

Submission of the Semiconductor Industry Association
U.S. House Committee on Ways and Means
Hearing on “*How Tax Reform Will Grow Our Economy and
Create Jobs Across America*”
May 18, 2017

Introduction

The **Semiconductor Industry Association** (“SIA”) appreciates the opportunity to provide to the House Committee on Ways and Means our priorities for comprehensive tax reform. SIA is the voice of the U.S. semiconductor industry. We commend the chairman, members of the committee, and staff for this hearing and continuing efforts to improve our tax system. SIA supports efforts to lower the U.S. corporate rate, move to a territorial international system with appropriate transition rules, and enhance U.S. incentives for research and development.

SIA supports the Better Way corporate tax reform blueprint as an appropriate starting point for reform. We believe the Better Way corporate tax reform blueprint would make America’s corporate tax system more competitive and allow U.S. semiconductor companies to grow, innovate, and create more jobs in the United States. While there are many details of significance to our industry that need to be understood and addressed, we support the proposal as a framework for moving forward with tax reform.

Background on the U.S. Semiconductor Industry

America’s semiconductor industry is critical to U.S. economic growth and national security. Semiconductors are the fundamental enabling technology for the modern economy and an essential component of our nation’s defense and homeland security, information

technology, global finance, transportation, and health care. The U.S. semiconductor industry is one of the world's most advanced manufacturing sectors, and the U.S. semiconductor industry is America's number one contributor to labor productivity growth by making virtually all sectors of the U.S. economy more efficient.

The U.S. semiconductor industry leads the world, accounting for roughly half of global market share through sales of \$164 billion in 2016. Nearly half of U.S. semiconductor companies' manufacturing base is located in the United States, and 21 states are home to semiconductor manufacturing facilities. Over 80% of industry sales are outside the United States, making semiconductors America's fourth-largest export.

Our industry directly employs nearly 250,000 people in the United States and indirectly supports more than 1 million additional American jobs. In 2016, the U.S. semiconductor industry invested approximately 20 percent of revenue into research and development (R&D). This was the second-highest share of any industry.

Global Competition for U.S. Semiconductor Companies

SIA would like to draw the Committee's attention to the fact that the tax policies of other countries present two tiers of competition for the U.S. semiconductor industry. The first tier is the competitive pressure we face along with other U.S. industries because many foreign countries have more attractive tax systems. The U.S. currently has the highest corporate tax rate in the Organization for Economic Cooperation and Development (OECD). In addition to lower rates, most other OECD countries have a territorial tax system. When their companies invest in subsidiary operations in another country, the tax imposed by that other country on the earnings from the investment will generally be the final tax imposed – home country tax generally does not apply when the earnings are repatriated. Finally, the U.S. research tax credit has fallen far behind the incentives for research offered by other countries. These

features of other tax systems – lower rates, a territorial system and strong research incentives – are imbedded in the tax laws of other countries and are available to any taxpayer with transactions that qualify.

Additionally, a second tier of competitive pressures for our industry come from special incentives that are given selectively by governments to taxpayers that bring to the country strategic investments. In our case, governments offer incentives for locating wafer fabrication, assembly/test or R&D. These incentives include full or partial “tax holidays” and other benefits such as loans and reduced utility costs. Countries target the semiconductor industry because they understand that semiconductor manufacturing and R&D operations have a significant positive “spillover” effect on their economies in the form of employment in high tech jobs and the development of an engineering and technology infrastructure. Over time, a package of these incentives usually results in a substantial cost advantage for an operation, compared to a similar operation without such incentives.

These competitive advantages create an after-tax income differential that results in our competitors having more funds for investment, more funds for R&D, and more of a profit cushion so they can drop prices when competing against U.S. semiconductor manufacturers. Importantly, if cash flow from our overseas operations is more valuable in their hands than in ours simply because of tax differences, it is likely that, over time, they will seek to acquire our operations, or more U.S. economic activity will migrate offshore – the after-tax return on offshore investment is simply too compelling. With higher after-tax profit margins, cost of capital is reduced creating financing, offshore hiring, and capital investment advantages. Corporate tax reform must level the multinational competitive landscape for U.S. companies and reinstate the U.S. as an attractive investment location.

Lower, Globally Competitive Tax Rate

The United States currently has the highest corporate tax rate in the OECD. In order for the U.S. to maintain its global leadership in high-tech manufacturing, we must move to an internationally competitive corporate rate of 20 percent or less; at 15 percent, the return to U.S. productive capital investment would reach a tipping point.

While a focus on the OECD average tax rate is useful, it's important to note that U.S. semiconductor companies also compete with companies headquartered in countries outside of the OECD, and their average tax rate is significantly lower. This creates strong competitive advantages for foreign semiconductor companies and we urge policymakers to address these critical areas.

SIA strongly supports the 20 percent rate proposed in the Better Way blueprint, as well as the 15 percent rate proposed by the Trump Administration. These significant reductions in the corporate rate would substantially enhance the competitiveness of semiconductor design and manufacturing in the United States.

Territorial International Tax System

The current U.S. international tax system has been widely criticized. By taxing revenues of foreign subsidiaries of U.S. companies (controlled foreign corporations, or CFCs) at the statutory rate of 35 percent, current law reduces the competitiveness of U.S. companies operating in foreign markets and discourages U.S. companies from repatriating overseas income to the United States and investing it here. Most OECD nations employ a territorial system. In order for the U.S. to maintain its global leadership in high-tech manufacturing, it must move toward a more competitive, territorial international tax system.

Rules for a transition to a territorial system, including a tax on historical CFC earnings that have not been repatriated to the U.S. parent, are a critical issue for the U.S. semiconductor industry. SIA maintains that any mandatory or deemed repatriation should only be considered as a transition to a territorial system in the context of tax reform. SIA also recommends that any transition tax impose a lower rate on earnings that have been invested into plant and equipment than the rate imposed on cash and cash equivalents. This is of particular concern because semiconductor manufacturing is a capital-intensive industry where companies may have reinvested a significant portion of those earnings in high-cost capital equipment.

Companies that have invested in capital assets outside the United States to address the needs of a global marketplace and the cost of capital advantages associated with offshore investment could face a significant tax liability without any corresponding increased cash flow to pay the tax. Any transition tax would impose additional costs and financial statement liability on U.S. companies while their competitors would face no comparable burden during the same period. This may lead to foreign acquisitions of U.S. companies and mergers of U.S. and foreign companies resulting in more offshore headquarters. To ameliorate this concern, companies must be allowed to pay this tax liability over several years. Furthermore, companies must be permitted to elect to offset the tax liability of a deemed repatriation with net operating losses (NOLs).¹

In recent years, the semiconductor industry has experienced a wave of consolidation as companies have acquired and merged with others to reach greater economies of scale and more effectively compete with foreign rivals. As long-term business planning is intrinsic to growth and

¹ If NOLs at 35 percent value are used 1-to-1 against a repatriated amount taxed at a rate significantly lower than that, it would result in a significant loss of value of the NOL. The NOL used must be computed as: $\text{NOL utilized} * \text{deemed repatriation tax rate} / 35\%$. See Section 37B of Singapore tax law (Adjustment of capital allowances and losses between income subject to tax at concessionary and normal rates of tax) as an example of a provision to allow previous NOLs to maintain their tax value when carried forward to lower tax years.

investment strategies, it is important that these business practices are not penalized and that the repatriation rules do not excessively tax foreign cash that is already committed to an acquisition. SIA supports a provision that would treat foreign earnings committed to the acquisition of a foreign company as amounts that have been reinvested to ensure that cash committed to an acquisition is not unduly taxed.

SIA supports the deemed repatriation provisions contained in the Better Way blueprint. The bifurcated rates – an 8.75 percent rate for cash and cash equivalents, along with a 3.5 percent rate for historical CFC earnings that have been invested into plant and equipment – properly address the issues raised above. The 8-year period during which companies would be allowed to pay the liability will minimize the short-term costs and disruptions in this transition.

Incentives for U.S. Research and Development (R&D)

Robust incentives for research and innovation that are competitive with incentives in other countries are another SIA priority. In 2016, the semiconductor industry invested into R&D 20 percent of total revenue – the second-highest share of revenue of any U.S. industry. Retaining the R&D credit and increasing the amount of the Alternative Simplified Credit (ASC) to 20 percent would support semiconductor research and design in the U.S. and American jobs in these fields. The U.S. R&D tax credit is primarily a jobs credit; 70 percent of credit dollars are used to pay salaries of U.S.-based researchers.

Other proposals regarding research tax incentives would harm the U.S. semiconductor industry and deter future research investment in the United States. Computer software is a key element in semiconductor design and manufacturing, and SIA opposes proposals to remove computer software from credit eligibility. No other country specifically denies credit eligibility for all software costs. Similarly, disallowing the credit for the cost of supplies would also reduce the positive effect of the

credit for U.S. semiconductor manufacturers since equipment, raw materials, and other instruments are used in semiconductor manufacturing research. Finally, proposals to limit the ability of companies to deduct the costs of U.S.-based research activities will act as a disincentive to research investment, and companies should not be required to capitalize these costs.

SIA strongly supports maintaining the R&D credit, as envisioned in the Better Way blueprint. SIA also urges Congress and the Administration to enhance the credit by increasing the rate of the ASC to 20 percent. In the 114th Congress, SIA supported H.R. 5187, the Research and Experimentation Advances Competitiveness at Home Act of 2016, the REACH Act of 2016, introduced by Rep. Tiberi, with 22 cosponsors, which increased the ASC rate to 20 percent.

Other Key Provisions

There are several other tax provisions that are significant to the U.S. semiconductor industry. As noted earlier, the semiconductor industry has in recent years experienced a wave of consolidation as semiconductor companies have acquired and merged with others to reach greater economies of scale and more effectively compete with foreign rivals. While some acquisitions will be funded by the use of unremitted foreign earnings, others have been financed through debt instruments. SIA does not oppose the elimination of the deduction for corporate interest contained in the Better Way blueprint, however we strongly recommend any legislation to eliminate this deduction contain a multi-year transition rule to ensure that companies are not unduly penalized for relying on this deduction in past transactions.

Semiconductor manufacturing is a capital-intensive industry, with the cost of a new, leading-edge semiconductor fabrication facility exceeding \$5 billion. The Better Way blueprint's proposal to allow immediate expensing of capital equipment is therefore a potentially

significant change to make U.S. semiconductor manufacturing more competitive. Finally, the semiconductor industry has historically suffered from large cyclical shifts in demand and production from year to year. Preservation of NOL carryforward rules are an appropriate tool to account for such cyclical shifts and help smooth the transition between up and down years.

Conclusion

SIA strongly supports efforts to reform, modernize, and make more competitive the U.S. tax code. Policymakers must seize this opportunity to eliminate the current disadvantages the U.S. tax code imposes on semiconductor research, design and manufacturing in America. Reducing the corporate rate to 20 percent or less, enacting a territorial system for CFC income with appropriate transition rules, and preserving and enhancing R&D tax incentives are policies SIA strongly supports, and which would make U.S. semiconductor companies and operations much more globally competitive. SIA looks forward to working with Congress and the Administration to enact these policies into law.