ways and Means

Thursday, June 2, 2011

Chairman Camp, Ranking Member Levin, and members of the House Committee on Ways and Means, thank you for the opportunity to submit this statement for the record on behalf of the Depreciation Fairness Coalition. We applaud the Chairman and the Committee's leadership on tax reform.

Currently, the tax law presents taxpayers with a great deal of complexity and uncertainty, impacting responses to tax incentives. Tax reform provides an opportunity to address these issues. Done properly, a comprehensive and nuanced review of the tax system could result in predictability, simplicity, and fairness, while encouraging economic growth and job creation.

The Depreciation Fairness Coalition is comprised of the following industries: retail, restaurants, construction, franchisees/franchisors, real estate, and small business in general. In this regard, we specifically urge Congress to make permanent the temporary 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements. Bipartisan legislation to this effect (H.R. 1265) has been introduced by Committee Members Gerlach and Neal. A Senate companion bill (S. 687) has been introduced by Finance Committee members Conrad and Cornyn.

15-year Depreciation Schedule for Leasehold Improvements, Restaurant Improvements and New Construction, Retail Improvements

The Internal Revenue Code ("Code") contains a temporary provision under which leasehold improvements, restaurant improvements, new restaurant construction, and retail improvements can be depreciated over 15 years rather than a 39-year recovery period that would otherwise apply to nonresidential real property. By way of background, Congress permanently provided for the 15-year depreciation schedule for retail motor fuels outlet stores in the Small Business Job Protection Act of 1996. In recognition of their shorter expected lives, Congress subsequently expanded property subject to the 15-year depreciation schedule to include leasehold improvements (American Jobs Creation Act of 2004), restaurant improvements (American Jobs Creation Act of 2004) and new construction (Emergency Economic Stabilization Act of 2008), and retail improvements (Emergency Economic Stabilization Act of 2008).

The 15-year depreciation schedule for leasehold improvements, restaurant improvements, new restaurant construction, and retail improvements reflects the tax policy principle that costs of assets are allocated over the period in which they are used. Assets with longer expected lives are depreciated over a longer period of time, while assets with shorter lives are depreciated over a shorter period of time. With more than 130 million Americans patronizing restaurants and retail establishments each day, such building structures experience a daily human assault. These businesses must constantly make changes to keep up with the structural and cosmetic wear and tear caused by customers and employees. The heavy use accelerates deterioration of a building's entrance, lobbies, flooring, restrooms, and interior walls. For restaurants, National Restaurant Association research shows that most restaurants remodel and update their building structures every six to eight years. As a result, 15 years is a much more accurate timeframe for writing off restaurant buildings and improvements than is 39 years.

Moreover, a 15-year recovery period reduces the cost of capital expenditures and increases cash flow. In turn, this provides needed capital for American businesses – which, in turn, translates into American jobs. As demonstrated in Figure 1 below, the annual tax savings and corresponding additional cash flow realized by restaurateurs from a 15-year, rather than a 39-year, depreciation schedule are considerable. For example, a restaurateur's annual tax liability would increase by nearly \$10,000 if the recovery period for a \$1 million investment were increased from 15 years to 39 years. In an industry with median profit margins of 3 to 5 percent, every penny counts. A more accurate recovery period frees resources to expand business either through new hires or further capital expenditures. Both contribute directly and indirectly to job creation as benefits are multiplied through the economy.

Figure 1.

Sample Calculations for 15-Year versus 39-Year Depreciation

Total Capital Expenditure on Eligible Property	Annual Depreciation Based on 39-year Schedule	Annual Tax Savings from Depreciation	Annual Depreciation Based on 15-year Schedule	Annual Tax Savings from Depreciation	Annual Difference in Tax Savings Between 15- & 39-Year Schedules
\$100,000	\$2,532	\$608	\$6,667	\$1,600	\$992
\$250,000	\$6,329	\$1,519	\$16,667	\$4,000	\$2,481
\$500,000	\$12,658	\$3,038	\$33,333	\$8,000	\$4,962
\$700,000	\$17,722	\$4,253	\$46,667	\$11,200	\$6,947
\$1,000,000	\$25,316	\$6,076	\$66,667	\$16,000	\$9,924
\$1,500,000	\$37,975	\$9,114	\$100,000	\$24,000	\$14,886
\$2,000,000	\$50,633	\$12,152	\$133,333	\$32,000	\$19,848

Expenditure Scenarios

Rebuild Costs:

Quickservice - \$700,000

Fullservice - \$1,500,000

Renovate Costs:

Quickservice - \$250,000

Fullservice - \$500,000

Note: Figures are based on a 24% effective marginal tax rate

However, the 15-year depreciation schedule for these properties is temporary and must be extended annually. The piecemeal and temporary approach to the 15-year depreciation schedule, requiring extension every couple of years, presents taxpayers with unnecessary uncertainty and complexity. Moreover, in some cases, the provision has been allowed to lapse. This situation occurred recently, when the provision expired at the end of 2009. The provision was later retroactively extended for 2010 and prospectively extended for 2011 by the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 ("2010 Act"), enacted in December 2010. The provision's lapse resulted in some businesses waiting to undertake capital improvements.

Making permanent the 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements would address this issue, providing taxpayers with predictability, simplicity, and fairness. Our nation's businesses are looking forward, planning capital expenditures to improve and expand their businesses. For example, according to the National Restaurant Association April 2011 Tracking Survey, 53

percent of restaurant operators plan to make a capital expenditure for equipment, expansion, or remodeling in the next six months---the highest level in 41 months. The ability to plan for these expenditures and know what the tax treatment will be in the future is important to those who are making those decisions right now.

Moreover, the 15-year recovery period is an important driver of economic activity, fueling investment and job growth. When restaurants invest in construction and renovations, the impact spreads through the economy. Before the economic downturn, the restaurant industry spent more than \$10 billion in 2007 on construction of restaurant buildings. According to the Bureau of Economic Analysis, every dollar spent in the construction industry generates an additional \$2.39 in spending in the rest of the economy and every \$1 million spent in the construction industry creates more than 28 jobs in the overall economy. That means that restaurant industry construction spending created nearly 400,000 jobs in 2008 and 2009, at a time when the overall economy was contracting (see figure 2 below).

Figure 2.
Restaurant Spending on New Construction

Year	Billions (\$)	Jobs Created In Overall Economy
2004	5.2	145,000
2005	7.4	208,000
2006	6.6	185,000
2007	10.4	292,000
2008	7.6	214,000
2009	6.2	174,000

Source: U.S. Census Bureau and National Restaurant Association

Conclusion

We greatly appreciate this opportunity to submit this testimony on behalf of the Depreciation Fairness Coalition today. Tax reform presents an opportunity to provide taxpayers with predictability and fairness, while encouraging economic growth and job creation. As Congress considers the important issue of tax reform, we are happy to be a resource for Congress and the Committee and urge you to make permanent the 15-year depreciation for leasehold improvements, restaurant improvements and new construction, and retail improvements.

**Testimony of Frank Knapp, Jr.
President and CEO, South Carolina Small Business Chamber of Commerce
Submitted to
House Ways & Means Committee
Hearing on Corporate Tax Reform and Job Creation**

June 2, 2011

My name is Frank Knapp, Jr. and I am President and CEO of the South Carolina Small Business Chamber of Commerce, which has more than 5,000 small business members in the State of South Carolina. I am also a member of Business for Shared Prosperity. Both the South Carolina Small Business Chamber of Commerce and Business for Shared Prosperity are members of the American Sustainable Business Council (ASBC). ASBC is a network of 30 small business organizations with more than 100,000 independent small business members.

I appreciate the opportunity to present this testimony on behalf of these three organizations on the subject of corporate tax reform and job creation.

While small businesses are often portrayed as significant supporters of corporate tax cuts, our members take a different view. We know that tax cuts must be paid for by cuts to spending, and have recently witnessed Congress's attempt to deal with the fiscal crisis by cutting programs that help our communities and our customers. These cuts have hurt our businesses.

Cutting Taxes Does Not Create Jobs

As small businesses, few of us have ever created a job because we got a tax break for doing so. We hire people when there is demand for our goods and services. The success of our businesses is dependent on economically healthy communities and strong customers. The lingering recession has left many of our communities suffering and weak. When Congress reduces aid to states, or slashes community development block grants that provide jobs in our communities, our businesses feel that. It stifles our ability to create jobs.

Corporate taxes, like individual income taxes, support the public services and infrastructure upon which all businesses depend. These include a publicly educated workforce, transportation systems, safe drinking water and sanitation, the judicial system, taxpayer-funded research (which has played a crucial role in health advances and the creation of the Internet, for example), federal emergency response and so on. But, the public services and infrastructure underpinning a healthy economy are now being cut dramatically because of inadequate revenues. This impedes both U.S. business competitiveness and job creation.

We believe the combination of the tax cuts of the last decade, coupled with underinvestment in infrastructure and innovation, has led to the stagnant economy we experience today. As *The Wall Street Journal* reported, President Bush “shows the worst track record for job creation since the government began keeping records” in 1939. The Bush administration created just 1.1 million net jobs, while the Clinton administration created 22.7 million. In the six years after Clinton’s 1993 tax increase, employment grew 16.2 percent compared to just 4.8 percent in the six years between Bush’s 2001 tax cut and the Great Recession. The 2001-2007 economic expansion was the weakest since World War II when it came to growth in GDP, consumption, non-residential investment, wages and salary, and net worth, as well as employment growth. And the meltdown following was the worst since the Great Depression.

We Agree Corporate Tax Reform Is Needed

While the small business organizations I represent do not agree that corporate tax reform focused on reducing corporate rates would lead to job creation, we are in full agreement that corporate tax reform is necessary.

Our corporate tax system is badly broken. The current tax system creates an unlevel playing field between multinational and domestic businesses and between large businesses and smaller ones. Some corporations are paying a full share of taxes, while other equally profitable companies pay nothing at all. Too many corporations have turned their tax departments into profit centers, mining existing loopholes and lobbying hard for new ones. All of this has left corporate income taxes as a share of federal government receipts at historically low levels. In the 1950s corporate taxes made up a third of federal government revenues; today corporate taxes contribute less than a tenth of what the federal government takes in. The result of this tax shift is that while major corporations have seen their share of the tax burden dramatically shrink, small business owners and the middle class have picked up the slack. In effect, small businesses are subsidizing their economically dominant peers.

Rather than having the corporate tax debate focus on the statutory rate paid by corporations; we believe the debate should center on the appropriate share of the costs of government that should be borne by corporations.

Tax Holidays Proposed in Recent Legislation Will Only Lead to More Abuse and Continued Unfairness

We oppose both short and long-term tax holidays, in the form of a one-time tax holiday on repatriated foreign earnings, or in the longer-term adoption of a territorial tax system which would exempt all foreign income from US taxes. This year, the U.S. Treasury will lose \$100 billion from the abuse of foreign tax havens, as companies use legal accounting tricks, to shift domestic income and repackage it as foreign earnings, upon which taxes are indefinitely

deferred. Following the 2004 tax holiday on repatriated earnings, we witnessed over seven short years a near tripling of the amount of foreign earnings held by large corporation. Moving to a territorial tax system would be like a shot of steroids and this tax avoiding behavior would explode. We fear that putting a territorial tax system in place would further entrench a two-tier tax system in which large multinationals shift their profits offshore and pay little in U.S. corporate income taxes, while domestic manufacturers and those who invest in this country, including the vast majority of small businesses, would be penalized by having to pay a full share of taxes.

Rather than adopting a territorial tax system, we favor Congress reforming the corporate tax system, by closing tax haven loopholes that have undermined the corporate tax system, rendering it ineffective and inequitable. In this regard we support measures like the Stop Tax Haven Abuse Act, introduced in the last Congress, and expected to be reintroduced in the near future. We remember the tax reforms of 1980s in which corporate tax loopholes were closed, rates lowered and still more revenue from corporate taxes flowed into federal coffers. This should be the objective of the corporate tax reform Congress is presently considering.

Finally, we object to efforts to use small businesses such as ours as the reason for extending and deepening reductions in the top individual income tax rates. The false claim is that it would keep small business owners from being adversely impacted should corporate tax reform limit the tax expenditure deductions for flow-through businesses like ours. But the fact is that less than 3 percent of tax filers with any business income make over \$200,000 (individuals) or \$250,000 (couples) a year, and many of those are not small business owners, much less small business owner operators with employees. They include K Street lobbyists, Wall Street investment partners, big business CEOs paid to sit on the boards of other big companies, wealthy people renting out their vacation homes when they aren't using them and even President Obama, who earns book royalties. Reducing top individual income tax rates would not benefit the overwhelming majority of small business owners who do not pay at the highest rates. In fact, since we would also lose the tax expenditure deductions we presently enjoy, many of us will end up paying more in taxes, while our larger brethren pay far less.

In conclusion I wish the Committee to be aware of the following sign-on letter posted on the Business for Shared Prosperity website (www.businessforsharedprosperity.org), which outlines many of the positions I have just discussed. I ask that the letter reprinted below be included in the written record of the hearing.

Thank you.

Small Business Letter on Corporate Tax Reform

June 2, 2011

Dear President Obama and Secretary Geithner,

We, the undersigned business organizations, like most Americans, want a tax system that is fair and provides sufficient revenue for the public services and infrastructure that underpin our economy. When powerful large U.S. corporations avoid their fair share of taxes, they undermine U.S. competitiveness, contribute to the national debt and shift more of the tax burden to domestic businesses, especially small businesses that create most of the new jobs. We believe corporate tax reform should be guided by three principles:

First, all businesses – large and small – should contribute fairly toward the costs of government and the well being of the economy. U.S. corporate income taxes comprise just 1.3% of GDP, among the lowest levels among OECD countries. The average *effective* tax rate paid by U.S. corporations is half the statutory rate and is low by international standards. The corporate tax share of federal government receipts has dropped from 32% in 1952 to 9% now.

Our nation cannot afford corporate tax reform that is revenue neutral. This would leave corporate taxes as a share of our economy at current low levels. It would deprive government of the resources necessary to provide the services and infrastructure that underpin our economy and our global competitiveness. The Tax Reform Act of 1986 lowered the statutory corporate tax rate but closed so many loopholes it increased corporate tax revenues. At this time of large government deficits, deepening budget cutbacks and deteriorating infrastructure, corporate tax reform should again be revenue positive today.

Second, businesses should not be rewarded for shifting jobs and investment overseas or disguising U.S. profits as foreign profits to reduce their taxes. At present, we have a two-tier corporate tax system, in which some profitable businesses pay 35% of their income in taxes, while other profitable businesses pay nothing at all. Too many corporations have turned their tax departments into profit centers, creating strategies that shift jobs and investment abroad and practicing aggressive accounting manipulation to disguise U.S. profits as foreign profits. This is done for the express purpose of avoiding tax payments. For example, as Bloomberg BusinessWeek reported, “Google reduced its income taxes by \$3.1 billion over three years by shifting income to Ireland, then the Netherlands, and ultimately to Bermuda.”

Now we find Google and other corporate tax avoiders demanding a tax holiday in order to repatriate the funds they shifted offshore to avoid paying taxes. This proposed repatriation would cost the U.S. Treasury \$80 billion according to the congressional Joint Committee on Taxation and increase pressure to cut government spending on services that our businesses depend on. As business organizations, we oppose a tax holiday on repatriated dividends from

foreign subsidiaries. We also oppose any shift to a territorial tax system, which would accelerate aggressive transfer pricing and shifts of domestic profits overseas, permanently rewarding those who seek to avoid their taxpaying responsibilities. Instead, we need to stop this irresponsible tax avoidance, which undermines the U.S. economy, and assure that all businesses play by the same tax rules.

Third, by ending unproductive tax loopholes and subsidies benefiting large corporations, we can level the playing field and raise revenues needed to restore economic vitality. Corporate taxes, like individual income taxes, support the public services and infrastructure upon which all businesses depend. These include a publicly-educated workforce, transportation systems, safe drinking water and sanitation, the judicial system, taxpayer-funded research (which has played a crucial role in health advances and the creation of the Internet, for example), federal emergency response and so on. But the vital public services and infrastructure that underpin a healthy economy are now being cut dramatically because of inadequate revenues.

A transparent corporate tax system that assures all companies pay for the services upon which our businesses, our customers, our workforce and our communities depend, would help restore the economic vitality and domestic job creation we all seek.

Sincerely,

Holly Sklar
Executive Director
Business for Shared Prosperity

Frank Knapp, Jr.
President & CEO
The South Carolina Small Business Chamber of Commerce

Sam Blair
National Director
Main Street Alliance

David Levine
Executive Director
American Sustainable Business Council

Wendy Rosen
Founder
American Made Alliance

Alisa Gravit
Executive Director
Green America

Rudy Arredondo
President
National Latino Farmers & Ranchers Trade Association

Deborah Nelson
Executive Director
Sustainable Venture Network

Alison Goldberg
Coordinator
Wealth for Common Good



**Statement for the record of
Mr. David J. Kautter
Managing Director of Kogod Tax Center
American University Kogod School of Business
Washington, District of Columbia**

**Committee on Ways and Means
U.S. House of Representatives**

**Hearing on
How Business Tax Reform Can Encourage Job Creation
June 2, 2011**

Chairman Camp, Ranking Member Levin and Members of the Committee, thank you for the opportunity to submit written comments on the need for business tax reform to encourage job creation.

I have been a tax professional for over 35 years. For most of that time, I advised clients on tax matters as a partner with a Big Four accounting firm. I also served as tax counsel to former Senate Finance Committee member John Danforth (R-MO), and I have remained closely involved in the tax policy process over the entire course of my career, including the period leading to enactment of the historic Tax Reform Act of 1986.

As this Committee and Congress consider how our Federal tax code can foster job creation and growth, I ask you to remain acutely aware of the impact of any proposed changes in the tax law on small businesses, which generate most of the new jobs in our economy. As more fully explained in the written comments

that follow, I hope that you will give full consideration to how proposals to lower the corporate tax rate and broaden the income tax base will affect small businesses organized using a flow-through structure or as sole proprietorships. Flow-through entities encompass partnerships, limited liability companies and S corporations.

Background on the Kogod Tax Center

The Kogod Tax Center is a non-partisan research institute of the Kogod Business School at American University in Washington, D.C. The Kogod Tax Center promotes independent research and expands knowledge with respect to tax policy, tax planning and tax compliance for small and mid-size businesses, entrepreneurs and middle income taxpayers.

We work closely with the Kogod Business School's Masters of Taxation (MST) program. Under the leadership of Professor Donald Williamson, who is widely known among tax professionals nationwide, the Kogod MST program in advanced taxation for accounting students is one of the most highly respected graduate tax programs in the country.

Our goal at the Kogod Tax Center is two-fold: (1) to increase public understanding of critical tax policy, planning and compliance issues and (2) to advocate for tax policies that promote job growth and innovation. Specifically, we focus on the tax law's impact on three core groups of the American economy: small businesses, entrepreneurs, and middle-income taxpayers. Together these

core groups serve as our nation's economic engine. We believe their success will help pave the road—as they have in the past—toward a stronger, more competitive American economy

The Critical Importance of Small Business to the Economy

Small businesses are central to our country's cultural and economic foundations; they symbolize and embody the values of entrepreneurship, upward mobility, and innovation.

The small business sector is also the growth engine of our economy. Today, small businesses employ about half the U.S. workforce, and created 65 percent of our net new jobs over the past 15 years. They are the core not only of our domestic growth, but increasingly a critical component to competing in the global marketplace.

In debating the swiftest path to job creation, economic growth and deficit reduction, policymakers from across the political spectrum are beginning to call for significant corporate tax reform. Indeed, President Obama's fiscal year 2012 budget calls for "Congress to work with the Administration on corporate tax reform that would simplify the system, eliminate . . . special interest loopholes, level the playing field, and use the savings to lower the corporate tax rate for the first time in 25 years."

Many agree our corporate statutory tax rate—soon to be the highest in the world—hinders our economic competitiveness. The reasons for reducing it are

compelling. But current proposals for corporate tax reform that would lower the corporate statutory tax rate and eliminate many traditional business tax deductions or credits (that is, “broadening the tax base”) could have unintended consequences for small businesses. That is because the vast majority of small businesses are not structured as traditional “C” corporations, and thereby not taxed at the corporate rate. Rather, they are organized as flow-through entities or as sole proprietorships.

Therefore, simply reducing corporate tax rates and broadening the tax base without addressing the needs of unincorporated businesses could have an unintended and serious negative consequence: it would increase the tax burden on unincorporated businesses. That is not the type of action that would be productive as our nation continues to struggle to emerge from a deep recession and looks to the small business sector as a vital pillar supporting job and economic growth.

Flow-through Businesses In the U.S. Economy

Structurally, most small businesses are organized as sole proprietorships or flow through entities—partnerships, limited liability companies and S corporations. These entities are not taxed at the company level; rather, they “flow through” to their owners any income or loss. Individual owners report these amounts on their individual tax returns—and these amounts are taxed at individual tax rates.

Currently flow-throughs comprise more than 90 percent of all business entities, and individual owners of flow through entities pay over 40 percent of all business taxes.

Small businesses in particular benefit from the flow-through structure, because they are able to avoid the double taxation that applies to corporate income. Often faced with limited cash flow, a flow-through structure can provide a small business with the opportunity to reinvest more capital, expand services, hire more workers, and develop innovative technologies and business processes.

The Potential Impact of Corporate Tax Reform for Many Small Businesses

There is widespread agreement that the federal tax code is too complicated. The number of deductions, credits, phase-outs, alternative calculations, and more has reached mind-numbing proportions.

So far, most of the proposals for corporate tax reform discussed in the media rely primarily on eliminating some business deductions, preferences, and credits to increase the amount of income subject to tax, i.e. broaden the tax base, and then apply a lower corporate tax rate to that broader income base. In most of the proposals, under discussion, the base-broadening changes would apply to all businesses, including those that are flow-through entities and sole proprietorships.

If corporate tax reform moves forward in this way, small businesses will shoulder an increased tax burden because they would be subject to the base broadening effort but they would not benefit from the rate reduction benefits. This would happen at a particularly inopportune time as many small businesses are already struggling to stay afloat. This approach seems to make little sense if we are interested in growing our economy.

Comprehensive Business Tax Reform, Not Just Corporate Tax Reform

Congress faces three strategic alternatives with respect to reforming our business tax system. I would like to share my views on how each of these three strategic alternatives would affect small businesses that are sole proprietorships or organized using a flow-through structure such as a partnership, limited liability company or S corporation.

I would also like to comment generally on how each alternative advances the cause of good tax policy in the areas of sound tax administration, business competitiveness and jobs growth.

Alternative 1: Eliminate Certain Deductions, Preferences, and Credits Only for “C” Corporations, Lower Corporate Tax Rates, and Leave Current Rules Intact for Flow-through Entities.

This alternative would allow small follow-throughs to continue to benefit from current tax incentives, and to continue to be taxed under the current rules.

While this would seem fairer to small flow-throughs, this approach would create two tax systems, and add immense complexity to the Federal tax code, which most agree is something to avoid. This alternative also has a notable shortcoming: It would exclude flow-through entities from the economic and other benefits that come from simpler rules and lower rates.

Alternative 2: Eliminate Certain Deductions, Preferences, and Credits for All Businesses and Only Lower the Corporate Tax Rate.

This alternative would result in an increase in taxes for flow-through entities unless individual income tax rates are lowered simultaneously with corporate tax rates. However, lowering individual rates across the board would result in a significant reduction in revenue. Further, since individual tax rates are part of an integrated system, simply lowering the rates at which individuals are taxed without making concurrent changes to other individual tax rules is impractical. This raises the specter of having to reform the individual tax rules to reform business tax rules.

While the tax rules for individuals are every bit as much in need of reform as the business tax rules, there is a third alternative for Congress to consider that would allow reform of business taxes to move forward without having to reform the entire Internal Revenue Code.

Alternative 3: Eliminate Deductions, Credits and Preferences, and Apply the Same Reduced Corporate Rate—a Business Rate—to All Businesses Regardless of the Structural Entity by Which They Choose to Conduct Business

This alternative would be relatively simple to administer. Income from flow-throughs already appears on separate schedules on individual tax returns. Income from sole proprietorships is reported on Schedule C, and income from both partnerships and S corporations is reported on Schedule E of the individual tax return (Form 1040).

Under this alternative, all that would be required would be for a taxpayer who is an owner of a flow-through entity to add his or her income on those two schedules (C and E) together and subject the total to a reduced “business tax” rate schedule. This is what happens today for individuals who have qualifying dividend income and capital gains on schedules B and D. The remaining income on an individual’s return would be subject to tax under the individual income tax rules.

Conclusion

The Kogod Tax Center thanks the Committee for permitting us the opportunity to share our insights about how business tax reform can encourage competitiveness and job creation.

As you move forward on this extremely important undertaking to reform the Federal tax code, we ask you to give close examination to how changes might affect the vitality and competitiveness of small businesses, especially those organized as sole proprietorships or flow-through entities such as partnerships, limited liability companies and S corporations. Tax costs are often the largest expenditure of these businesses, and tax burdens have a direct impact on the ability of any business, especially a small business, to expand its operations and its payroll. We are not asking that you give special benefits to this vital sector of the economy but rather you not create any obstacles to its ability to grow.

The third alternative that we discuss above, namely eliminating deductions, credits and preferences, and applying the same reduced corporate tax rate (a business tax rate) to all businesses regardless of the structural entity by which they choose to conduct business, offers a sound approach that advances all of the Committee's goals and the goals of good tax policy overall.

A major advantage to this approach is that it would help to level the playing field for corporate and non-corporate entities. It would move us toward a single, comprehensive business taxation system—one that applies to all businesses equally across the board. If done right, it could ease compliance and increase simplicity and fairness. And ultimately, that could provide small businesses with the certainty they need in order to compete, thrive and create jobs.



June 2, 2011

The Honorable Dave Camp
Chairman
Committee on Ways & Means
U.S. House of Representatives
Washington, DC 20515

The Honorable Sander Levin
Ranking Member
Committee on Ways & Means
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Camp and Ranking Member Levin:

On behalf of the Retail Industry Leaders Association (RILA), I write to offer retailers' perspectives on tax reform for your committee's hearing today titled "How Business Tax Reform Can Encourage Job Creation." RILA supports tax policies that will improve the business climate for retailers, both domestically and internationally, by helping them continue creating jobs, investing in this country, and bring price-competitive value to American consumers.

By way of background, RILA is the trade association of the world's largest and most innovative retail companies. RILA promotes consumer choice and economic freedom through public policy and industry operational excellence. Its members include more than 200 retailers, product manufacturers, and service suppliers, which together account for more than \$1.5 trillion in annual sales, millions of American jobs and more than 100,000 stores, manufacturing facilities and distribution centers domestically and abroad.

Growth-Orient Tax Reform: Lower Business Tax Rate

The retail industry is vital to our nation's economy, representing one of the largest industry sectors in the United States with nearly 15 million jobs and \$3.9 trillion in annual sales overall in 2010. The industry pays billions of dollars in federal, state, and local income taxes, and collects and remits billions more in state and local sales taxes. At the federal level, retail taxpayers typically have among the highest effective tax rates, hitting the top statutory rate of 35 percent in many cases. As you consider tax-reform options, one of the most far-reaching options that the Committee could endorse would be a reduction in the federal tax rates on business income.

The last major overhaul of the system occurred with the enactment of the Internal Revenue Code of 1986, which substantially reduced the corporate tax rate along with major restructurings to the corporate and individual tax system. Over the ensuing 25 years, Congress has made thousands of changes to the tax code increasing its complexity and tax rates, resulting in greater burdens for American businesses. Today, the United States has nearly the highest statutory tax rate on corporate income, which has a number of significant ramifications for U.S. retailers.

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Overall, high corporate taxes reduce the availability of critically needed capital for business to invest in their workforce. A number of studies confirm that a significant share of corporate taxes is borne by labor. Thus, a reduction in the tax burden will free companies to create new jobs, increase real wages and income, and improve standards of living for U.S. workers. With the unemployment rate hovering around 9 percent nationally, this is a critical opportunity for Congress and the Administration to reverse the job losses that have occurred over the past several years.

Moreover, our current high corporate tax rate hinders retailers' ability to maintain their existing operation and invest for the future. Especially in the current economic environment where the flow of private-sector capital has been constrained, a lower tax rate would free up essential corporate earnings for investments in new equipment, facilities and products. Similarly, it would enable retailers to retain more of their earnings to reinvest for the long-term growth of their companies, which will contribute to nation's economic recovery and ultimately to sustained economic expansion.

Looking beyond the domestic benefits, a lower corporate tax rate also holds significant potential for improving the competitiveness of U.S. businesses. In recent years, a growing number of U.S. retailers have expanded into the global marketplace. Yet, the United States is set to have the highest corporate tax rate in the world once Japan implements its proposed rate reduction, and the United States remains one of the only countries with a system for taxing worldwide income. As a result, the United States has created a difficult environment for its multinational businesses to compete in the global economy. And further exacerbating this situation, other members of the Organisation of Economic Cooperation and Development (OECD) have been pursuing measures to reduce their tax rates. Lowering the U.S. corporate tax rate would help level the playing field for U.S. multinationals and encourage companies to keep jobs and investments in this country. At the same time, it is important to recognize the tremendous growth in the number of businesses operating as pass-through entities (e.g., sole proprietorships, partnerships, limited liability companies, and S corporations), including some RILA members. These business taxpayers are critically important to the U.S. economy and must be taken into consideration in the debate if overall tax reform is to be successful.

For the foregoing reasons, RILA applauds the Chairman's call for a significant reduction in the rate applicable to U.S. corporations and other forms of business. We encourage the Committee to endorse this approach as a step toward improving the business climate for retailers, both domestically and internationally, which will help the retail industry continue creating jobs, investing in new equipment and technologies, and contributing to the nation's long-term economic growth.

Principles for a Simpler, Permanent and Stable Tax System

While we believe a reduction in the business tax rates is fundamental to successful reform of the tax code, we also recognize that myriad other aspects of the tax law must be examined in the

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overall effort to broaden the tax base and simplify the tax code. To contribute to that goal, RILA has developed the attached a set of tax reform principles. These principles represent a foundation on which a tax system can be built that will achieve necessary revenues while minimizing the burdens and complexities of our current tax system, which stifle innovation, hinder job creation, and deter overall economic growth.

Fundamental to any successful tax reform is a simple, permanent, and stable tax system. While RILA strongly endorses the objectives underlying tax reform, we urge the Committee to be cognizant of this imperative. Every day, businesses across the country struggle with the increasingly complex tax code. Current law requires a substantial number of employees, advisors, and time for the required tax compliance, including tax accounting and reporting. Moreover, the current system also forces retailer to expend enormous resources to undertake annual audits by the Internal Revenue Service (IRS), which often entail a lengthy and costly process for resolving frequent disputes over the application of the tax laws and regulations.

Clearly, a simplified tax system would mean significant savings for taxpayers and the IRS by lowering compliance costs, reducing filing burdens, and minimizing disputes between taxpayers and the government, freeing resources to be put to more productive use.

Similarly, business taxpayers would benefit greatly from a tax law that is stable and predictable. Over the past two decades, dozens of provisions have been added to the tax code, many well intended and achieving their particular employment, investment, or other objective. Yet, in too many cases, these provisions were added on a temporary basis, even when the tax policy objective should have been permanent. Examples particularly relevant to the retail industry include 15-year depreciation for improvements to retail and restaurant property, the research and development tax credit, the Work Opportunity Tax Credit (WOTC), and the controlled foreign corporation look-through rules, to name a few. And, compounding the tenuousness of these provisions are recent instances when they have expired and taxpayers have been left with no certainty of even retroactive renewal until nearly the end of the year in which the tax provisions were supposed be effective.

Long-term planning is essential for business success, and with federal and state taxes playing such a significant role in retailers' financial decision making, the continual expiration and uncertainty of renewal of so much of the tax code has had adverse consequences – it has forced increased tax reserves, postponed investments in new facilities and improvements, and held back critically needed new jobs.

Accordingly, RILA urges the Committee to resist including temporary provisions in tax reform legislation. While we appreciate that significant changes to the current tax system will necessitate the need for transition rules, which are inherently temporary, we encourage the Committee to establish such rules that provide adequate time for implementation of a new tax system and that take into account existing agreements, practices, and other requirements without letting them become new expiring provisions that become another source of uncertainty.

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This country is in desperate need for an efficient and effective tax system. Once that is achieved, the temptation to make on going changes must be resisted.

Additional Retail Considerations for Tax Reform

For RILA members, the need for lower tax rates and a simple, stable and predictable tax code are top priorities for tax reform. As the Committee examines all the contours of tax reform, we also offer some considerations on select issues that have been of historic importance to the retail industry.

Inventory Accounting Methods

In the context of broadening the base, inventory accounting methods are often referenced as tax expenditures or benefits that could be eliminated. RILA strongly believes that such a view is erroneous and misguided. Any effective tax system must have rules to determine which goods are sold in a given year and which remain in a business' inventory for future sale. Similarly, procedures are necessary to determine the cost of the merchandise sold and the value of the products that remain in ending inventory for a business to clearly reflect its income that is subject to tax.

Without such rules, businesses would be forced to employ a system of specific identification, with each product sold having to be traced back to its original purchase price. In the retail environment such a system would be simply infeasible. A retailer may have hundreds of thousands of products for sale on a given day in hundreds of stores across the country. Moreover, a retailer will continually purchase quantities of a single product (e.g., style and size of a shirt, type of hammer, particular quantity of a brand of aspirin, etc.) in order to maintain a sufficient supply for sale. Since each product is indistinguishable from the other, it would be impossible to assign the actual cost to the product at the time it is ultimately sold.

Given that inventory accounting methods are indispensable, RILA submits that they should be treated as fundamental operating rules, not a tax expenditure or other benefit that could be eliminated to offset other tax reforms, such as a reduction in tax rates.

The existing inventory accounting methods, on which retailers have relied for decades, enable retailers to assign costs to the goods sold and reflect their income clearly. For the retail industry, these inventory accounting methods include the first-in/first-out (FIFO) method, the last-in/first-out method (LIFO), and the retail inventory method. For purposes of determining a company's remaining inventory at year end, financial and tax accounting rules also permit businesses in certain cases to write down the book value of an inventory item – under the lower-of-cost-or-market (LCM) method – to take into account a decrease in the economic value of the item offered for sale.

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We are concerned by the Administration's proposals in its budget submissions to repeal LIFO and LCM (particularly under the retail inventory method), both of which are widely used within the retail industry. For many retail businesses, LIFO is a much more accurate method for measuring financial performance and calculating the associated income tax. LIFO takes into account the greater costs of replacing inventory as costs rise, thereby giving a more conservative measure of both the financial condition of the business and the economic income subject to tax. Absent LIFO, phantom profits would be taxed, which would be inconsistent with the fundamental principle of U.S. tax law that unrealized appreciation in the value of assets is ordinarily not taxed.

LIFO repeal would have two adverse effects on countless retail businesses. First, they would have to recapture their LIFO reserves, which would result in substantial additional cash required to pay the resulting income tax, even if spread over several years, especially for businesses that have relied on LIFO for many years or even decades. This would amount to an enormous retroactive tax increase by repealing fully authorized deductions from income with respect to products sold, in many cases years or decades in the past. Moreover, since companies would have no economic income from such an accounting adjustment, they would effectively be taxed on non-existent cash flow. Second, LIFO repeal would create future tax increases for businesses if inflation accelerates as some expect due to the fiscal imbalances facing the United States. Since inflation increases prices, a business that can no longer utilize LIFO would have to calculate its taxable income based on older inventory costs that do not reflect the inflationary growth in prices, resulting in a higher future tax bills with less earnings available for growth, capital investment, and job creation.

Similarly, the LCM method allows retailers to write down the book value of their ending inventory that has declined in economic value, which frequently occurs with products like clothing at the end of a season or when particular styles change. The loss in value is a real economic loss, and these methods allow businesses to recognize the loss in the year it occurs rather than having to wait until it is able to dispose of the inventory. Moreover, any recovery in the value of the inventory in a subsequent year is not lost since the business would then recognize a larger amount of taxable income in the year the inventory is sold.

Repeal of the LCM method would mean higher taxes on a retailer that would no longer be able to account for a current economic loss in inventory value when it occurs. In addition, during economic downturns, the value of the LCM write-down will also grow, especially under the retail inventory method as retailers are forced to mark down retail prices. Thus, the repeal of the LCM method would have an even greater adverse effect on businesses' tax liabilities in a down economy, at a time when businesses can least afford additional tax liabilities.

Overall, inventory accounting methods are essential to any tax system. And, to achieve the goal of simplicity, stability and predictability, such accounting methods should be simple to apply in order to ensure proper compliance and predictably enforced by the IRS to minimize disputes.

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Investment in Workforce

Fundamental to every retail business is its workforce of sales associates, managers, and company executives, and for retail businesses to grow, whether by brick-and-mortar stores or online, requires a dedicated workforce to make the retail sales that ultimately contribute significantly to the overall economy. From that perspective, reducing the tax burden on American businesses holds significant potential for job creation by allowing retailers to invest tax savings in their workforce along with retail facilities.

Depending on the degree to which the tax rates are reduced, RILA urges the Committee to evaluate the continued benefits of providing employment incentives, such as the WOTC, which are intended to increase employment of individuals from specific targeted groups. Historically, the WOTC has helped offset the added costs of hiring and training individuals who rely on public assistance programs or are qualified veterans, disabled persons, low-income seniors, high-risk youth, or residents of designated areas. And, through these credits, businesses have helped disadvantaged individuals find meaningful employment in retail and other settings.

If the WOTC is retained as part of overall tax reform, which RILA would support, it should be made permanent, rather than perpetuating its current temporary status with periodic, and often retroactive, extension. Moreover, consideration should be given to simplifying the program to reduce the associated compliance costs. A permanent and simplified program would remove uncertainty in business planning, expand employer participation, and improve program administration.

Investments in Capital Assets

Along with its workforce, retailers must maintain an inviting, modern shopping environment to attract and maintain customer loyalty. Investment in new stores and facilities is an enormous financial undertaking that can be influenced greatly by the tax treatment of that investment along with the treatment of repair and remodeling costs, which typically occur every five to seven years. Whether a large format retail operation or a smaller store, retailers spend significant resources on "build out" and other improvements to reflect changes in their customer base and to compete with newer stores.

As the cost recovery rules are considered, RILA urges the Committee to ensure that they reflect the true economic life of the property. It is well established that the current 39-year depreciation period for buildings often bears little relationship to the economic life of such structures and even less to building improvements and upgrades required in successful retail businesses. The current 15-year recovery period for retail and restaurant remodeling costs is a step toward such an economically reflective cost recovery, although the period still exceeds the true life of the improvements in many cases. In order to achieve an accurate reflection of the income derived in large measure through such property, RILA believes that retailers, whether they own or lease

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their stores, should depreciate such improvements over their economic useful lives, rather than based on an arbitrary and substantially longer recovery period set out in the tax code.

Similarly, RILA urges the Committee to examine rules governing the capitalization of expense relating to capital assets versus those permitting the deduction of expenses for maintenance and repairs. The complexity and ambiguities surrounding such rules lead to ongoing disputes with the IRS, with substantial amounts of time and money spent to resolve issues, in some cases year after year. Clear rules would free up resources, facilitate investment in new facilities as well as improvements to existing ones, and ultimately support overall business growth and job creation.

International Tax Reform

RILA applauds the Committee's efforts to examine the international implications of tax reform on the competitiveness of U.S. businesses operating in the global economy. A growing number of U.S. retailers have expanded into the global marketplace in recent years through the establishment of both retail operations in other countries as well as subsidiaries that strengthen the supply-chain of goods and services they provide to their customers. With the United States being one of the last countries to tax worldwide business income and soon to have the highest corporate tax rate, U.S. retailers operating and looking to expand abroad face significant competitive barriers. These obstacles not only constrain a retailer's ability to grow internationally, but also cost the United States the well-paying jobs that a company typically must add to oversee such global operations.

As the tax reform debate progresses, we urge the Committee to continue examining the international tax regime and consider moving the United States to some form of a territorial tax system. With the United Kingdom and Japan most recently embracing such a construct for the taxation of foreign subsidiaries of their domestic companies, the United States should not be left behind while putting U.S. multinationals at a further disadvantage to their global competitors. We appreciate that shifting to a territorial tax system raises a number of challenges such as the treatment of intangible property, transfer pricing rules, and business expense allocation rules. Nevertheless, we believe that the benefits that such a system could bring in terms of simplification, improved competitiveness, and reduction in economic distortions would far exceed any challenges.

Retailers compete every day for consumers' loyalty and spending. The nation's tax rules, domestic and international, should foster their success – not erect competitive barriers – especially as retailers continue to expand into the global marketplace.

Individual Tax Reform

While not directly affecting the business income tax system, the individual tax rules have a significant indirect impact on the retail industry. Individual tax rates and taxable income have a direct effect on consumer spending as well as on their ability to save and invest, which is an

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important source of capital for retail businesses. Accordingly, RILA applauds the Committee's recognition that tax reform should not be undertaken piecemeal, but rather comprehensively. And, RILA urges the Committee to give careful consideration to the effect that tax rates, as well as other components of the individual tax code like the alternative minimum tax, have on consumer spending, which contributes to the overall growth in the economy and businesses ability to increase capital for investment and job creation.

Conclusion

Thank you for this opportunity to present our views on tax reform. RILA and its members look forward to working with the Committee to enact meaningful tax reform that includes provisions that support the retail industry and help it to continue to create jobs and grow.

Sincerely,

A handwritten signature in dark ink, appearing to read "Bill Hughes", with a stylized flourish at the end.

Bill Hughes
Senior Vice President, Government Affairs



PRINCIPLES FOR TAX REFORM

- **Keep tax rates low** – Enabling individuals to keep more of what they earn encourages savings and enables them to make purchases of needed consumer products, which also has the benefit of providing a major stimulus to the economy including sustained, improved retail sales. Similarly, low tax rates help American businesses by increasing capital for investment and job creation.
- **Enact simple, predictable and easy to understand tax rules** – A tax system that individual and business taxpayers can easily understand will improve compliance and reduce the cost of tax administration.
- **Establish tax rules that are consistent with economic reality** – For business taxpayers in particular, tax rules need to result in appropriate timing and accurate reflection of income without arbitrary rules that, for example, delay deductions beyond the period in which the income is earned or set depreciation periods inconsistently with the real economic life of the property.
- **Ensure the tax system fosters business competitiveness and promotes economic growth** – In an increasingly global economy, the tax system should not hinder the ability of U.S. businesses to compete internationally as well as domestically against foreign firms. A tax code that treats business fairly and equitably will minimize burdens on compliance and decision-making, thereby enhancing the productive capacity of U.S. businesses and the U.S. economy.
- **Implement reforms that ensure industry-specific neutrality** – Business decisions should be based on economic benefits of the particular transaction, not driven by special tax benefits targeted to one industry versus another. The economy does not benefit when the tax code chooses winners and losers. Accordingly, tax reform should allow the marketplace, not the tax system, to allocate capital and resources appropriately.
- **Avoid a whole-scale change in the tax base** – Dramatic shifts in tax policy, such as implementing a national retail sales or value-added tax, would be immensely disruptive to the economy and particularly detrimental to lower-income workers and families.
- **Make changes permanent and ensure certainty** – A new tax system must be permanent and stable, not littered with expiring provisions that cause uncertainty for families saving for college and retirement and business striving to expand, create jobs, and remain competitive in the United States and abroad.
- **Provide realistic transitions rules** – Significant changes to the current tax system will create substantial burdens on taxpayers, especially in the business sector, to ensure compliance. Establishing transition rules that provide adequate time for implementation and that take into account existing agreements, practices, and other requirements is essential for the success of any new tax system.
- **Recognize that tax revenues are one part of fiscal discipline** – As with any business, long-term fiscal viability requires careful management of *both* revenues and expenses. The tax-revenue lever can only be pulled so much and so often before it harms the business sector (with resulting effects on tax revenues from businesses, employees, and investments). Equal attention must be given to government spending to strike a reasonable balance with a tax code that fosters economic growth, job creation, and investment.