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The Committee on Ways and Means

Hearing on How Business Tax Reform Can Encourage Job Creation

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FULL COMMITTEE (HTTP://WAYSANDMEANS.HOUSE.GOV/SUBCOMMITTEE/FULL-COMMITTEE/)

HEARING ON HOW BUSINESS TAX REFORM CAN ENCOURAGE JOB CREATION

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS

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HEARING ON HOW BUSINESS TAX REFORM CAN ENCOURAGE JOB CREATION

Thursday, June 2, 2011
U.S. House of Representatives,
Committee on Ways and Means,
Washington, D.C.

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

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, at 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 Grand 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 statement of Mr. Corum follows:] (http://waysandmeans.house.gov/UploadedFiles/Corum_testimony.pdf)

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 statement of Mr. Galvin follows:] (http://waysandmeans.house.gov/UploadedFiles/Galvin_testimony.pdf)

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 statement of Ms. Brown follows:] (http://waysandmeans.house.gov/UploadedFiles/Brown_testimony.pdf)

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 statement of Mr. Zrust follows:] (http://waysandmeans.house.gov/UploadedFiles/Zrust_testimony.pdf)

Chairman Camp. Thank you very much.

Mr. Misplon, 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 online 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 statement of Mr. Misplon follows:] (http://waysandmeans.house.gov/UploadedFiles/Misplon_testimony.pdf)

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 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 statement of Mr. Stutman follows:] (http://waysandmeans.house.gov/UploadedFiles/Stutman_testimony.pdf)

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 you 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.

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Mr. Herger. 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 it 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. -- 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 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, 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 of 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 is 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 a 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: Mr. Stark Submission] (http://waysandmeans.house.gov/UploadedFiles/Mr_Stark_SFR.pdf)

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 talking 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 are 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.

RPTS KESTERSON

DCMN HOFSTAD

[12:03 p.m.]

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. -- 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 deduct 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 gimmes 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. -- 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. -- 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:
Mr. Levin, Question (http://waysandmeans.house.gov/UploadedFiles/Levin6211QFR.pdf)
Walter J. Galvin (http://waysandmeans.house.gov/UploadedFiles/Galvin6211QFR.pdf)
Judy L. Brown (http://waysandmeans.house.gov/UploadedFiles/Brown6211QFR.pdf)
James H. Zrust (http://waysandmeans.house.gov/UploadedFiles/Zrust6211QFR.pdf)
James Misplon (http://waysandmeans.house.gov/UploadedFiles/Misplon6211QFR.pdf)

Members Submissions for the Record follow:
Mr. Stark (http://waysandmeans.house.gov/UploadedFiles/Mr_Stark_SFR.pdf)
(http://waysandmeans.house.gov/UploadedFiles/Galvin6211QFR.pdf)

Submissions for the Record follow:
Research and Development Incentives in the U.S. and Abroad
(http://waysandmeans.house.gov/UploadedFiles/RESEARCH_AND_DEVELOPMENT_INCENTIVES_IN_THE_U.S._AND_ABROAD.pdf)
Aerospace Industries Association (http://waysandmeans.house.gov/UploadedFiles/Aerospace_Industries_Association.pdf)
The Depreciation Fairness Coalition
(http://waysandmeans.house.gov/UploadedFiles/The_Depreciation_Fairness_Coalition.pdf)
President and CEO, South Carolina Small Business Chamber of Commerce
(http://waysandmeans.house.gov/UploadedFiles/South_Carolina_Small_Business_Chamber_of_Commerce.pdf)
American University Kogod School of Business
(http://waysandmeans.house.gov/UploadedFiles/American_University_Kogod_School_of_Business.pdf)
The Center for Fiscal Equity (http://waysandmeans.house.gov/UploadedFiles/The_Center_for_Fiscal_Equity.pdf)
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