



PRESIDENT'S ADVISORY
PANEL
ON FEDERAL TAX REFORM

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The Honorable Connie Mack
Chairman
Advisory Panel on Tax Reform
1440 New York Avenue NW
Suite 2100
Washington, DC 20220

The Honorable John Breaux
Vice Chairman
Advisory Panel on Tax Reform
1440 New York Avenue NW
Suite 2100
Washington, DC 20220

Dear Chairman Mack and Vice Chairman Breaux:

On behalf of the membership of the Information Technology Association of America, we would like to submit the following comments for your consideration with regard to tax reform.

The information technology sector has created more jobs for US citizens than any other sector over the past decade. America's technology sector has made an enormous contribution to the US economy both directly and indirectly, supporting science and math education at all levels, promoting innovation and research, creating jobs, boosting efficiency and productivity, and enhancing the competitiveness of every industry sector. The explosive growth in the information technology sector over the last ten years has had a positive impact on the quality of life for all Americans.

As a general matter, we believe that any tax reform effort should be designed to support economic growth, to make US companies more competitive globally, and to promote the spirit of innovation upon which this nation was founded. Furthermore, tax reform should not result in increased net taxes on the business sector, and given the complexity of existing corporate taxation, there needs to be appropriate transition rules to account for treatment of various tax assets and liabilities.

Information Technology Association of America

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Specifically, we would like to address four critical issues that we believe are essential to the future competitiveness, innovation and productivity of our sector.

Lowering the Corporate Tax Rate

First, the information technology industry supports a reduction in the overall corporate tax rate. Today, foreign nations are lowering their tax rates to attract corporate investment. The US tax code must seek to provide a level playing field for US business interests relative to foreign competitors by reducing corporate tax rates, making them commensurate with major US trading partners. A globally level tax playing field is crucial for the information technology industry's continued growth and productivity.

Supporting Research and Development

Second, we strongly support tax code provisions that promote increased research and development spending across all industry sectors. For example, a permanent and strengthened R&D tax credit should be adopted so that more companies that perform significant R&D can benefit. Many positive economic benefits are driven by the performance of research and development, including increased revenue streams to US companies that enhance their ability to hire employees, purchase capital goods, pay dividends to shareholders and contribute to a strong US tax base. It also secures US leadership in areas that are critical to sustained economic growth and US and global security.

Successful research and development not only affects the kinds of goods that flow to consumers, but also enhances the labor and capital inputs used to produce them. It is widely agreed that firms doing research and development do not capture all or even most of their investment through the price mechanism. The existence of the essentially free spillovers means the social return from research and development exceeds the private return.¹

Significant social benefits from conducting research and development in the United States include the creation of quality jobs with higher-than-average wages, a more educated and adaptable workforce, and upward social and economic opportunities for a broad segment of the population.

Without a permanent and strengthened R&D tax credit, more innovative activities may move offshore thereby benefiting foreign workers, foreign providers of capital goods, and foreign governments. This will result in the transfer of critical technology and knowledge overseas, and undermine America's leadership position.

Today, foreign nations are not only lowering their overall tax rates to attract US companies, they are also providing robust and stable research and development tax incentives in order to access US knowledge and expertise. We must have a strong and

¹ *Securing America's Future: The Case for a Strong Manufacturing Base*, a report by Joel Popkin and Company for the National Association of Manufacturers, June 2003.

permanent research and development tax credit in the US that is widely available to a broad range of research-intensive companies.

Reforming U.S. International Tax Rules

Third, many of the United States' international tax rules were crafted in the 1960s at a time when U.S. multinationals were dominant and the IT industry of today was non-existent. Over the years, various tax bills have further complicated the rules. Present law taxes active business operations on a current basis in ways that other countries do not, thereby adding to the tax costs of U.S. global firms vis-à-vis their foreign competitors.

Current U.S. law has not kept pace with the rapid development of the global economy. Specifically, the treatment of foreign subsidiary income and the treatment of the foreign tax credit need to be reformed. The IT industry, in particular, is highly competitive in the global marketplace and U.S. firms face higher relative tax costs due to the outdated nature of US tax rules relative to international operations.

Eliminating Communications Excise Tax

Finally, the information technology industry supports the repeal of the federal communications excise tax (FET). The FET of three percent on telecommunications services has been in place since the Spanish American War. The FET was premised on the concept that the telephone was a luxury, available only to the wealthy, instead of the standard, widely available communications service that it is today.

In order for tax reform to succeed, we must rid the code of antiquated provisions such as the FET. To continue the imposition of an outmoded luxury tax on a service that is the infrastructure of the modern digital economy merely perpetuates an irrational system that has not kept up with the changing needs of our country. Moreover, the out-of-date wording of the current law, together with the growth of new and radically different technologies and services, has left taxpayers in an uncertain state as to what is and what is not taxable. The FET must be repealed.

A Note on Transition Rules

Any tax reform effort must weigh the benefits of change against the cost of transition. Imposing additional costs without clear benefit is counterproductive. It is critical that clear rules be stated to provide a smooth transition of valuable tax assets.

Conclusion

With 400 direct and affiliate member companies, the Information Technology Association of America (ITAA) is the leading trade association serving the information technology industry. ITAA seeks to foster an environment that is conducive to the health, prosperity and competitive nature of the information technology industry and to help its members succeed in delivering the benefits of IT to their customers.

We believe that a forward-thinking, non-discriminatory tax system in the United States is essential to the continued growth and prosperity of the high technology industry. As a key driver of innovation, productivity, employment and economic prosperity in the United States, the technology industry needs a tax system that is fair and equipped to respond to its rapidly changing nature.

ITAA urges you to consider these recommendations as you develop your recommendations to the President. We welcome the opportunity to discuss them in further detail with you. Please contact Stephanie Childs at schilds@itaa.org or 703.284.5352 for more information.

Respectfully,



Harris N. Miller
President
Information Technology Association of America