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Senator Ben Cardin
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Senator Rob Portman
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Senator Chuck Schumer
322 Hart Senate Office Building
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Via e-mail to Business@finance.senate.gov and International@finance.senate.gov

RE: TD Bank Group Comments on Tax Reform

Dear Senators:

TD Bank, America's Most Convenient Bank, is one of the 10 largest banks in the United States. The bank has over 26,000 employees in the United States, where it offers a broad array of retail, small business, and commercial banking products and services to more than 8 million customers throughout the Northeast, Mid-Atlantic, Metropolitan D.C., the Carolinas, and Florida. TD Bank is a member of TD Bank Group and a subsidiary of The Toronto-Dominion Bank, a top 10 financial services company in North America.

TD Bank believes tax reform is critical for America's continued economic growth and prosperity. We welcome the Finance Committee's continued interest in tax reform and appreciate the Committee's formation of working groups to analyze current law and policy and solicit feedback from stakeholders. We appreciate the opportunity to share TD Bank's perspective on corporate tax reform with the Business Income Tax and International Tax working groups.

Our comments address the following issues:

- U.S. corporate tax reform should include a significant reduction in the U.S. corporate tax rate, which would promote U.S. economic growth and investment, benefit U.S. workers, and create a more even playing field for corporations and pass-through vehicles.
- The current deduction for interest expense is appropriate and should be preserved. Interest is an ordinary cost of doing business, especially for financial institutions, for which interest expense is the equivalent of cost of goods sold.

- A reformed U.S. tax system should include neutral tax rules that do not unfairly target certain industries. A tax levied on financial institutions is one example of a proposal that would unfairly target an industry and should be rejected.
- U.S. tax reform should promote certainty for businesses and include appropriate transition rules.

I. U.S. Corporate Tax Rate

As is frequently observed, the United States' statutory corporate tax rate is the highest in the developed world. Although the United States had one of the lowest corporate tax rates following the country's last major tax reform in 1986, other countries have since significantly reduced their own corporate tax rates to encourage investment. As explained below, reducing the U.S. corporate tax rate to a rate consistent with international norms would promote U.S. economic growth and investment, benefit U.S. workers, and create a more even playing field for corporations and pass-through vehicles.

The United States' high statutory corporate tax rate makes the United States a less attractive place for business investment. As capital is increasingly mobile, differences in countries' statutory corporate tax rates increasingly influence where businesses choose to invest.[1] Further, high statutory rates provide strong incentives for taxpayers to seek both legislated and self-help tax benefits, which often create economic distortions, add complexity, increase compliance costs, and shrink the tax base.[2]

Lowering the corporate tax rate would encourage inbound investment by foreign-headquartered companies, which make a key contribution to the U.S. economy.[3] According to statistics collected by the Bureau of Economic Analysis, U.S. affiliates of foreign multinational companies employ 5.8 million Americans (5% of all U.S. private industry employment) and contribute $773.8 billion to the U.S. economy.[4] As a top 10 U.S. bank, TD Bank itself is a

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[1] *See* George R. Zodrow, Capital Mobility and Capital Tax Competition, Nat'l Tax J. (Dec. 2010) (summarizing economic studies on the impact of tax rates on the capital, and concluding that "the empirical literature as a whole suggests that international capital is quite mobile and in particular is significantly affected by tax factors.").

[2] *See* Kimberly A. Clausing, Multinational Firm Tax Avoidance and Tax Policy, Nat'l Tax J. (Dec. 2009) (observing that "[f]inancial responses to corporate taxation include efforts to shift income to more lightly taxed locations" and estimating the extent of financial responsiveness to tax rate differences among countries).

[3] For example, economists Ruud De Mooij and Stef Ederveen analyzed 25 foreign direct investment studies and found that a one percentage point reduction in a host country tax rate raises foreign direct investment by 3.3 percent. Ruud A. de Mooij and Stef Ederveen, Taxation and Foreign Direct Investment, A Synthesis of Empirical Research, 10 Int'l Tax and Pub. Fin. 673 (2003).

[4] Thomas Anderson, Bureau of Economic Analysis, Activities of U.S. Affiliates of Foreign Multinational Enterprises in 2012, p. 1 (Nov. 2014).

significant contributor to the U.S. economy, with 26,000 employees, 1,300 retail stores, and 8 million customers in the United States. TD Bank is also a significant source of credit for both individuals and businesses, with $117 billion in loans outstanding.

Economists recognize that the corporate income tax is the tax with the most negative impact on economic growth. For example, a study by the Organisation for Economic Co-operation and Development concluded that "[c]orporate income taxes are the most harmful for growth as they discourage the activities of firms that are most important for growth: investment in capital and productivity improvements."[5] Reducing the growth-impeding corporate tax rate would therefore promote economic growth and investment in the United States. As economists John Diamond and Alan Viard concluded in a study analyzing the macroeconomic effects of various tax reforms, "a broad-based, low-rate tax system will increase economic growth while a narrow-based, high-rate tax system will reduce economic growth."[6]

A reduction in the corporate tax rate would also benefit U.S. workers. Although corporations pay the corporate income tax, they do not economically bear the burden of that tax. Rather, the corporate income tax is borne by some combination of owners (in the form of lower returns), employees (in the form of lower wages), and/or customers (in the form of higher prices). Many economists believe that, in today's global economy, the corporate income tax is increasingly borne by labor in the form of lower real wages and living standards.[7] The incidence of corporate tax on workers is also reflected in the work of the Congressional Budget Office, Department of Treasury, and Joint Committee on Taxation, which all assume in their revenue estimates that labor bears a portion of the burden of the corporate income tax.[8]

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[5] OECD Tax Policy Studies, Tax Policy Reform and Economic Growth, p. 22 (2010).

[6] Tax Reform, Growth, and Efficiency, Testimony of John W. Diamond before the United States Senate Committee on Finance (Feb. 24, 2014) (summarizing the conclusion of John D. Diamond and Alan D. Viard, "Welfare and Macroeconomic Effects of Deficit–Financed Tax Cuts: Lessons from CGE Models," in Alan D. Viard (ed.), Tax Policy Lessons from the 2000s, pp. 145–193 (2008).

[7] *See, e.g.*, Li Liu and Rosanne Altschuler, Measuring the Burden of the Corporate Tax under Imperfect Competition, Nat'l. Tax J. (March 2013). *But see* Kimberly Clausing, Corporate Tax Incidence in a Global Economy, Nat'l. Tax J. (March 2013) (suggesting that studies showing labor bearing a large portion of the corporate tax are flawed).

[8] The Distribution of Household Income and Federal Taxes, 2011, Congressional Budget Office, p. 32 (2014) ("In this analysis, CBO allocated 75 percent of corporate income taxes to owners of capital in proportion to their income from interest, dividends, rents, and adjusted capital gains . . . . CBO allocated the remaining 25 percent of corporate income taxes to workers in proportion to their labor income.") ; Julie Anne Cronin et al., U.S. Treasury Distributional Analysis Methodology, Office of Tax Analysis, Working Paper, p. 29 (2012) ("In the final analysis the new methodology assumes 82 percent of the corporate tax burden is borne by supernormal or normal capital income and 18 percent is borne by labor."); Modeling the Distribution of Taxes on Business Income, Staff of the Joint Committee on Taxation, p. 8 (Oct. 16, 2013) ("In estimating the long-run burden of corporate income taxes on capital and labor, the Joint Committee staff follows the middle range of the current economic literature by assuming

In addition, reducing the corporate tax rate would help reduce the disparity among corporations and the increasing number of businesses that operate in the United States through pass-through vehicles (i.e., S corporations, partnerships, limited liability companies, sole proprietorships, and REITs).[9] Corporations are subject to a tax on their earnings twice (once when earned at the corporate level and again when distributed to shareholders), while pass-through vehicles are subject to only a single tax on their earnings.[10] This preferential treatment for investment through pass-through vehicles distorts the choice of organizational form.[11] In addition, the double tax on corporate profits distorts decision-making by management—corporations must take the corporate tax into account when making investment decisions, while pass-through vehicles do not. As a result, corporations face an uneven playing field—while the effective marginal tax rate on new investment by corporations is 32.3%, the effective marginal tax rate on new investment by pass-through businesses is 26.4%.[12] Reducing corporate tax rates would help relieve the growth-impeding double tax imposed on corporations and create a more even playing field among all businesses.

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that 25 percent of corporate income taxes are borne by domestic labor and 75 percent are borne by owners of domestic capital.").

[9] More than 90 percent of businesses are structured as flow-through entities. *See* Joseph Rosenberg, Tax Policy Center, Tax Facts from the Tax Policy Center (Sept. 29, 2014). Over the past two decades, "the importance of flow-through businesses—partnerships and S corporations in particular—has grown dramatically. In 2012 net income from sole proprietorships, partnerships, and S corporations totaled nearly $840 billion and accounted for more than 9 percent of total adjusted gross income reported on individual income tax returns." *Id.*

[10] Foreign persons investing in the United States through pass-through vehicles are generally subject to U.S. tax on their U.S. business income only if such income is effectively connected to a U.S. trade or business (or attributable to a U.S. permanent establishment if the foreign person is eligible for the benefits of a U.S. tax treaty).

[11] The President's Framework for Business Tax Reform, A Joint Report by the White House and the Department of Treasury, p. 7 (Feb. 2012) (hereinafter "President's Framework for Business Tax Reform") ("The ability of large pass-through entities to take advantage of preferential tax treatment has placed businesses organizing as C-corporations at a disadvantage. By allowing large pass-through entities preferential treatment, the tax code distorts choices of organizational form, which can lead to losses in economic efficiency; business managers should make choices about organizational form based on criteria other than tax treatment.").

[12] President's Framework for Business Tax Reform, p. 7 (citing calculations completed by the Department of Treasury Office of Tax Analysis); *see also* Robert Carroll and Thomas Neubig, Ernst & Young, Business Tax Reform and the Tax Treatment of Debt: Revenue Neutral Rate Reduction Financed by an Across-the-Board Interest Deduction Limit would Defer Investment, at pp. 9-10 (May 2012) ("The effects of the double tax on corporate profits can also be seen . . . by comparing the [effective marginal tax rate] in the corporate sector (31.0%) to the [effective marginal tax rate] in the non-corporate sector (24.6%).").

Broadening the tax base, which could involve repealing or reducing narrowly targeted tax benefits, could pay for lower corporate tax rates. Base-broadening, in conjunction with a rate reduction, would also promote growth by reducing economic distortions and improving economic efficiency.[13] In addition, broadening the tax base would simplify the tax code and reduce compliance costs. Alternative revenue sources, such as a consumption tax that would be less damaging to economic growth than a corporate income tax, have also been proposed.

II. Interest Deductibility

There have been several recent proposals to restrict the deductibility of interest.[14] We believe that new rules limiting interest deductibility are inappropriate. Interest expense is not a tax expenditure or unwarranted tax break; rather, it is an ordinary cost of doing business that should be fully deductible. **This is especially true with financial institutions, where interest expense is the equivalent of the cost of goods sold.**

Companies rely on debt to carry out essential business activities (including hiring employees, meeting payroll, and buying new equipment) and finance new investments. There are many valid non-tax reasons for using debt rather than equity. It is typically cheaper to issue debt than equity. Because debt holders have greater security with respect to repayment of their investment, they will accept lower returns than equity holders. In addition, a corporation may choose to raise funds by issuing debt rather than equity to avoid taking on new shareholders with a voice in corporate decision-making. The use of debt to finance an investment also helps optimize the overall cost of the investment and, as a consequence, the return on investment. Companies assess whether to make an investment in significant part based on the after-tax return that will be generated by that investment. Without a deduction for interest expense, significant job-creating investments in the United States would not be made because the after-tax return would not be high enough to justify making the investment.

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[13] *See* John W. Diamond and George R. Zodrow, Dynamic Macroeconomic Estimates of the Effects of Chairman Camp's 2014 Tax Reform Discussion Draft (Mar. 2014) ("Corporate [base broadening, rate reducing] reforms tend to improve the efficiency of resource allocation and thus increase the productivity of the nation's assets and enhance opportunities for economic growth by equalizing the tax treatment of different assets and industries. Lower statutory rates also reduce many other inefficiencies associated with the corporate income tax, including distortions of the choice of organizational form, methods of finance, and methods of distributing profits to shareholders, while reducing incentives for tax evasion and avoidance.").

[14] *See, e.g.*, § 4212, Tax Reform Act of 2014 (113th Cong.) (denial of deduction for interest expense of U.S. shareholders that are members of worldwide affiliated groups with excess domestic indebtedness); General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals, p. 10 (Feb. 2015) (hereinafter "FY 2016 Greenbook") (proposals to restrict deductions for excessive interest of members of financial reporting groups and defer the deduction of interest expense related to deferred income of foreign subsidiaries); President's Framework for Business Tax Reform, p. 10 (suggesting reducing the deductibility of interest for corporations as part of a "menu of options" that should be under consideration to reduce the corporate tax rate).

The role of interest expense as an ordinary cost of doing business is true regardless of whether interest is paid to a third party or a related party. Companies often borrow from a related party, such as a parent or a financing affiliate, because that party is the most cost-efficient source of funds. For example, in the case of a foreign-headquartered company such as TD Bank, the foreign parent company or foreign affiliate may have a higher credit rating and can borrow at lower interest rates than a U.S. affiliate, thereby allowing the foreign parent or affiliate to lend to the U.S. affiliate at a lower interest rate than the U.S. affiliate would have been able to obtain by itself from third parties. In addition, a worldwide group may realize efficiencies by centralizing borrowing with a single entity that is able to manage and oversee the financing of the group.

Proposals to restrict the deductibility of interest expense are frequently justified by claims that the tax code currently has a bias toward debt financing and that such bias encourages destabilizing corporate leverage.[15] However, economists suggest that these claims are overstated.[16] Further, the root cause of any bias toward debt financing is not the deductibility of interest, but rather the current classical corporate tax system, which taxes equity income twice.[17] Restricting interest deductibility would simply expand this double taxation, with deleterious effects on economic growth. As discussed above, fundamental corporate tax reform, and a significant reduction in the corporate tax rate, is needed to make the United States' tax system more conducive to investment. In addition, reducing the corporate tax rate would by itself reduce any bias toward debt financing by reducing the value of the interest deduction.

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[15] *See* President's Framework for Business Tax Reform, pp. 6, 10 ("[A] large bias towards debt financing in the corporate tax code may lead to greater aggregate leverage and the associated firm-level and macroeconomic costs of debt financing. . . . [A] tax system that is more neutral towards debt and equity will reduce incentives to overleverage and produce more stable business finances, especially in times of economic stress.").

[16] *See, e.g.*, John R. Graham, Estimating the Tax Benefits of Debt," Journal of Applied Corporate Finance, p. 44 (Spring 2001) (concluding that firms are in fact "leaving money on the table" rather than borrowing at financially optimal levels); Testimony of Mihir Desai, Professor of Law, Harvard University, before the Senate Finance Committee and House Ways and Means Committee (July 13, 2011) ("[T]he leverage of financial institutions [preceding the financial crisis] appears to have become problematic largely for reasons associated with prudential regulations rather than tax incentives. . . . The leverage of the non-financial sector was not a contributing factor to the crisis and, in fact, the remarkable underleverage of the non-financial sector prior to the financial crisis was a saving grace in ensuring that the financial crisis was not nearly as severe as it could have been.").

[17] Flow-through entities subject to a single layer of taxation, such as partnerships or S corporations, generally have less of an incentive to incur entity-level debt. Data compiled by the Joint Committee on Taxation shows that "C corporations' interest expense, in the aggregate and as a percentage of net income before interest expense, exceeds the comparable figures for partnerships and S corporations." *See* Staff of the Joint Committee on Taxation, Present Law and Background Relating to Tax Treatment of Business Debt, JXC-41-11, p. 57 (July 11, 2011). For example, in 2008 (the most recent year covered by the study), interest as a percentage of net income before interest was 60.8% for C corporations, 16.8% for S corporations, and 25.6% for partnerships. *Id.* at 62.

Restricting the deductibility of interest expense would discourage investment by increasing the cost of capital. A study by economists Robert Carroll and Thomas Neubig found that a limitation on the deductibility of interest expense would increase the marginal effective tax rate on new investment in the corporate sector, even when coupled with a significant reduction in the corporate tax rate.[18] Thus, restricting interest deductibility would be counter to a significant motivation for reducing the U.S. corporate tax rate—increasing U.S. investment and economic growth.

Although we believe that restrictions on interest deductibility are in general inappropriate, if any such restrictions are considered, they should take into account the unique circumstances of financial institutions. Because a bank's basic business is borrowing and lending, interest is a bank's single largest business expense. Further, interest is closely tied to a bank's ability to generate income—banks must borrow in order to earn income. As a result, imposing a restriction on the deductibility of gross interest expense would have a significant negative impact on a bank's business model. For these reasons, financial institutions should be exempted from any proposal to limit interest deductibility. This is the approach taken in the Administration's FY 2016 budget proposal to expand section 163(j).[19] Under that proposal, the interest expense of a U.S. group owned by a foreign-parented company would be limited to the U.S. group's interest income plus its proportionate share of the group's net interest expense. Recognizing the unique circumstances of financial institutions, the proposal would not apply to financial services entities.

If any restrictions on interest deductibility were to apply to financial institutions, such restrictions should apply to net, not gross, interest expense. For financial institutions, interest expense is the equivalent of the costs of goods sold, and like other companies, financial institutions should be able to deduct their cost of goods sold. Restricting the deductibility of gross interest expense would significantly increase the effective tax rates of financial institutions and would place financial institutions with U.S. operations at a competitive disadvantage with respect to their foreign-only peers.

III. Neutrality Across Sectors

As the working groups consider fundamental tax reform, they should heed the general principal that tax rules should avoid economic distortions and apply evenly across sectors. Rules that would specifically target certain industries to raise revenue should be avoided.

A tax levied on financial institutions (a "bank tax") is one example of a proposal that would unfairly target an industry and should be rejected as Congress considers fundamental tax reform. A bank tax was proposed in former Ways & Means Chairman Camp's Tax Reform Act of 2014, which would impose an excise tax of .035 percent on the total consolidated assets in

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[18] Robert Carroll and Thomas Neubig, Ernst & Young, Business Tax Reform and the Tax Treatment of Debt: Revenue Neutral Rate Reduction Financed by an Across-the-Board Interest Deduction Limit would Defer Investment, at i (May 2012).

[19] FY 2016 Greenbook, pp. 10-12.

excess of $500 billion of any "systemically important financial institution."[20] A bank tax has also been proposed in the Administration's recent budgets. The FY 2016 budget would impose a 7-basis point "financial fee" on the covered liabilities (i.e., assets less equity for banks) of a financial entity with worldwide consolidated assets of $50 billion or greater.[21]

The bank tax proposals appear motivated, at least in part, by a desire to regulate the risk of financial institutions through the tax code. For example, FY 2016 Greenbook states that "[e]xcessive risk undertaken by major financial firms was a significant cause of the recent financial crisis and an ongoing potential risk to macroeconomic stability. The financial fee proposal is intended to reduce the incentive for large financial institutions to leverage, reducing the cost of externalities arising from financial firm default as a result of high leverage."[22] The excise tax is also intended to "help recapture" a portion of a purported "implicit subsidy" provided to financial institutions under the Dodd-Frank Wall Street Reform and Consumer Protection Act.[23] The behavior of financial institutions should be addressed through specific laws and regulations, not the tax system.

Even if it were proper to regulate financial institutions through the tax code, the bank tax proposals are not narrowly targeted to achieve their goals. For example, the Administration's proposal would apply to any U.S. bank holding company with assets in excess of $50 billion. As a result, it would apply to many institutions, such as TD Bank, that do not destabilize the financial system. TD Bank is a low-risk, community-focused bank with high credit ratings and strong capital ratios. Yet, it could be subject to a significant tax under the Administration's proposal. At the same time, institutions with assets not exceeding $50 billion would be completely exempt merely because of their smaller size, without regard to their risk-taking or leverage.

In addition, the Administration's FY 2016 "financial fee" would be imposed on all assets, without regard to risk.[24] This is in contrast to the Administration's FY 2015 proposal, which would have imposed a 17-basis point tax on the consolidated risk-weighted assets of a financial firm, less its capital, insured deposits, and certain loans to small businesses.[25] Regulators require

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[20] § 7004, Tax Reform Act of 2014 (113th Cong.). A "systemically important financial institution" is defined by reference to section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which in turn defines such an institution as (1) any bank holding company with at least $50 billion in total consolidated assets, or (2) any non-bank financial institution designated by the Financial Stability Oversight Council.

[21] FY 2016 Greenbook, p. 160 (Feb. 2015).

[22] *Id.*

[23] Tax Reform Act of 2014, Discussion Draft, Section-by-Section Summary, p. 180.

[24] The FY 2016 Greenbook proposal also cites excessive leverage as a reason for imposing a bank tax, yet the proposal is not narrowly tailored to distinguish between types of liabilities or determine a bank's ability to repay those liabilities.

[25] General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals, p. 173 (Mar. 2014).

banks to calculate risk-weighted assets to determine the amount of capital that they must hold—the higher the amount of risks-weighted assets, the more capital that must be held. Risk-weighted assets are calculated by reference to all of a bank's assets, weighted according to risk. For example, government debt has a 0% risk-weighting, meaning that it is subtracted from total assets for purposes of determining capital. By failing to differentiate between assets on the basis of risk, the current proposal does not create an incentive for banks to avoid investing in risky assets. In fact, it may encourage banks to engage in riskier, but potentially more profitable, types of business to offset the tax. A bank tax that was risk-weighted would be more consistent with how financial institutions themselves evaluate their own assets and returns and how regulators evaluate the health of financial institutions. As in prior proposals, capital, deposits, and loans to small businesses should be subtracted from the asset calculation to encourage banks to hold them. However, as noted above, it is not appropriate to regulate financial institution risk through the tax code.

IV. Promoting Certainty for Businesses

When making investment decisions, businesses consider the likely tax burden on an investment over the long-term. If the tax impact of investing in the United States is uncertain, a business may choose to invest elsewhere. For example, the tax code contains several tax provisions (commonly referred to as "extenders") that are enacted on a temporary basis and then renewed, often retroactively. Many of the extenders are intended to create an incentive for businesses to make certain investments or conduct certain activities, such as investing in low-income communities (the new markets credit) or increasing research in the United States (the research credit). Yet, the temporary nature of these provisions makes it difficult for businesses to evaluate whether they should in fact make investments or conduct activities affected by these provisions. When the provisions are retroactively extended, they cannot incentivize investments or activities as intended by the statute. As part of tax reform, Congress should enhance certainty by either making the provisions permanent or eliminating them.

Fundamental tax reform should also include appropriate transition rules. Sudden changes upset settled expectations and create uncertainty that may negatively impact the investment climate.[26] Appropriate transition rules are also needed to minimize unfair losses or undeserved windfalls to companies whose investment decisions were driven in part by existing law. Because businesses have long relied on the current rules, changes to existing rules should be applied prospectively only. It may also be appropriate to phase-in certain changes to allow businesses adequate time to adjust to the new rules. Grandfathering provisions may also be warranted in certain cases.

[26] *See* OECD Policy Brief, Reforming Corporate Income Tax (July 2008).

V. Conclusion

We appreciate the opportunity to provide our input and look forward to a continued dialogue with the members and staff of the Senate Finance Committee. We would be pleased to provide further information or discuss these matters further.

Sincerely,

Michael T. Brown
Vice President, Tax
TD Bank Group

C: Peter van Dijk, Senior Vice President, Tax Services