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Chairman Orrin Hatch (R-UT)
Senate Finance Committee
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Hatch,

The Metals Service Center Institute (MSCI) appreciates your call for stakeholder feedback, comments, and proposals for federal tax reform. As you noted in your June 17, 2017 letter to stakeholders, our tax code is outdated, unfair, and too complex. MSCI believes the current Internal Revenue Service (IRS) code puts members of the U.S. industrial metals supply chain at a disadvantage against their foreign competitors and, as such, we strongly support efforts to pass comprehensive tax reform.

MSCI's comments will address three of the four categories that you outlined in your letter to stakeholders:

- Strengthening businesses – both large and small – by lowering tax rates and broadening the relevant tax base in order to put the economy on a better growth path and create jobs;
- Removing impediments and disincentives for savings and investment that exist in the current tax system; and
- Updating our international tax system in order to make our nation more competitive in the global economy and preserve our tax base.

First, a little bit about the industry that MSCI represents.

Who We Are

MSCI is a U.S. trade association representing more than 300 member companies that operate in more than 1,200 business locations across North America. Our membership is very diverse, consisting of primary metals producers, metals service centers, and others with a vested interest in the industrial metals supply chain. The industry, including primary producers and metals service centers, employs more than 400,000 people, paying more than $30 billion in wages and generating more than $180 billion of economic impact to the United States economy. Metals service centers supply the metals requirements of an estimated 300,000 downstream manufacturers and fabricators.

Collectively, service centers represent an important outlet for domestic aluminum and steel mills. Service centers inventory, cut, fold, shape, polish, and further process metals purchased from both domestic and foreign mills and then sell these processed products directly to manufacturers, fabricators, machine shops, and others in the industrial metals supply chain.

Given the position of service centers as the "middlemen' within the industrial metals supply chain, MSCI believes they are an important barometer of the health of the entire industrial metals industry.

Service centers will suffer economic harm if our tax system is unbalanced. The entire industrial metals supply chain – mills, service centers and the downstream U.S. manufacturing base – require a strong and viable U.S. production base. Like the country as a whole, the entire industrial metals industry requires thoughtful tax policy initiatives that will facilitate broad economic growth and will keep jobs here in the United States.

MSCI's Principles For Tax Reform

MSCI supports comprehensive federal tax reform and we very much appreciate your efforts to tackle this broad and complex issue. We also understand that comprehensive tax reform will require trade-offs. Our members are willing to accept certain trade-offs, provided there are **substantial** reductions in **both** the corporate and individual income tax rates. Tax reform must deliver parity between corporations and the millions of small and medium-sized businesses that pay through the individual tax code.

In general, we believe reform should produce a total rewrite of the Internal Revenue Service code and must:

- Create a globally competitive North American manufacturing industry by reducing, not increasing, the tax burden on members of the U.S. metals industry.
- Ensure that the approximately 28 million pass through businesses that pay their federal taxes through the individual income tax system are treated equitably and fairly by passing comprehensive, not corporate-only, tax reform.
- Safeguard against certain individuals, businesses or industries benefitting over others.
- Retain the interest deduction and move to a cash based taxation system that allows the current expensing of machinery.
- Maintain the last in, first out (LIFO) accounting principle in its current state—retroactive repeal must be taken off the table completely.

- Move to a territorial tax system and allow U.S. companies that have a global footprint to bring back their overseas profits without double taxation. End the estate tax once and for all.
- Establish permanent policies that foster certainty and avoid temporary fixes that breed business and individual taxpayer anxiety.

Relief and Parity For C-Corps and Pass Through Entities

Successful tax reform must be measured by lawmakers' ability to reduce discrepancies between the corporate and individual tax systems and to create a more level playing field for businesses of all sizes across all industry sectors.

Like the vast majority of businesses in the United States, most MSCI members are structured as S corporations or Limited Liability Companies and have their profits taxed as individuals. As the Coalition for Fair Effective Tax Rates noted in a letter last year to your counterparts on the House Ways and Means Committee, the disparity in effective tax rates paid by different U.S. industries is huge. According to the U.S. Treasury, effective rates, e.g. actual federal corporate tax rates, paid between 2007 and 2010, ranged from 30.3 percent by construction firms, 29.4 percent by services companies and 27.9 percent by wholesaler-distributors and retailers to 17.7 percent by leasing companies and 14.5 percent by utilities. The gap is simply unfair.

Tax reform must be extended to both C-corporations and pass through entities. There has been much discussion about a corporate-only tax package – that is simply unacceptable to our membership. Such a plan would not only be unfair, it would hurt the U.S. economy. The goal of tax reform should be to create parity across *all* U.S. businesses so that the United States is more globally competitive, not just among our largest corporations. Businesses that pay through the individual tax system employ just as many workers as corporations, and they account for more than half of all business income. Keeping rates high for pass through entities will make it harder for these businesses to provide good benefits for current employees, hire more workers, increase investment, and remain competitive.

There's a lot of talk in Washington about economic fairness and ending income disparities in America. When it comes to tax reform, lawmakers worried about fairness have a chance to prove to their constituents that they're serious about this principle. To ensure that tax reform truly results in a simpler, fairer and more competitive tax code that incentivizes all U.S. businesses to expand and create jobs, Congress needs to reduce top tax rates for all types of taxpayers

Interest and Expensing

Tax reform must maintain the interest deduction. Access to investment loans are required by most businesses in order to reinvest, grow, modernize and enhance productivity. Reinvestment and growth are key to maintaining and creating new jobs, developing higher skilled workers and maintaining U.S. competitiveness. Reducing or eliminating a business's ability to deduct interest would reduce and undermine incentives to encourage research and development, productivity reinvestment, new product development and skills training. Debt has historically provided an efficient means of business financing, but debt financing would likely become underutilized without a deduction for interest, which could lead to a string of undesirable results.

Because of the interest deduction, firms are encouraged to use debt, which is good for industry. In effect, increasing the borrowing pool will increase industry awareness, as lenders will continually examine potential borrowers. Ultimately, this decreases lending costs as lenders have access to more sources of industry information. This also makes lenders more willing to lend, as they can spread their risk throughout multiple positions. Being able to spread risk allows lenders to make more loans, which leads to more funds being made available for reinvestment, innovation, and jobs.

Debt is also good for market discipline. Every lender examines a borrower's financial condition before making a loan. As such, potential borrowers will have more incentive for successful investments. As a condition to a debt issuance, lenders will require covenants and perform an oversight function on the borrower's continued financial condition. In this manner, a lender with industry experience plays an oversight role in the borrower's operations. Without this corrective factor, a borrower may be more apt to take unsound positions.

Debt without a deduction for interest can have negative consequences. It has been hypothesized that debt is a signal that the borrower cannot generate enough funding internally, and may be facing financial hardship. This theory has the effect of negatively affecting all borrowers through higher interest rates than would otherwise be economically efficient and a risk of their stock being devalued.

The deduction for corporate interest counteracts negative implications of borrowing in several ways. First, the deduction offsets the increased borrowing costs, encouraging a more efficient lending rate. Second, the interest deduction reduces the signal that borrowers are financially troubled since a borrower's use of debt may be seen as prudently blending debt and equity to maximize investment, rather than using debt as a last resort.

The corporate interest deduction also is good tax policy for several reasons. First, if interest payments are not deductible, there would effectively be a double-tax on interest, as the interest would be taxed when received by the borrower as income and taxed again when received as interest income by the lender. It would be proper for the borrower to deduct its interest payment so the interest gets taxed to the lender instead. Second, the interest deduction is in line with the concept of the corporate income tax, since, like salaries, investments in depreciable assets, and other expenses interest is among one of the costs of income creation.

Debt is a business expense and is used solely for creation of income. As such, the interest deduction is good for American business and good tax policy, independent of other provisions such as expensing of corporate investments.

We would also like to a see a move closer to a system that allows for accelerated or immediate deductions for certain capital expenditures of machinery and equipment. However, if forced to choose between expensing and the interest deduction, we clearly prefer the interest deduction. Metal service centers maintain and manage the inventory for the entire industrial metals supply chain. Maintaining the proper levels of inventory requires a significant level of debt financing with interest payments that are large in comparison to our members' net income. Losing the interest deduction would result in a huge permanent tax increase for members of our industry while receiving a much smaller temporary benefit from expensing. If the committee favors expensing with loss of the interest deduction as a pay-for, we would recommend that this be made an optional election to avoid harming capital-intensive industries such as ours.

Last-In, First-Out (LIFO) Accounting Principle

MSCI understands that lowering the top corporate and individual tax rates will require trade-offs. However, we believe that LIFO repeal, especially retroactive LIFO repeal, should be taken off the table as one of those trade-offs. Ending LIFO is a significant tax increase for many of our members and could very well put many of our members out of business. Our members could only accept LIFO repeal if rates are reduced to such a level that repeal would not result in an effective tax increase.

As noted by the LIFO Coalition in a 2015 letter to your office, the LIFO method of inventory is used by a diverse array of American companies, including hundreds of thousands of pass-through businesses, to most accurately record inventories and measure income. Despite the widespread use of LIFO, LIFO repeal has been considered several times in recent years as a way to raise revenues to offset various spending initiatives or to pay for certain tax reform objectives.

All the proposals to repeal LIFO have included a feature requiring LIFO users to recapture to taxable income their existing LIFO reserves, further exacerbating the adverse impact of LIFO repeal. Under this approach, LIFO users would be required to pay a retroactive tax on their existing LIFO reserves, long before such amounts would ever be due under current law. This would force many businesses to make the choice between going into significant debt or going out of business, with some not having a choice, since they would not be able to secure financing. For these reasons, keeping LIFO in the tax code will promote ongoing economic growth; repealing LIFO will have exactly the opposite effect.

Therefore the issue of LIFO reserves also must be considered. The tax savings from LIFO has built up over 50 to 70 years for many LIFO users. That tax savings is not sitting in the bank; it has been used to finance the replacement of inventory at ever increasing prices. Most businesses that are required to repay the tax savings from LIFO will not have to do so until they sell their entire inventory and go out of business, which would then provide a funding event enabling the business to repay the accumulated tax savings from LIFO. Being forced to pay back that tax savings now, even if spread over a number of years, will irreparably harm those businesses.

According to a 2013 Congressional Budget Office (CBO) estimate, LIFO repeal would increase taxes on U.S. businesses by $112 billion over 10 years. The CBO also explains that implementing tax rate reform alongside LIFO repeal would not mitigate the harm done to LIFO-dependent businesses. Indeed, several MSCI members have said LIFO repeal could very well put them out of business.

Moving Toward A Territorial System

The U.S. House and the White House have both proposed a move to a territorial tax system. MSCI supports this proposal because it will allow U.S. companies to repatriate their earnings, creating more capital flowing through the economy to create jobs and investment here at home. As the House Ways and Means Committee "Blueprint" noted, "The existing U.S. international tax regime has led to trillions of dollars in foreign earnings of American-based companies being 'stranded' overseas because the tax rules discourage companies from bringing those earnings back to reinvest at home."

A move to a territorial tax system also will make the system fairer and will ease our members' tax compliance burden. It will make U.S. companies more competitive against global competitors since the majority of our major trading parties operate on a territorial tax system. We cannot be left behind. Now is the time to make this long-needed change to encourage greater investment in the United States by both foreign and American businesses.

Estate and Gift Tax

This past January, MSCI joined the Family Business Coalition on a letter to Senate leaders that called for full repeal of the estate, or death tax. Repealing the death tax would spur job creation and grow the economy. Last year, the Tax Foundation found that the United States could create more than 150,000 jobs by repealing the estate tax. A 2012 study by the House Joint Economic Committee found that the death tax has destroyed over $1.1 trillion of capital in the U.S. economy. Lawrence Summers, former Secretary of the Treasury under President Clinton; Alicia Munell, member of President Clinton's Council of Economic Advisors; Joseph Stiglitz, a Nobel laureate for economics; and Douglas Holtz-Eakin, former Congressional Budget Office director have all published work on the death tax's stifling effect on job growth and the economy as a whole.

The estate tax does significant damage to family-owned businesses while doing little to ease our federal deficit. Our January letter also noted that the death tax only contributes a small portion of federal tax revenues, about one half of one percent to be exact.

Transition Times

Ensuring adequate, transparent and clear transition times and rules will be vital for the metals industry. A chief driver of the health of U.S. metals service centers is successfully managing inventory, cash flows and liquidity. As the middle-man of the industrial metals supply chain, a major and primary function of services centers is maintaining and distributing the right metals inventory to downstream fabricators and manufacturers at the right time. Any changes to U.S. tax law must consider appropriate transition rules and periods for service centers to be able to effectively maintain appropriate inventory quantities and types to respond to the shifting market demands and thus perform their critical role in the supply chain.

Certainty Is Crucial

For too long, Washington has set tax policy on a temporary basis, passing stopgap extensions to critical tax policies. For example, in 2001 and 2003, Congress passed significant tax cut packages, but the majority of the provisions in these bills, including the estate tax, which should be fully repealed, expired within a decade. Lawmakers extended the cuts until the 2012/2013 fiscal cliff crisis. Facing an expiration of all the 2001 individual income tax rate reductions, Congress and the White House then cut a deal that raised income, capital gains, and dividend taxes for many taxpayers, including some pass-though entities.

Setting tax policy on a year-to-year, or even decade-to-decade basis fuels uncertainty, stifles growth and inhibits investment. Business must be able to plan well into the future, we urge you to make your tax bill permanent.

Growth or Revenue Neutrality?

The United States is burdened with a large national debt, persistent annual federal budget deficits, and unsustainable entitlement programs. Higher taxes will not solve these problems, and will only make it harder for U.S. companies to create jobs, invest in expanding their business, provide quality employee benefits and compete against their global counterparts. Alternatively, establishing more competitive tax rates for small businesses, corporations and individuals will make the United States a more attractive place to invest, live and work. A stable, fairer tax system that encourages risk and investment will spur greater economic growth, which will produce higher revenues for the federal government.

With the national debt nearing $20 trillion, MSCI recognizes lawmakers will be under significant pressure to keep comprehensive tax reform "revenue neutral." While this goal is laudable, and lawmakers should take care not to add to the national debt or annual budget deficits, revenue neutrality should not be a stated principle for tax reform. The Senate Finance Committee's goal, instead, should be to create a system that will restore growth and competitiveness, which in turn will ensure more tax receipts flowing into the Treasury.

Conclusion

MSCI urges members of Congress to complete a comprehensive tax reform package as soon as possible, but to take time to get this reform right. Thank you for engaging stakeholders now and we encourage you to do so throughout the policy-making process. We look forward to continuing to work with you and your team.

Many thanks,

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