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THE NATIONAL FOREIGN TRADE COUNCIL

SUBMISSION OF WRITTEN COMMENTS FOR THE HEARING RECORD

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS

HEARING ON THE NEED FOR COMPREHENSIVE TAX REFORM TO HELP AMERICAN COMPANIES COMPETE IN THE GLOBAL MARKET AND CREATE JOBS FOR AMERICAN WORKERS

MAY 26, 2011

Mr. Chairman, Ranking Member Levin, and Members of the Committee:

The National Foreign Trade Council (the "NFTC") is pleased to submit written comments for the record in connection with the May 12, 2011 hearing of the Committee on Ways and Means (the "Committee") on the important topic of comprehensive tax reform. The NFTC, organized in 1914, is an association of some 300 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities, and we seek to foster an environment in which worldwide American companies can be dynamic and effective competitors in the international business arena.

Based on Chairman Camp's opening statement, we understand that the purpose of the hearing was to provide the Members of the Committee with a better understanding of how the current structure of U.S. international tax rules affects the ability of worldwide American companies operating in a global environment to invest, grow, and create jobs. Accordingly, our comments provide some background on comprehensive tax reform, a discussion of the current U.S. tax structure, and recommendations to enhance the ability of worldwide American companies to compete in the global market as well as their ability to invest and create jobs in the United States.

Comprehensive Tax Reform

As discussed in more detail below, comprehensive tax reform is necessary to address the changing global landscape, making the U.S. economy more attractive for investment and job creation. It has been 25 years since Congress has reformed the tax code, and nearly 50 years since Congress has undertaken a detailed review of our international tax laws. During this time, the conduct of global commerce has changed dramatically and many foreign countries have responded to this change by updating their international tax regimes. The United States

however, continues to lag in its response to the new global landscape. For example, as Chairman Camp noted in his opening statement, in 1960 nearly all of the largest worldwide companies were American companies, with 17 of the 20 largest companies headquartered in the U.S. In 1985, only 13 of the 20 largest companies were American companies, and as of 2010, only six of the 20 largest companies in the world were American. This represents a decrease of 55% since 1960. Since 1985, Brazil, China, India Russia and Eastern Europe moved from essentially non-market economies to fast growth developing countries whose markets have opened to worldwide companies from the United States, Europe, Japan, Korea, and India. This very competitive marketplace is wide open to low cost producers. To address this changing global landscape, Congress should pass a comprehensive tax reform plan for the United States that makes the U.S. corporate income tax rate competitive with our trading partners and adopts a competitive territorial tax system much like those in most of the rest of the world.

The U.S. Should Reduce the Corporate Income Tax Rate

The current U.S. federal corporate income tax rate is 35%; when this rate is added to the state corporate tax rates, the U.S.'s overall corporate income tax rate amounts to 39.2%. This makes the United States the second highest in combined corporate income tax rates among the member countries of the Organisation for Economic Co-operation and Development ("OECD"), trailing only Japan, which has a current tax rate of 39.5% but has proposed a 5% rate reduction that is currently pending. The U.S.'s combined rate is nearly 15 percentage points higher than the 25% average corporate tax rate among OECD member countries.1

The U.S.'s high statutory corporate income tax rate presents a number of problems for worldwide American companies and the U.S. economy more generally. First and foremost, it makes it very difficult for worldwide American companies to compete effectively with companies that have the benefit of a lower corporate income rate within their respective countries. Other countries have recognized the competitive advantages of a lower corporate income tax rate and responded accordingly. Over the past four years, 75 countries have cut their corporate income tax rates in order to promote investment and create jobs.2 For example, Canada lowered its federal rate from 18% to 16.5% and has plans to further reduce the rate to 15%. Similarly, this year, the United Kingdom lowered its rate from 28% to 26% and has plans to reduce the rate to 23% by 2014. Further, as noted above, Japan, the only OECD member country currently with a higher corporate income tax rate than the United States, has introduced a plan to reduce its rate by 5%. These examples demonstrate the continued lack of competitiveness of the U.S. corporate tax system, which ultimately results in slower economic growth and impedes the creation of jobs in the United States.

The high U.S. corporate income tax rate also provides a barrier to worldwide American companies seeking to expand through foreign acquisitions. Foreign-based companies who benefit from lower tax rates can typically outbid worldwide American companies for foreign targets. This makes it more difficult for worldwide American companies to enter new markets and prevents these companies from reaping the benefits of increased market share, access to

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1 *See* 2011 OECD Tax Database, Table II.1.

2 Tax Foundation Special Report, "Ten Benefits of Cutting the U.S. Corporate Tax Rate," No. 192 at 3 (May 2011).

key customers, cost synergies, and efficiency gains. In this regard, the United States is in need of a corporate tax system that places worldwide American companies on an equal footing with their competitors.

By lowering the corporate income tax rate, the United States economy will experience a number benefits. Recent research indicates that because the economic burden of corporate income taxes generally falls most heavily on labor,3 a lower rate will effectively lead to higher wages and living standards among U.S. workers. A lower corporate tax rate will also boost investment, entrepreneurship, and productivity in the United States. Companies will have an incentive to locate their headquarters and create more offices in the United States, which will in turn create new job opportunities and improve the U.S.'s economic outlook. A reduction in the corporate income tax rate also will help attract and retain more U.S. investment, including foreign direct investment, also resulting in additional jobs and tax revenue. The statutory rate is the rate that is the measure of the net after-tax rate of return on a given investment project.

According to a recent OECD report investigating how tax structures can best be designed to support GDP per capita growth: "The analysis suggests a tax and economic growth ranking order according to which corporate taxes are the most harmful type of tax for economic growth . . . ." 4 As such, the NFTC is encouraged by the fact that there appears to be a growing consensus among policymakers in both Congress and the Administration that a reduction in the corporate income tax rate is a necessary policy prescription for a higher U.S. standard of living.

The U.S. Should Implement a Competitive Territorial Tax System

In addition to its high statutory corporate income tax rate, the United States also taxes worldwide American companies on their worldwide earnings whether earned in the United States or abroad. The U.S. tax system provides temporary relief to companies through deferral of tax on the active business earnings for foreign subsidiaries until those earnings are repatriated. In other words, worldwide American companies can decide either to reinvest foreign profits in their foreign operations or to bring those profits back to the United States with the consequence of having to pay residual U.S. tax on those profits. Conversely, a competitive territorial tax system consistent with that of most of our major trading partners imposes little or no additional home country tax on active business profits earned abroad, providing no disincentive to repatriation. The U.S. worldwide tax system thus creates artificial barriers to investment within the United States. Conversely, most other countries rely on a territorial system that allows foreign-based companies to deploy capital around the world without additional home country taxation.

There are numerous examples of how the current U.S. worldwide tax system puts worldwide American companies with global operations at a competitive disadvantage against foreign competitors. For example, in Singapore, the corporate tax rate is 17%, and that rate is

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3 Tax Foundation Special Report, "Ten Benefits of Cutting the U.S. Corporate Tax Rate," No. 192 at 3 (May 2011) (*citing* R. Alison Feliz and James R. Hines, Jr., "Corporate Taxes and Union Wages in the United States," National Bureau of Economic Research, *Working Paper* 15263 (August 2009)).

4 OECD (2010), Tax Policy Reform and Economic Growth, OECD Publishing. http://dx.doi.org/10.1787/9789264091085-en

sometimes reduced through tax incentives. There is no withholding tax on dividends from Singapore. If a worldwide American company earns $1,000 in Singapore, it pays $170 in corporate tax to Singapore. If that company distributes the remaining income ($830) to the U.S. parent, the U.S. parent must pay another $180 to the U.S. Treasury, bringing the total tax to the 35 percent U.S. corporate rate. However, if a competitor from the U.K. earns $1,000 in Singapore, it pays only the $170 Singapore tax. The U.K., with its territorial system, taxes only the corporate income earned inside its borders. Thus, the U.K. company has $180 more net income to be used to invest and grow, and that benefit will be even greater if the Singapore subsidiary benefits from local tax incentives. In each case, the Singapore subsidiary of a worldwide American company and the Singapore subsidiary of a U.K. company can compete equally within Singapore – but the overall tax burden on the worldwide American company is substantially greater.

The current U.S. worldwide tax system also impairs the ability of worldwide American companies to move capital around the world to meet business needs. For example, moving cash from a German subsidiary to a French subsidiary, or back to the United States, could cause a U.S. tax. While the so-called "look-through" rule and the foreign tax credit rules can mitigate that additional U.S. tax, they require worldwide American companies to implement complicated and costly monitoring and planning. Conversely, our competitors from countries with territorial systems can deploy capital around the world as needed without the added costs of taxes, or complicated and costly monitoring and planning.

Of the 34 OECD member countries, 26 use a territorial system, with only the remaining eight, including the U.S., using a worldwide system.[5] Importantly, 18 of the 26 countries using a territorial system provide for a 100% exemption of foreign subsidiary earnings from home country taxation, and none require home country expense allocation.[6] By switching to a competitive territorial system, the United States would encourage businesses both at home and abroad to invest in the United States. The switch would also align the United States with its global trading partners, including Canada, the United Kingdom, Germany, France, and Japan. In this regard, a move to a territorial system would place the American economy and worldwide American companies on a level playing field with competitors throughout the world. Further, a competitive territorial system would make the United States more attractive place to locate company headquarters, new plants and service locations, which would ultimately lead to additional job opportunities in the United States.

It is also important to note that, in adopting a territorial system, the U.S. should not deny deductions for interest or other expenses allocated to foreign income. Such a limitation would be inconsistent with the tax systems of every major industrialized country and would put worldwide American companies at a competitive disadvantage in both the U.S. and foreign markets. Denying deductions for business expenses may also put the U.S. at a competitive disadvantage when global businesses are making investment and location decisions. Further, disallowing interest expense allocable to foreign income (as proposed in the U.S. Department of the Treasury FY2012 revenue proposals) would devastate U.S. banks and financial services

5 Business Roundtable, "Taxation of American Companies in the Global Marketplace: A Primer," at 14 (April 2011).

6 *Id.*

companies for whom interest expense effectively represents the cost of raw materials. No major industrialized country has taken the approach of denying deductions for expenses allocable to deferred or exempt income, and we recommend that the U.S. system be consistent with this norm.

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Thank you for the opportunity to submit these written comments for the record. The NFTC looks forward to working with you, your staffs, and all Members of the Committee to ensure that U.S. comprehensive tax reform facilitates and enhances the competitiveness of the U.S. economy and of worldwide American companies.

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