OFII | GLOBAL INVESTMENT GROWS AMERICA'S ECONOMY

Senate Select Committee on Federal Tax Code Implementation
Hearing on January 31, 2019

Chair Wagle, Vice Chair Kerschen and members of the Select Committee:

On behalf of the Organization for International Investment (OFII), I urge the Select Committee on Federal Tax Code Implementation to pass **SB 22.** While this bill tackles many conformity issues, this letter only addresses the bill's provision that would allow Kansas corporate taxpayers to subtract non-deductible interest expense under IRC §163(j).[1] OFII supports this provision because it would remove a corporate tax increase, prevent a hike in the cost of capital, alleviate compliance concerns and ensure the state remains competitive for international investment.

OFII is a trade association representing the U.S. subsidiaries of international companies, including over 60 Kansas employers. OFII's membership list is enclosed. OFII ensures that policymakers understand the critical role that foreign direct investment (FDI) plays in America's economy. OFII advocates for fair, non-discriminatory treatment of international companies and promotes policies that will encourage them to grow and hire in the United States.

International companies are vital to Kansas's economy. They provide jobs to 58,000 Kansans, including over 20,000 in manufacturing.[2] Nationwide, international companies employ 7.1 million U.S. workers, produce 25 percent of U.S. exports, fund 16 percent of U.S. research and development efforts and provide average compensation that is 26 higher than private-sector averages. Furthermore, international companies created 62 percent of new U.S. manufacturing jobs over the past five years.

SB 22's provision to allow a subtraction of non-deductible interest expense is important for the following five reasons:

- **Minimizes New State Corporate Tax Increases Post Tax Reform**: The Tax Cuts and Jobs Act (TCJA) was a seismic shift in tax policy that dropped the federal corporate income tax rate and added new base broadeners. Since states conform to this larger tax base but not to the rate cuts, conformity to the TCJA would increase Kansas's corporate tax base by 11 percent.[3] SB 22 would effectively deconform Kansas from the new federal limitations on interest expense deductibility under IRC §163(j). Doing so would reduce this sudden 11 percent increase to Kansas' corporate tax base.

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[1] The Tax Cuts and Jobs Act (TCJA) limits interest deductibility to 30 percent of a taxpayer's adjusted taxable income under IRC §163(j). This rule applies to almost all taxpayers and to both related party and unrelated party interest expense. Pre TCJA, companies that met certain tests could deduct all interest expense, which flowed down to their state returns because interest expense deductibility affects a taxable base. As a taxpayers base in Kansas starts with federal taxable income before making adjustments, disallowing interest expense deductibility for federal tax purposes will amount to a tax increase in Kansas.

[2] All data in this letter is from the Bureau of Economic Analysis, released December 2018.

[3] "The Impact of Federal Tax Reform on State Corporate Income Taxes," prepared by EY. Released March 5, 2018. Of all base broadeners, the limitations on interest expense deductibility is the largest increase to the federal corporate income tax base besides the one-time tax on repatriated earnings.

- **Prevents a Hike in the Cost of Capital:** The ability to deduct interest as an ordinary and necessary business expense is a longstanding principle of U.S. tax policy that reduces the cost of capital. Having more capital translates into building new plants and facilities in the United States or acquiring new assets to further grow in this market. However, failing to pass SB 22 would limit interest expense deductibility, which increases the cost of capital. This makes it more difficult for companies to justify investments in Kansas compared to other locations where their cost of capital is lower.

- **Improves U.S. Competitiveness:** Georgia, Indiana, Tennessee, South Carolina, Wisconsin and Connecticut passed legislation that has the same effect of SB 22 on interest expense deductibility.[4] As Kansas competes with many of these states for jobs and investment, the state should pass SB 22 to remain competitive.

- **Reduces Uncertainty:** Many Kansas corporate taxpayers file state returns on a combined group basis but will determine their interest limitations for federal returns on a consolidated group basis. As companies do not plan their debt limits down to the state-level, reconciling the differences between their federal consolidated and state combined groups will lead to complexity in determining a fairly-allocated interest expense limitation in Kansas.

- **Ensures International Competitiveness**: Kansas competes against other states and countries for FDI. Disallowing interest expense deductibility increase the cost of capital, which could alter an international company's investment. This is important because competition for FDI is fierce. In 2000, the United States attracted 37 percent of international investment flows but attracted only 25 percent in 2017.[5]

For these reasons, OFII urges the Select Committee on Federal Tax Code Implementation to pass SB 22. Thank you for considering this request. If you have questions, please contact Evan Hoffman, OFII's director of state government affairs, at ehoffman@ofii.org or (202) 659-1903.

Sincerely,

Nancy McLernon
President and CEO, Organization for International Investment

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[4] Georgia decoupled from IRC §163(j) in H.B. 918, enacted March 2. South Carolina decoupled from IRC §163(j) in H.5341, enacted October 3. Wisconsin decoupled from IRC §163(j) in A.B. 259, enacted April 3. Indiana decoupled from IRC §163(j) in H.B. 1316, enacted May 14. Connecticut decoupled from IRC §163(j) in S.B. 11, enacted May 31. Tennessee decoupled from IRC 163(j), effective in 2020, in SB 2119, enacted May 21.

[5] This data point is from the United Nations Conference on Trade and Development (UNCTAD)'s World Investment Report 2018.

2019 OFII Membership List

ABOUT OFII The Organization for International Investment is a not-for-profit business association in Washington, D.C., representing the U.S. operations of many of the world's leading international companies. OFII advocates for fair, non-discriminatory treatment of foreign-based companies and promotes policies that will encourage them to establish U.S. operations, increase American employment and boost economic growth to ensure the United States remains the top location for global investment. For more information, please visit www.OFII.org.

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Global Atlantic Financial Company
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