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October 15, 2009

President's Economic Recovery Advisory Board (PERAB)
Tax Reform Subcommittee

Ladies and Gentlemen:

The tax subcommittee of the President's Economic Recovery Advisory Board (the "task force") has been charged with "considering ideas on tax simplification, better enforcement of tax law, and reforming corporate taxes and to present the pros and cons of potential tax options." [1] On September 24, 2009, the task force requested ideas and opinions from the public regarding the issues within the task force's mandate.[2] TD Bank regards this invitation as extremely important, and submits these views in response.

TD Bank is the first truly "North American bank," with approximately 1,100 branches in each of the United States and Canada. We are one of the 15 largest commercial banks in the United States and a member of TD Bank Financial Group, which is one of the top 10 financial services companies in North America and one of the few banks in the world rated Aaa by Moody's.

We view tax reform as important for America's economic growth and, therefore, deeply appreciate President Obama's interest in the issue and in the task force's efforts. Although it appears that the task force will be not be making recommendations for a new tax system, we hope that the task force will consider TD Bank's perspective on the taxation of U.S. businesses.

I. U.S. Tax Policy Should Encourage Growth and Investment in the United States

TD Bank believes that its ability to grow and prosper in the United States depends on the strength of the U.S. economy. Further, we believe that U.S. tax policy is a key factor affecting the U.S. business climate, and we support tax policy that encourages sustainable growth and

[1] PERAB Tax Reform Subcommittee, "Tax Reform Subcommittee Requests Ideas," Whitehouse.gov Blog, *available at* http://www.whitehouse.gov/blog/Tax-Reform-Subcommittee-Requests-Ideas.

[2] *Id.*

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investment in the United States. As a retail bank whose customers are primarily individuals and small businesses, our perspective is that corporate tax policy affects not only the amount of tax that TD Bank pays, but also the prosperity of our customers.

A. Corporate Tax Reform is Needed to Promote U.S. Economic Growth

While many other countries have lowered their corporate rates and reformed their tax systems in the past several decades, the United States has not significantly reformed its corporate income tax since 1986. As has been observed many times, the United States' statutory corporate tax rate is the second-highest within the Organisation for Economic Co-operation and Development.[3] This higher statutory corporate tax rate likely makes the United States a less attractive place for both U.S.- and foreign-headquartered companies to invest.

At the same time, however, the United States is said to have a low average effective corporate tax rate. Even if the United States does have such a low effective corporate rate, there is broad agreement that a high statutory rate with a low effective rate is a sign of a poorly-functioning tax system. High rates provide strong incentives for taxpayers to seek both legislated and self-help tax benefits, which often create economic distortions, add complexity and inequity, and shrink the tax base.

Therefore, we support consideration by the task force of options that would lower corporate tax rates while broadening the tax base. Lowering the corporate tax rate would encourage investment in the U.S. economy. Broadening the tax base could pay for the rate reduction, and could involve repealing or reducing narrowly targeted tax benefits and narrowing provisions that, as currently drafted, allow for unintended results (i.e., eliminating so-called "loopholes"). We look forward to working with the task force to identify such loopholes.

If the task force does consider corporate tax reform involving lower rates and a broader base, we recommend that the task force also consider transition rules. Because immediately eliminating or reducing targeted tax benefits would be a fundamental change to the current U.S. tax system, transition rules would ease the negative economic effects that likely would result from sudden change. We would be pleased to discuss further potential transition rules.

B. U.S. Corporate Tax Policy Should Not Discourage Foreign Investment

TD Bank, one of the 15 largest commercial banks in the United States, employs over 23,000 employees in the United States and serves more than 6.5 million U.S. customers. We believe that the United States is the key market for our continued growth.

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[3] Organisation for Economic Co-operation and Development, OECD Tax Database, Corporate Tax Rates, *available at* http://www.oecd.org/dataoecd/26/56/33717459.xls.

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Certain U.S. tax rules, however, may discourage foreign-headquartered companies like TD Bank from investing and growing in the United States. For instance, section 163(j) may disallow a portion of the interest expense of U.S. subsidiaries of foreign-headquartered banks if: (1) the U.S. corporation has a debt-to-equity ratio of 1.5 to 1 or greater, and (2) the corporation's net interest expense exceeds 50 percent of its adjusted gross income. Although TD Bank's interest deduction currently is not limited under section 163(j), further growth in the United States could become unprofitable for TD Bank if section 163(j), and particularly its net interest expense limitation, were made more punitive.

Many other foreign-headquartered companies, if not already facing expansion constraints due to section 163(j), similarly would find continued U.S. investment unprofitable if section 163(j) were made more punitive. In an environment of continued concern about the U.S. economy, we hope that the task force will consider the deleterious effects of tax rules, like section 163(j), that create a disincentive for foreign investment.

C. Simplification of the Tax Code is Needed

We understand that the task force has been asked to consider ways to simplify the federal income tax. We applaud this focus. In general, complexity in the tax code both reflects and causes inefficiencies and inequities in the tax system. Further, a tax system that is perceived by the public as overly complex or manipulable erodes taxpayer compliance.

1. Individual Tax Complexity

As a retail bank whose customers are primarily individuals and small businesses, we recognize that non-corporate filers often bear the brunt of a complex system. They are often the least able to cope with the complexity of the tax code, and so we urge that individual tax simplification be made a priority.

2. Corporate Tax Complexity

As noted above, the tax code contains many targeted provisions, which are designed to encourage certain activities or promote certain industries. The task force should consider the added complexity and revenue cost of these provisions, and whether the Internal Revenue Code is the best place for these subsidies to be administered. It has been observed by eminent commentators that

> where economic subsidies are necessary, it is usually less efficient to use the tax system than to pay a direct subsidy to the activity involved. Use of the tax system imparts a degree of permanence that preserves the subsidy long past the period of its need, complicates and undermines efficient enforcement of the revenue laws generally, introduces government intervention through revenue officials who are not equipped to police the qualifications of those

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> subsidized, and, most important perhaps, is inefficient because of the inflexibility inherent in defining the proper objects of the subsidy in tax law terms.[4]

We therefore recommend that the task force look very closely at the benefits and detriments of targeted tax provisions, starting (for efficiency) with the most costly.[5]

Certain structural aspects of the tax code also create complexity. For example, the distinction between ordinary income and income from the sale of capital assets has a long history in our corporate income tax. This distinction has added complexity to the tax code as lawmakers have sought to achieve various policy goals, such as incentivizing capital formation and investment.

When earned by corporations, ordinary income and capital gains generally are taxed at the same rate. This may appear, at first glance, to promote simplicity, but the complexity retained by the rules governing offsets and the carryback and carryforward of ordinary and capital losses can far outweigh any potential simplicity gains, especially in a loss environment such as this one.

As a specific example, although corporate capital gains are taxed at the same rate as ordinary income, corporations may not use capital losses to offset ordinary income (even though a corporation may use ordinary losses to offset capital gains). Further, ordinary losses and capital losses incurred by corporations are subject to different carryback and carryforward periods: ordinary losses generally may be carried back two years and carried forward twenty years, while capital losses generally may be carried back three years and carried forward five years.

For banks, the rules on the taxation of income and losses from ordinary and capital assets are even more complex. Certain assets (e.g., loan assets) are treated as ordinary assets when held by banks, due to a Congressional recognition that such assets are part of the bank's ordinary business of borrowing and lending.[6] When these same assets are held in the bank's subsidiaries, however, they are treated as capital assets, even when the subsidiaries are part of the bank's consolidated group for both financial and tax purposes and the assets are a part of the bank's business. As a result, a loss from an asset held in the bank may be used to offset both ordinary

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[4] Ward M. Hussey and Donald C. Lubick, Basic World Tax Code and Commentary, A Project Sponsored by the Harvard University International Tax Program (Tax Analysts, 1996 ed.), p.8.

[5] We are aware of the political issues associated with eliminating popular targeted tax breaks, and the concerns that the task force may have, based on recent similar efforts, with even offering such options for consideration. We would be remiss, however, if we did not recommend this most fundamental building block of reform.

[6] Section 582(c).

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income and capital gains and may be carried forward twenty years and back two, but a loss from the same asset, when owned by a bank subsidiary, can only offset capital gains and may be carried forward five years and back three. Because the types of assets held by banks and bank subsidiaries rarely generate capital gains to offset capital losses, bank groups may seek to avoid wasted tax losses by retaining their loss assets even though sound business judgment and a liquid banking sector would call for selling such assets, by engaging in self-help transactions, or by holding assets in the bank even when sound business judgment calls for holding those assets in subsidiaries of the bank. Stated differently, the application of these different rules to banks and bank subsidiaries may distort business decision-making to avoid a negative tax result.

We respectfully request that the task force consider the benefits and detriments of the current law with respect to ordinary income and income from the sale of capital assets. For example, we request that the task force consider the benefits and detriments of changes to the current system of taxing corporate capital gains and losses, including: (1) allowing capital losses to offset ordinary income for corporations generally, (2) extending the ordinary asset rule applicable to banks to bank subsidiaries, and (3) providing a uniform carryback and carryforward period for both ordinary and capital losses.

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We appreciate the task force's efforts and would be pleased to discuss further our comments. Please contact Peter van Dijk at (416) 983-5368, Richard Angelone at (207) 761-8641, or our tax counsel, Philip R. West, Steptoe & Johnson LLP, at (202) 429-6247.

Sincerely,

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