American Bankers Association
Building Success. Together.

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July 30, 2013

The Honorable Max Baucus
Chairman, Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Orrin Hatch
Ranking Member, Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

RE: *American Bankers Association Initial Input on Tax Reform*

Dear Chairman Baucus and Ranking Member Hatch:

The American Bankers Association (ABA)[1] is pleased to provide initial input pursuant to the June 27, 2013, letter from the Committee on Finance ("the Committee") requesting ideas on existing tax expenditures that should be preserved in the Internal Revenue Code (the "Code") as the Committee embarks on the difficult task of tax reform.

The ABA appreciates the Committee's efforts and supports its goal of simplifying the Code in order to make it fairer and more efficient. The Committee has noted that it plans to operate on a "clean slate" platform with respect to special provisions and preferences for special interests as it embarks on a comprehensive tax reform process. In effect, the beginning assumption would be that "all special provisions are out unless there is clear evidence that they: (1) help grow the economy, (2) make the tax code fairer, or (3) effectively promote other important primary objectives.

We agree with the Committee that it might be necessary to achieve this goal by eliminating some of the special provisions in the Code, i.e., exclusions, deductions, credits, and other preferences (commonly referred to as "tax expenditures"). We know that the Committee understands that the elimination of the "tax expenditures" will have consequences to taxpayers, communities, and our economy as a whole.

As the Committee may be aware, banks and savings associations do not derive any "direct" benefit from many of the tax expenditures that currently exist in the Code. In fact, only a few of these expenditures have a direct impact on the activities and operations of banks and savings associations, as opposed to having an impact on the customers and communities they serve. Several of these items are listed below. We will be glad to supplement this letter at a future date with additional comments that support the need to retain selected tax expenditures in an overhauled Code that have important policy implications for our communities.

DEDUCTION FOR INTEREST EXPENSE

While the June 27, 2013, letter asks for suggestions for items that are defined as "tax expenditures," we are taking this opportunity to focus on an issue that is not on the tax expenditure list. We understand and have observed some level of formal and informal discussions regarding limiting the deductibility of interest expense. Interest expense is a financial institution's "cost of goods sold" and, accordingly, we

[1]The ABA represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its two million employees.

need to express strong concerns about potential changes in this area for banks and savings associations and their customers.

Our comments are organized in line with your suggested format:

Help grow the economy:

Limiting the interest expense deduction would not only hurt the U.S. economy, but also run counter to one of the most important objectives of tax reform – making the U.S. a more attractive place to invest and locate. Limiting deductibility would have a significant adverse impact on new investments in the U.S. by raising the cost of such investments (not to mention making the U.S. unique among other developed countries). Once investors start to view the U.S. as a less attractive place to invest, there will be fewer investments in the U.S., and there is no question that such a situation will impede, rather than spur, economic growth.

According to a recent study by Ernst & Young,[2] limiting the deductibility of interest from the U.S. tax regime would have a significant negative effect on the cost of investing in the U.S. The resulting loss of new investments would harm the U.S. economy. Hence, rather than help move the U.S. forward, tax reform that includes the limitation of the interest expense deduction would harm the U.S. by inhibiting economic growth and productivity.

The interest expense deduction serves a useful objective in the Code by helping to provide a true reflection of income. Retaining it will help promote other important objectives, including making the U.S. a more competitive and attractive place for investors (citizens and foreigners alike).

Banks and savings associations represent a very important segment that contributes significantly to the U.S. economy. Limiting this deduction would have a significant impact on the industry. This would likely slow economic growth and cause undue harm to the overall economy. Retaining the interest expense deduction will help ensure the continued smooth flow of capital within the economy in general and the financial services industry in particular, which will in turn continue to help the economy as it rebounds from the recent economic downturn.

Make the tax code fairer:

Eliminating the deduction for interest expense would run afoul of the long-standing U.S. income tax principle dating back to the adoption of the modern Code in 1913, which provides for a tax on income and a deduction for legitimate expenses incurred in producing such income. Hence, the deductibility of interest expense has long been an established component of the U.S. tax regime for measuring economic income. Like any other business, banks and savings associations incur legitimate expenses in conducting business, and such expenses should be deductible. When a bank borrows money for purposes of engaging in its trade or business of banking/financial services, it should be allowed, like any other business, to take a deduction for expenses related to such borrowing. The interest expense is a significant aspect of the industry's business expense, and to disallow the deduction for such expenses would be unfair.

[2] "Macroeconomic analysis of a revenue-neutral reduction in the corporate income tax rate financed by an across-the-board limitation on corporate interest expenses," Ernst & Young, July 2013.

In considering how to make the tax code "fairer," we anticipate there will be an analysis prepared regarding which taxpayers will receive favorable or unfavorable results from changes. We believe that a reduction in the income tax rate would be welcome by all – including the financial services industry. In considering the fairness questions that will be raised, we urge the Committee to look beyond simple analysis of rate differentials and consider the overall economic impact on taxpayers. For example, the financial services industry has many members that have deductions that are required to be deferred for tax purposes (relative to Generally Accepted Accounting Principles or GAAP) under rules currently in place. While a lower rate at face would be beneficial, there could also be important negative implications as these deductions will be taken on tax returns at lower rates. This represents a real additional economic cost to those banks and savings associations.

Additionally, ABA believes that any form of a "bank tax" is ill-conceived and irresponsible regardless of the economic cycle. This idea has persisted out of the government investments made through bank programs associated with the Trouble Asset Relief Program (TARP). Since this is the case it is important to note that as of today (7/30/13) the federal government has made a profit of $26 billion on these programs.

<u>Effectively promote other important primary objectives</u>:

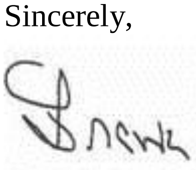
There is a variety of tax expenditures that benefit the employees, customers, and communities of banks and savings associations. Banks and savings associations pursue investments, products, credit transactions, etc. in line with helping to achieve the policy objectives that Congress desired when the tax rules were put in place.

The following are "tax expenditures" that we believe have important policy implications to our constituencies and should be strongly considered to be retained in an overhauled Code:

- Tax exemption for interest on municipal obligations (support for state and local communities)
- Low income housing credit (support for affordable quality housing)
- New markets tax credits (growth in economy in needed areas)
- Deduction for mortgage interest (promotion of home ownership)
- Deduction for employee health benefits (affordable benefits for employees)
- Corporate owned life insurance (support for funding of employee health benefits).

We look forward to working with you as you proceed with the important task of tax reform.

Sincerely,



Frank Keating

Cc: Members of the U.S. Senate