Statement
of the
U.S. Chamber
of Commerce

ON: **How Other Countries Have Used Tax Reform to Help Their Companies Compete in the Global Market and Create Jobs**

TO: **House Committee on Ways & Means**

DATE: **May 24, 2011**

The Chamber's mission is to advance human progress through an economic,
political and social system based on individual freedom,
incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 115 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

Chairman Camp, Ranking Member Levin, and Members of the Committee, the U.S. Chamber of Commerce greatly appreciates the opportunity to comment on how we can reform the tax code[1] to help companies compete in the global market and create jobs.

INTRODUCTION

We live in an increasingly global economy. Technology advances have changed the way business works. Unfortunately, the U.S. tax code has not kept pace. It is plagued by problems – including a too high tax rate, a bias against capital investment, an outdated worldwide system of taxation, and excessive complexity. As other countries have reformed their tax systems, our failure to make similar reforms threatens the ability of American companies to compete, deters foreign investment in the United States, decreases capital investment, and risks American job losses.

MARGINAL TAX RATES

The Chamber believes that tax reform legislation should lower the corporate tax rate to a level that will enable U.S. businesses to compete successfully in the global economy, attract foreign investment to the United States, increase capital for investment, and drive job creation in the United States. Congress also should consider the impact of a corporate rate reduction on passthrough entities.

OECD Country Comparisons

The U.S. tax code is lagging sadly behind its worldwide competitors. The U.S. top marginal corporate tax rate, at 35 percent, is completely out of step with other major industrialized OECD nations. As noted by the Tax Foundation,[2] a nonpartisan organization:

> [T]he simple average of non-U.S. OECD nations has fallen from 38 percent in 1992 (the first year in which it fell below the U.S. rate) to 25.5 percent today. Similarly, the weighted average—which accounts for country size—has fallen from 42.5 percent in 1992 to 30.1 percent today. The weighted average rate of non-U.S. countries fell below the U.S. rate in 1998. Thus, 2011 marks the twelfth straight year in which the U.S. has been above the weighted average rate.

Further, as noted in another Tax Foundation study,[3] we not only shackle our businesses with high rates, but we have taken no action to lower our rate as other countries have acted. As the study notes, "[i]n the past four years alone, 75 countries have cut their corporate tax rates to make themselves more competitive." Our major trading partners– Canada and Great Britain – have already taken steps to make themselves more competitive by dropping their corporate tax rates, while the United States has done nothing to reduce rates.

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[1] All references to the code are to the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

[2] See Tax Foundation, Fiscal Fact No. 261, Countdown to #1 : 2011 Marks 20th Year That U.S. Corporate Tax Rate Is Higher than OECD Average, available at http://www.taxfoundation.org/publications/show/27100.html.

[3] See Tax Foundation, Special Report No. 191, Ten Reasons the U.S. Should Move to a Territorial System of Taxing Foreign Earnings, available at http://www.taxfoundation.org/files/sr191.pdf.

In Canada, the business tax rate was reduced from 18% to 16.5% on January 1, 2011. Further, the government plans to lower it to 15% of business profits as of January 1, 2012. This tax cut is Canada's fourth in recent years and will lower its federal corporate income-tax rate from the current 18% to less than half of the U.S.'s 35%. The Canadian government has stated that these cuts will give Canada the lowest overall tax rate on business investment in the Group of Seven Industrialized Nations when deductions and credits are factored in.[4]

The United Kingdom also has taken rate reduction measures in recent years. British Chancellor George Osborne recently cut the corporate tax rate to 26% from 28%. A one-point cut to 27% had already been planned. In addition, Osborne said the rate would be cut by one point in each of the following three years, bringing it to 23%. Osborne has noted that other countries have been "quite deliberately" making their tax systems more competitive to attract multi-national companies.[5]

PassThrough Entity Considerations

In addition to small businesses being impacted because they operate as part of larger companies' supply chains, the Chamber believes Congress would be remiss to take action to reform the code for businesses operating in C corporation structures while ignoring those operating in passthrough form. While passthrough entities exist worldwide, they are extremely prevalent in the United States and, thus, the impact of tax reform on businesses operating in passthrough structures must be given careful consideration.

According to a recent study by Ernst & Young, more than 90 percent of businesses in the United States are organized as flow-through entities. That study also found that individual owners of passthrough entities paid 44 percent of all federal business income taxes between 2004 and 2008 and, moreover, that passthrough businesses employ 54 percent of the private sector work force in the United States. [6] Flow-through businesses are a critical source of job creation and innovation in the United States that cannot be ignored in fundamental tax reform.

Under current law, the same top marginal income tax rate of 35% applies both to corporations and pass-through entities. In addition, business tax expenditures included in the code apply to both corporations and flowthrough businesses. If corporate tax reform takes place separate from individual tax reform, pursuant to which the corporate rate is lowered in exchange for the elimination or reduction of business tax expenditures, passthrough entities will lose the

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[4] See Dvorak, "Canada Slashes Business Levies," *Wall Street Journal* (12/30/10), *available at* http://online.wsj.com/article/SB10001424052970203525404576050080874854882.html. See also "Manufacturers rally behind importance of business tax cuts," CME News (1/26/11), *available at* http://www.cme-mec.ca/?action=show&lid=JCKNC-E742G-1W6JA&cid=S1BRV-5JA8C-XF48P&comaction=showhttp://www.cme-mec.ca/?action=show&lid=JCKNC-E742G-1W6JA&cid=S1BRV-5JA8C-XF48P&comaction=show#http://www.cme-mec.ca/?action=show&lid=JCKNC-E742G-1W6JA&ci.

[5] See "Osborne to cut UK's company tax rate," RTE News (3/23/11), *available at* http://www.rte.ie/news/2011/0323/britain-business.html.

[6] Carroll and Prante, "The Flow-Through Business Sector and Tax Reform," April 2011, available at http://www.scorp.org/wp-content/uploads/2011/04/Flow-Through-Report-Final-2011-04-08.pdf.

benefit of business tax expenditures without a corresponding rate reduction. Piecemeal corporate tax reform thus could have a negative financial impact on passthroughs, putting jobs at risk.

TAXATION OF FOREIGN SOURCE INCOME

In the international arena, the Chamber believes that the current worldwide tax system should be replaced with a territorial system for the taxation of foreign source income to enable U.S. businesses to compete successfully in the global economy, as well as domestically against foreign firms, and to promote economic growth domestically.

For U.S. companies to compete in global markets, they need a level playing field. In 2011, the United States suffers not only the second highest corporate tax rate in the world but is the only major industrialized OECD country that continues to employ a worldwide system of taxation.[7] This high tax rate and possibility of double taxation, while mitigated by provisions such as deferral and the foreign tax credit, harms the ability of U.S. companies to compete against foreign companies who face little or no home country tax.

In recent years, countries seeking to see their domestic companies succeed in global markets have shifted to territorial systems of taxation. For example, Great Britain adopted a quasi-territorial system of taxation and continues to make changes to shift closer to territorial tax system.[8] The driving force behind this change was to make Great Britain more competitive and to reduce compliances costs.[9] Further, in 2009, Japan also shifted to a territorial tax system.[10] Key factors in this decision were Japan's desire to see foreign profits reinvested domestically and to encourage domestic intellectual property investments.[11]

While the Chamber urges a shift to a territorial system of taxation, we also believe that the details of a territorial system are of the utmost significance. Proper consideration must be given to issues such as the specific exemption system applicable to foreign dividends, the treatment of other foreign income, exceptions to the exemption regime, the use of foreign tax credits for income that continues to be subject to foreign tax levies, and the treatment of expenses. These issues are unquestionably complex but must be addressed if the United States wishes to keep pace in the global economy.

R&D INCENTIVES

[7] See Tax Foundation, Special Report No. 191, Ten Reasons the U.S. Should Move to a Territorial System of Taxing Foreign Earnings, *available at* http://www.taxfoundation.org/files/sr191.pdf.

[8] See Tax Foundation, "U.K. Strives to have "Most Competitive Tax System Among G20," *available at* http://www.taxfoundation.org/blog/show/27157.html.

[9] See Wilson, "Open for business," *The Sun* (5/20/10), *available at* http://www.thesun.co.uk/sol/homepage/news/money/2980284/George-Osborne-Corporation-tax-to-be-lowest-in-G20.html. See also "Lessons in Reform—Discussion of Recent Tax Reform in Other Countries," TCPI 11th Annual Tax Policy and Practice Symposium (Statement of Anneli Collins).

[10] See Ernst & Young, "International Tax Alert: Japan's move to territorial taxation contrasts with US international tax policy," *available at* http://tax.uk.ey.com/NR/rdonlyres/edb7ggulansyuajnmmscid3lcobk6ap35suar4geem22gu5bvacg3r52522yugcoujqtmppkniq4qf4zw5sz4zuuayd/ITA077.pdf.

[11] See "Lessons in Reform—Discussion of Recent Tax Reform in Other Countries," TCPI 11th Annual Tax Policy and Practice Symposium (Statement of Jonathan Stuart-Smith).

The Chamber has long advocated that research and development (R&D) expenses should be deductible in the year incurred and a larger credit for increases in research expenditures should be allowed. Further, as other countries expand R&D benefits, the Chamber believes we should consider how the tax code impacts the decision whether to conduct research and development in the United States and, also, where the ensuing intellectual property that is created is located.

A recent Information Technology and Innovation Foundation paper[12] notes the decline in tax incentives to conduct R&D in the United States. Noting that the United States was the first country to implement a R&D tax credit in 1981, the paper concludes that we have failed to keep pace globally with R&D tax incentives. Examining our position globally it concludes:

> By 1996 the United States had fallen to seventh in R&D tax generosity among the 30 OECD nations, behind Spain, Australia, Canada, Denmark, the Netherlands, and France. And the slide continued. By 2004 we had fallen to 17th. Even with the recent expansion of the ASC from 12 to 14 percent the United States was only able to hold position at 17th (and 19th for small businesses R&D incentives), as other nations also expanded their R&D tax incentives. However it is not just OECD nations that have overtaken the United States, a number of other nations, including China, India, Brazil, and Singapore, provide more generous tax treatment for R&D expenditures.

The Chamber believes that innovation is a crucial long-term driver of growth and jobs. Any reform to the tax code should contain incentives for companies to conduct research and development activities in the United States and locate the resulting intellectual property within U.S. borders.

OTHER CONSIDERATIONS

While issues such as marginal rates, systems of taxing foreign source income, and R&D incentives easily lend themselves to international comparisons, certain other issues are more challenging to quantify and thus contrast. These issues are, nonetheless, highly relevant and merit consideration.

Certainty

The Chamber believes that any changes should be permanent to ensure certainty for businesses striving to expand, create jobs, and remain competitive in the United States and abroad. We believe that U.S. companies are disadvantaged by not only high rates and our system of taxing foreign source income, but also by the uncertainty that results from the temporary nature of so many crucial business tax provisions.

Since 1986, the code has seen over 15,000 changes, and, as of last count at the end of 2010, contained 141 temporary provisions, such as the CFC look-thru rule active financing

[12] See Information Technology and Innovation Foundation, "17 is Not Enough: The Case for a More Robust R&D Tax Credit," *available at* http://www.itif.org/files/2011-17-is-not-enough.pdf.

exception, which generally require annual renewal by Congress.[13] As other countries have introduced tax reforms and provided detailed information on when such reforms will be implemented, the Chamber urges Congress to create the same certainty in the United States to allow for the most efficient business decisions and effective long term planning.

Simplification

The Chamber believes Congress should enact simple, predictable and easy to understand tax rules to improve compliance and reduce the cost of tax administration. As noted above, other countries, such as the United Kingdom, have carefully considered compliance burdens in shifting to new systems of taxation. The Chamber urges Congress to give the same weight to this issue in considering reforming the tax code.

Cost Recovery

In addition to reducing tax rates, the Chamber believes that tax reform should eliminate the bias in the current U.S. tax system against capital investment. Capital investment should be expensed or recovered using a capital cost recovery system that provides the present value equivalent to expensing with due regard to the impact the system may have on cash flow.

Transition Rules

The Chamber believes that comprehensive tax reform should include realistic transition rules to provide adequate time for implementation and help minimize economic hardships businesses may encounter in transitioning to the new tax system.

CONCLUSION

The Chamber thanks Chairman Camp, Ranking Member Levin, and Members of the Committee for the opportunity to comment on tax reform. As Congress considers possible fundamental tax reform, the Chamber believes lowering the marginal tax rates, shifting to a territorial tax system, and addressing the uncertainty of our code are critical matters. We appreciate the continued discussions the Committee is having on these issues and look forward to our continued work with Congress on these issues.

[13] See, e.g., Hearing Statement of Senator Max Baucus (D-Mont.), Regarding Changes in the Tax Code since the 1986 Tax Reform Act, *available at* http://finance.senate.gov/imo/media/doc/03012011%20Baucus%20Hearing%20Statement%20on%20Changes%20in%20the%20Tax%20Code%20since%201986%20Reforms.pdf.