August 5, 2014

The Honorable Ron Wyden Chairman Committee on Finance United States Senate Washington, DC 20510	The Honorable Orrin Hatch Ranking Member Committee on Finance United States Senate Washington, DC 20510

Re: July 22 Senate Finance Committee Hearing "U.S. Tax Code: Love It, Leave It or Reform It"

Dear Chairman Wyden and Ranking Member Hatch:

The Organization for International Investment (OFII) appreciates the opportunity to submit comments in response to your recent hearing on the "U.S. Tax Code: Love It, Leave It or Reform It."

OFII is a business association representing U.S. subsidiaries of global companies, a business community that plays a major role in U.S. job creation and economic growth. OFII advocates for policies that increase U.S. competitiveness in attracting foreign direct investment (FDI) and works to ensure fair and non-discriminatory treatment for its member companies. FDI has long been vital to the American economy, providing millions of high-wage jobs, supporting the economies of local communities in all 50 states, and fuelling U.S. manufacturing, innovation, and exports.

U.S. subsidiaries generate precisely the types of high-value jobs and economic activities that policymakers want to maintain and grow. According to the most recent U.S. government statistics, U.S. subsidiaries employ 5.6 million Americans, or five percent of the private sector workforce and 17 percent of U.S. manufacturing jobs. They generate 6.3 percent of U.S. private sector GDP and undertake 14.4 percent of all U.S. non-residential capital investment. With a combined annual payroll of $438 billion and average employee salaries of $77,632, these companies provide well-paying jobs at levels substantially higher than the economy-wide average. Additionally, this business community comprises a significant portion of the U.S. corporate tax base; according to the most recently published IRS data, U.S. subsidiaries pay approximately 16 percent of total U.S. corporate income taxes – even though these companies make up less than 1 percent of all U.S. businesses with payrolls.

Unfortunately, the current policy debate on so-called inversions threatens to inadvertently impact all U.S. subsidiaries and make the United States less attractive for future FDI. OFII is concerned that legislative proposals go beyond the intended scope of limiting corporate expatriations of U.S.-based companies and instead will discourage foreign-based multinationals from allocating global resources to the United States.

OFII is specifically concerned by calls to tighten rules governing the deduction of interest expense and proposals that include management and control provisions in a new definition of an inverted company, such as the Stop Corporate Inversions Act (S. 2360 and H.R. 4679). These policies would have unintentional effects on foreign direct investment, while potentially doing little to stop U.S. companies from inverting.

OFII opposes further tightening of current rules on Interest Deductibility

OFII is concerned that attempts to tighten existing rules on the ability of companies to deduct interest expense may not be limited to U.S. companies that re-incorporate abroad through inversions, but instead impact all U.S. subsidiaries with foreign ownership. OFII urges the Committee to carefully consider the manner in which possible changes to the tax treatment of business debt will impact the U.S. investment climate, particularly given the economic benefits of FDI as outlined above.

The longstanding ability to deduct interest as an ordinary business expense is directly linked to critical economic activities and provides essential flexibility in a company's capital structure. The deduction for interest expense reduces the after-tax cost of debt financing and thus lowers the *cost of capital* for all businesses operating in the U.S., making investing here more attractive. Changes to the tax code, which arbitrarily penalize debt and increase the cost of capital carry the risk of reducing domestic investment, employment, wages, and economic growth.

One key source of investment financing for a subsidiary company is its global parent company. In addition to equity investment, the parent company plays a critical role in ensuring the U.S. subsidiary has access to the funding it needs to carry out its business activities – everything from meeting payroll to buying new equipment to building a new factory. U.S. subsidiaries are already subject to unique interest limitations under section 163(j) of the Internal Revenue Code, which was intended to prevent base erosion through "excess" interest expense. Section 163(j) limits deductions of interest on loans from a foreign related party, such as a non-U.S. parent company, even if the terms of the loan meet the arm's-length standard. It also imposes limitations on deductions of interest paid to an *unrelated* lender, such as a U.S. bank, when the loan is guaranteed by a related party (e.g., a parent or affiliate company).

The Treasury Department has periodically reviewed data on U.S. subsidiaries in relation to 163(j). These studies, including a 2007 report, found no evidence of wide-spread earnings stripping by traditional U.S. subsidiaries. Furthermore, a subsequent 2008 Treasury study found that U.S. subsidiaries and U.S.-headquartered corporations were largely on par in their levels of debt and profitability.

Likewise, recent IRS data from 2002 to 2011 (the latest available) on U.S. subsidiaries' tax payments, debt levels, and interest expense, both in aggregate and in comparison with all U.S. taxable corporations, provide no justification for broad changes to current earnings stripping rules.

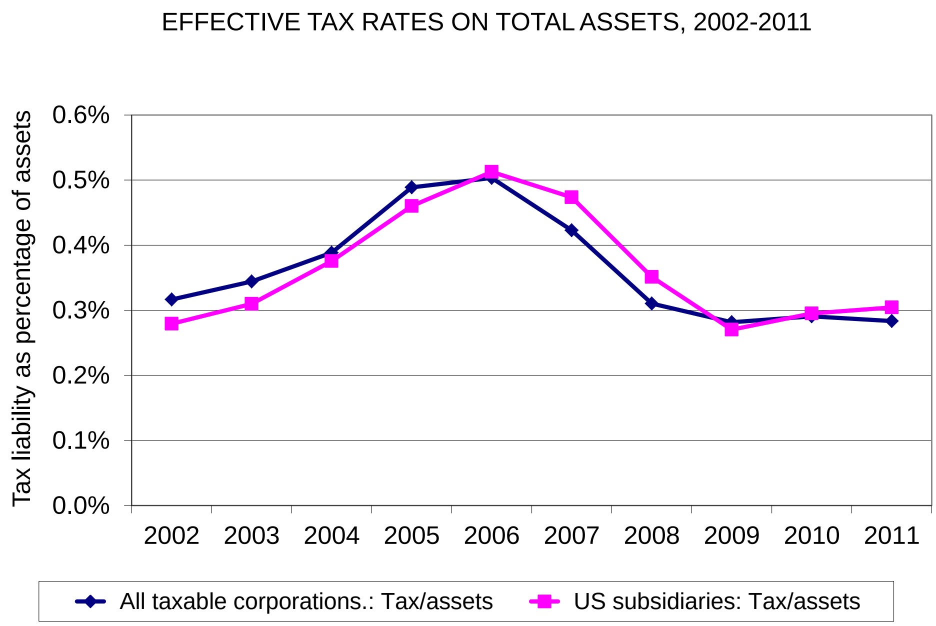
A key indicator of the extent to which earnings stripping may be a significant problem is whether U.S. subsidiary taxes are significantly lower than those of comparable U.S. companies. IRS data (see Figure 1) show that the effective tax rate[1] of U.S. subsidiaries (measured as a percent of assets) is comparable to that of all U.S. corporations.[2] IRS data suggest the effective tax rates of U.S.

[1] Effective tax rates are generally considered to be taxes paid as a percentage of economic income. Because federal tax returns provide no measure of economic income, total assets is used as an indicator of the ability or potential to earn economic income.

[2] S Corporations are excluded from these data; however, it is not possible to exclude mutual funds (RICs) and Real Estate Investment Trusts (REITs).

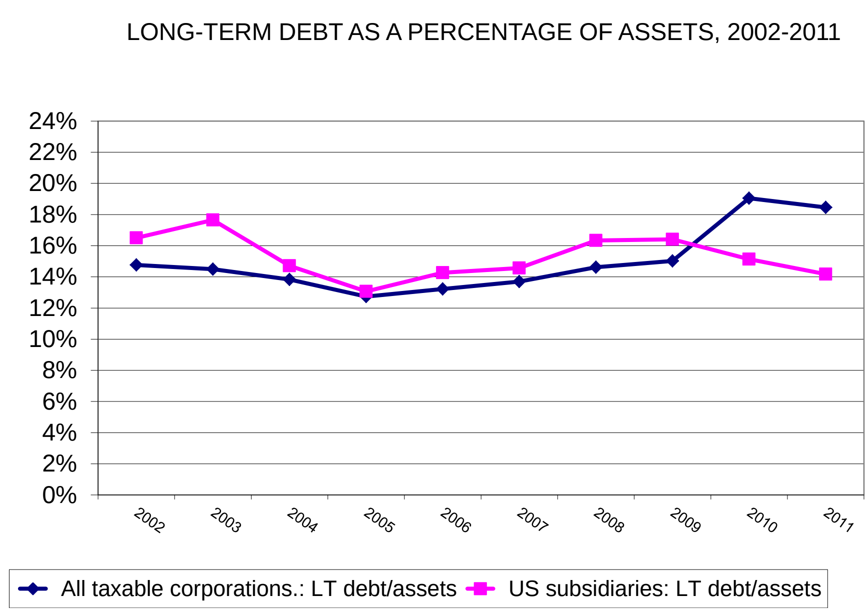
subsidiaries are similar to and vary in largely the same ways as those of all corporations, which generally relate to the state of the U.S. economy.

Figure 1



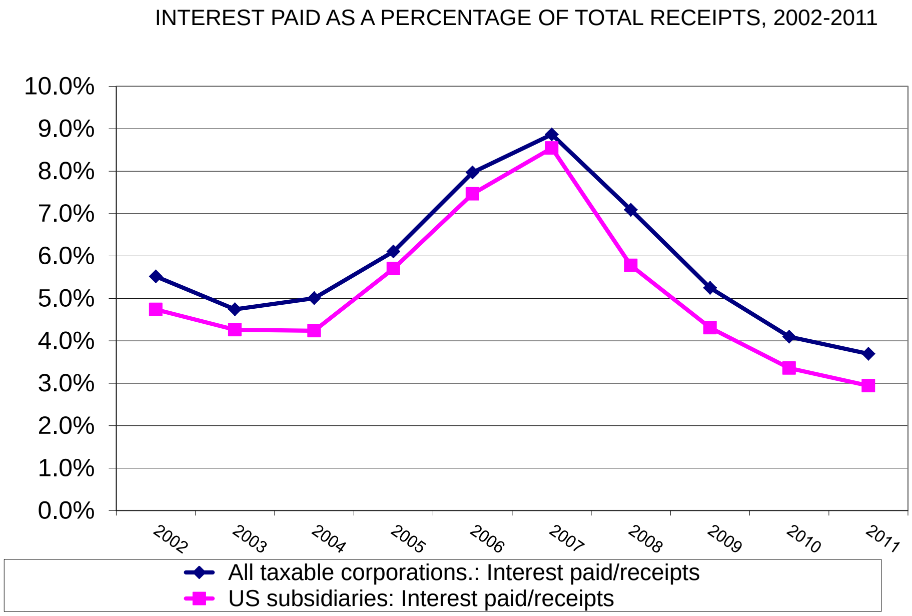
Over the most recent 10 years, trends in the long-term debt of U.S. subsidiaries generally have reflected economic conditions, increasing during periods of economic weakness and decreasing with economic recovery. Over the past 10 years, long-term debt as a percentage of assets peaked in 2003 at 17.6 percent and has declined to 14.2 percent in 2011. These same U.S. subsidiary data may be compared with the long-term debt of all taxable U.S. corporations. While U.S. subsidiary debt is generally a similar share of total assets compared with all taxable U.S. corporations from 2004 through 2009, the debt of all U.S. companies increased significantly to 19.0 percent in 2010 and 18.5 percent in 2011 (see Figure 2), while U.S. subsidiary debt declined to 15.1 percent and 14.2 percent, respectively.

Figure 2



Furthermore, U.S. subsidiary interest payments have declined sharply and are a lower percentage of total receipts than those of all U.S. companies (see Figure 3).

Figure 3



In short, multiple studies and many years of IRS data provide no evidence of a need to further tighten current rules governing interest deductibility for traditional U.S. subsidiaries. More importantly, additional restrictions on the ability of U.S. subsidiaries to raise capital through intercompany debt would make the United States a far less competitive environment for investment – especially for global businesses with a wide array of choices for where to place their investments.

OFII opposes Management and Control Test

Additionally, OFII strongly opposes the inclusion of management and control provisions in the Stop Corporate Inversions Act. These provisions, if enacted, could essentially – and inappropriately so – introduce a subjective management and control test for corporate residence into U.S. tax law, jeopardizing American jobs and undermining foreign direct investment.

Many U.S. subsidiaries with foreign headquarters have significant business activities in the United States, which include some senior-level management personnel. These management level jobs are of great benefit to the U.S. subsidiary and encourage additional investment and allocation of resources in the United States. Under the proposal, if such a foreign-parented group makes an acquisition of a U.S. business – however small – such acquisition could cause the foreign parent of the group to be treated as a U.S. corporation for tax purposes. This would capture foreign-based multinational companies that locate regional business units or business lines within the United States, likely resulting in senior management personnel and business units moving outside the United States. A management and control test creates a disincentive for future investment, discourages global companies looking to expand and grow in the United States, and threatens high-value American jobs.

Conclusion

OFII urges the Committee to avoid enacting measures that penalize historic U.S. subsidiaries of foreign-based companies. The U.S. tax code should encourage job-creating investment from all sources – including homegrown companies and those whose parent companies are headquartered abroad. Punitive measures that apply broadly to foreign-based companies would have a chilling effect on the U.S. investment climate to the detriment of American workers. This response would compound the problems policymakers are seeking to address in the current environment.

Ultimately, the best way to ensure U.S. competitiveness and encourage job-creating investment from all sources is through comprehensive tax reform. OFII is united with the broader business community in its support for a substantial reduction in the U.S. federal corporate income tax rate and elimination of unnecessary complexity that will provide the certainty critical to long-term business planning. The U.S. statutory rate – the highest in the developed world – is out of step with international norms, creates an artificial barrier to inward investment, and harms overall U.S. competitiveness.

When surveying the Chief Financial Officers of its member companies regarding factors impacting the U.S. investment decisions of global firms, OFII consistently finds that reducing the corporate tax rate will significantly increase investment in the United States and lead to further job growth associated with high-value FDI.

Thank you for this opportunity to comment. I appreciate your consideration and look forward to working with you as the Committee addresses tax reform.

Sincerely,

Nancy McLernon
President and CEO
Organization for International Investment