Testimony of
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Before the
House Committee on Ways and Means

Hearing on Tax Reform

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Overview

Chairman Camp, Ranking Member Levin, and distinguished members of the Committee, I appreciate the opportunity to share the views of the Business Roundtable on this very important topic.

Business Roundtable is an association of chief executive officers of leading U.S. companies with nearly $6 trillion in annual revenues and more than 12 million employees. Member companies comprise nearly a third of the total value of the U.S. stock markets and more than 60 percent of all corporate income taxes paid to the federal government. Annually, they pay $167 billion in dividends to shareholders and the economy.

On behalf of the member companies of Business Roundtable, I appreciate your holding this hearing on tax reform and the invitation to appear before you to discuss the importance of corporate tax reform to competitiveness, U.S. investment, and U.S. job growth.

Today, the U.S. corporate tax system stands out as an outlier relative to the tax systems of our trading partners, imposing a high rate of tax on corporate income and maintaining other structural features that result in American companies being less globally competitive, reducing investment in the United States, and resulting in fewer jobs for American workers and a more slowly growing economy.

Done properly, tax reform can significantly enhance the growth of the U.S. economy and the well-being of Americans through increased investment, higher wages, and more jobs in the United States.

The world has changed dramatically since the basic operating rules of our international tax system were put in place some 50 years ago and since the last major overhaul of our tax system in 1986, 25 years ago. The spread of free markets around the world has opened up new opportunities for America's businesses to sell their products to the 95 percent of the world's population that live outside the United States. At the same time, American companies face heightened competition from foreign competitors as they seek out these new markets, and foreign competition is significantly stronger in our domestic market as well.

The enhanced competition American companies face both at home and abroad is evident in the data showing the growth of foreign direct investment around the world. Across all countries, cross-border foreign direct investment among all countries has expanded from less than 6 percent of the world's GDP in 1980 to 33 percent by 2009. But American companies comprise a much smaller share of this cross-border investment than they did 30 years ago. Whereas American companies accounted for 40 percent of world cross-border investment in 1980, they now account for less than 23 percent.

Not only is competition in foreign markets much greater than it was in the past, competition in the domestic U.S. market from abroad is also much stronger. In 1980, foreign direct investment into the United States was just 3 percent of GDP; by 2009 the stock of foreign direct investment in the United States had grown to 23 percent of GDP.

This intense global competition for consumers and new markets has resulted in a very different world for America's corporations and workers. In 1960, the largest worldwide companies were nearly all American companies -- U.S.-headquartered companies comprised 17 of the world's largest 20 companies. By 1985, there were only 13, and by 2010 just six U.S.-headquartered companies ranked among the top 20. The world is much more competitive for American companies and American workers than ever before.

In the hyper-competitive environment we face today, many factors can disadvantage American companies and cause them to lose out in this competition -- to the detriment of the U.S. economy and American workers. Taxes are a very important factor. American companies seeking to expand in markets at home and abroad are working with one of the least competitive tax systems among developed countries in the world. Why?

- Tax Rates: After Japan adopts its proposed five-percentage point corporate rate reduction this spring, the U.S. will have the highest corporate tax rate in the 34-member Organization for Economic Cooperation and Development, 14 percentage points above the average of the others.

- Tax Base: The United States is also one of the few remaining advanced economies that taxes its companies on foreign earnings from active business operations when remitted home. All other G-7 countries and most other OECD countries have adopted "territorial" tax systems that largely exempt these active earnings from home country taxation.

- Innovation Tax Policy: Once a leader in promoting innovation, the United States now ranks 24th out of 38 OECD and advanced emerging economies in terms of the competitiveness of its R&D tax incentives.

The tilted playing field created by the U.S. tax system hurts the competitiveness of American companies in the world's markets both at home and abroad. Diminished sales around the world directly reduce U.S. exports of goods and services, along with investment and jobs in the United States. High taxes imposed on American companies that bring foreign earnings back to the United States discourage use of these funds to expand U.S. operations. And a high U.S. corporate tax rate on domestic profits discourages investment here in America by both U.S.-based companies and foreign-based companies. The highest price paid for the uncompetitive U.S. corporate tax system is paid by the American worker.

A growing body of research shows that the corporate income tax burden is borne in large part by labor in the form of lower wages, a result of reduced worker productivity due to the smaller amount of capital investment.[1] OECD research concludes that the corporate income tax has the most adverse effect on economic growth of any tax, lowering per capita GDP by more than any other tax.[2]

American companies with operations both at home and abroad are responsible for 63 million U.S. jobs. These companies directly employ 22 million American workers and they create an additional 41 million American jobs through their supply chain and the spending by their employees and their suppliers. It is estimated that worldwide American companies purchased $1.52 trillion in supplies from U.S. small businesses alone in 2008. The ability of American companies to be competitive in both domestic and foreign markets is essential to the <u>creation</u> of well-paying American jobs and rising living standards.

Business Roundtable strongly supports tax policies that increase the opportunity of American companies and their workers to be competitive in markets at home and abroad. Business Roundtable believes that tax reform must increase the competitiveness of American companies in order to boost U.S. employment in the short term and to set the country on a strong path for long-term economic growth.

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[1] See, for example, William C. Randolph, "International Burdens of the Corporate Income Tax," Congressional Budget Office, August 2006; Kevin A. Hassett and Aparna Mathur, "Taxes and Wages," American Enterprise Institute, June 2006; and Wiji Arulampalam, Michael P. Devereux, and Giorgia Maffini, "The Direct Incidence of Corporate Income Tax on Wages," Discussion Paper No. 5293, Institute for Study of Labor, Bonn Germany, October 2010. Reviews of the theoretical and empirical literature on the degree to which the incidence of the corporate income tax is borne by labor are provided in Rosanne Altshuler, Benjamin Harris, and Eric Toder, "Capital Income Taxation and Progressivity in a Global Economy," Tax Policy Center, May 12, 2010, and William M. Gentry, "A Review of the Evidence on the Incidence of the Corporate Income Tax," OTA Paper 101, U.S. Department of the Treasury, December 2007.

[2] See, Åsa Johansson, Christopher Heady, Jens Arnold, Bert Brys and Laura Vartia, "Tax and Economic Growth," OECD Economics Department Working Paper No. 620, July 11, 2008, and Jens Arnold, "Do Tax Structures Affect Aggregate Economic Growth? Empirical Evidence from a Panel of OECD Countries," OECD Economics Department Working Paper No. 643, October 14, 2008. Other OECD studies showing reduced investment and reduced productivity from high corporate taxes include Cyrille Schwellnus and Jens Arnold, "Do Corporate Taxes Reduce Productivity and Investment at the Firm Level? Cross-country Evidence from the Amadeus Dataset," OECD Economics Department Working Paper No. 641, September 30, 2008; and Laura Vartia, "How Do Taxes Affect Investment and Productivity? An Industry-Level Analysis of OECD Countries," OECD Economics Department Working Papers No. 656, December 19, 2008.

The U.S. Corporate Tax System Hinders U.S. Competitiveness

The U.S. tax system is no longer competitive for American companies and American workers competing in a global economy. Specifically, the United States has a high corporate tax rate and an antiquated international tax system that together discourage investment in the United States, reduce U.S. production and U.S. exports, disadvantage American companies competing in foreign markets, and reduce U.S. wages.

A more internationally competitive corporate tax system would provide greater opportunities for American companies to succeed in world markets; boost domestic investment, production and exports of American-made goods and services; and result in more and higher wage jobs for American workers.

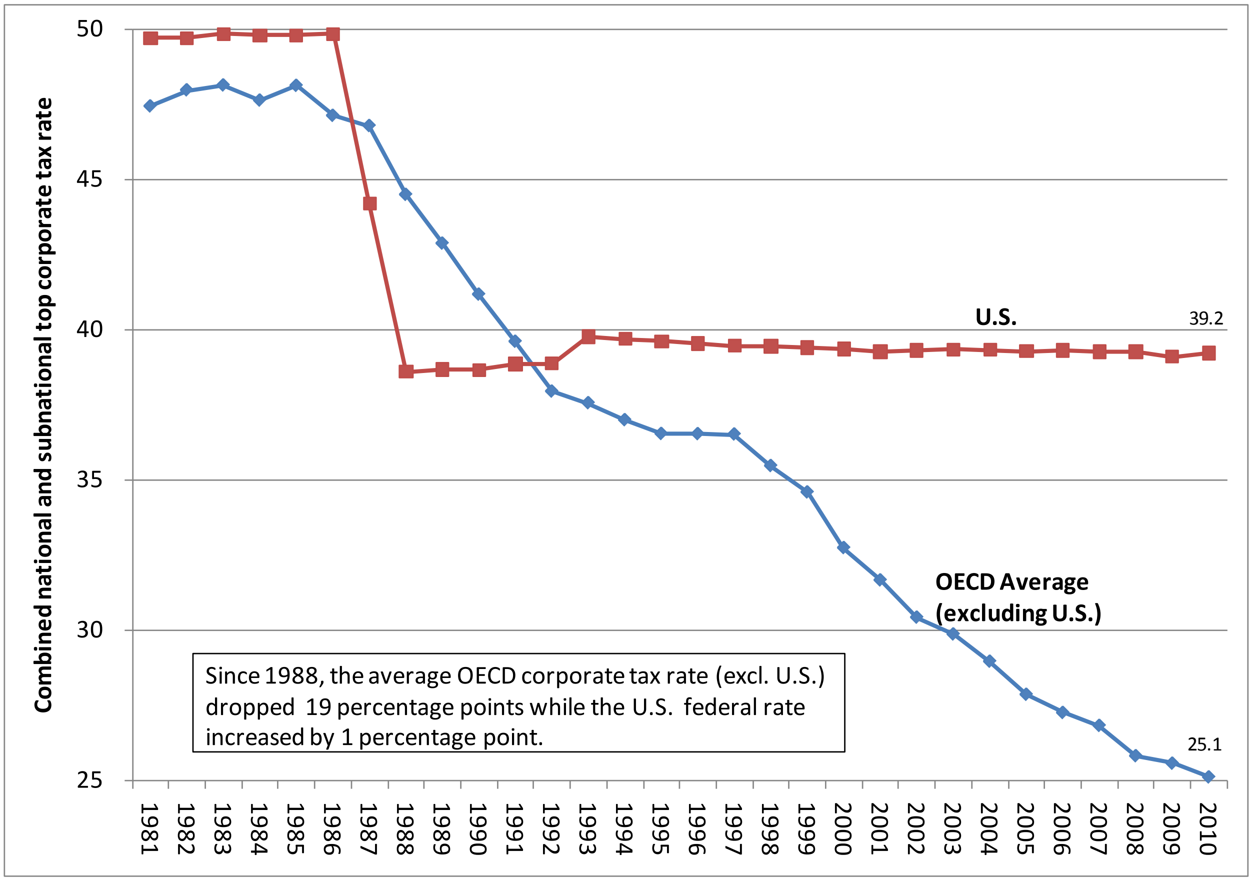
Let me highlight two of the ways in which our current corporate tax system inhibits growth of the U.S. economy: (1) the high U.S. corporate tax rate and (2) the method by which the United States taxes foreign earnings of American companies with global operations.

1. Corporate tax rates

In 1986, when the last major tax reform was undertaken, the U.S. went from among the world's highest corporate tax rates to among the lowest, reducing the federal rate from 46 percent to 34 percent. A principal objective of the 1986 reform was to lower marginal tax rates to promote economic growth by encouraging all income-producing forms of capital investment. Since 1986, there has been widespread recognition throughout the world of the importance of lower corporate tax rates to increase capital investment and promote economic growth. With increasing international mobility of capital, through both direct foreign investment and portfolio investment, the importance of corporate tax rates in competitiveness is multiple times greater than in 1986.

As shown in the accompanying figure (**Figure 1**, next page), corporate income tax rates in the rest of the OECD have fallen steadily since the 1986 U.S. reform. Since 1988, corporate rates in the rest of the OECD have fallen by an average of slightly less than one percentage point a year: falling from 44.5 percent in 1988 to 25.1 percent in 2010. By contrast, the U.S. corporate rate has actually risen in the United States since 1988, principally from a one percentage point increase in the federal corporate tax rate in 1993. In 2010, the U.S. federal and state combined corporate tax rate stood at 39.2 percent -- 14 percentage points higher than the 25.1 percent average rate of the other OECD member countries.

Figure 1.--Average OECD Member Country Corporate Tax Rate, 1981-2010



Source: OECD tax database; 2010 average includes reported tax rates for three members that acceded to the OECD in 2010 that are not yet included in the tax database. The U.S. rate is based on the 35-percent federal tax rate and average state taxes of 6.47 percent, which are deductible from federal taxes.

In 2010, the U.S. combined corporate tax rate was the second highest in the 34-member OECD, just fractionally lower than Japan's 39.5 percent rate (**Table 1**, next page). Japan has announced its intention to lower its corporate tax rate by five percentage points beginning in April 2011, at which time the U.S. will have the ignominious distinction of having the highest corporate tax rate among advanced economies in the world.

Table 1.--OECD Combined National and Sub-National Corporate Tax Rates, 2010

1	**Japan***	39.5
2	**United States**	**39.2**
3	**France**	34.4
4	**Belgium**	34.0
5	**Germany**	30.2
6	**Australia**	30.0
7	**Mexico**	30.0
8	**New Zealand**	30.0
9	**Spain**	30.0
10	**Canada**	29.5
11	**Luxembourg**	28.6
12	**Norway**	28.0
13	**United Kingdom**	28.0
14	**Italy**	27.5
15	**Portugal**	26.5
16	**Sweden**	26.3
17	**Finland**	26.0
18	**Netherlands**	25.5
19	**Austria**	25.0
20	**Denmark**	25.0
21	**Israel**	25.0
22	**Korea**	24.2
23	**Greece**	24.0
24	**Switzerland**	21.2
25	**Estonia**	21.0
26	**Turkey**	20.0
27	**Slovenia**	20.0
28	**Czech Republic**	19.0
29	**Hungary**	19.0
30	**Poland**	19.0
31	**Slovak Republic**	19.0
32	**Chile**	17.0
33	**Iceland**	15.0
34	**Ireland**	12.5
	OECD average, excluding U.S.	**25.1**

Source: OECD tax database; 2010 average includes reported tax rates for three members that acceded to the OECD in 2010 that are not yet included in the OECD tax database. The U.S. rate is based on the 35-percent federal tax rate and average state taxes of 6.47 percent, which are deductible from federal taxes.

* Note: Japan has proposed a 5-percentage point reduction in its tax rate to be effective in 2011 that would result in the United States having the highest combined national and sub-national corporate tax rate in the OECD.

Other countries in addition to Japan are also continuing to reduce their corporate tax rates. For example:

- The United Kingdom lowered its corporate tax rate from 28 percent to 27 percent in 2011, and over the next three years will further reduce it at a rate of one percent each year until it reaches 24 percent in 2014.

- Canada has lowered its federal rate in several stages from over 22 percent in 2007 to 18 percent last year, and will further reduce its rate to 16.5 percent in 2011 and 15 percent beginning in 2012.[3]

Lower U.S. corporate tax rates would attract investment to the United States and make American companies more globally competitive, boosting jobs and wages for American workers.

2. U.S. taxes on international operations

In addition to a very high corporate tax rate, the United States also stands out from other OECD countries in its tax treatment of foreign earnings. Most OECD countries (27 of the 34) employ a "territorial" tax system under which their multinational companies pay foreign taxes to the countries in which they operate but pay little or no additional home country tax on their foreign earnings when remitted home as a dividend to the parent corporation. Under territorial tax systems, a multinational corporation operating in a particular country generally pays the same tax in that country as its local competitors.

In contrast, under the U.S. system of worldwide taxation, foreign subsidiary earnings are additionally subject to U.S. tax when remitted home to the U.S. parent. As a result, the earnings of a foreign subsidiary of a U.S. company bears additional tax when these earnings are remitted home to the U.S. that is not faced by a competitor headquartered in most other OECD countries. This additional tax burden faced by a U.S.-owned subsidiary makes American-owned companies less competitive in the local foreign market and, once an American company has made a foreign investment, the additional U.S. tax levied on dividend remittances discourages such payments and reduces the reinvestment of foreign earnings in the United States.

These additional taxes make American companies less competitive in competing for customers in foreign markets and ultimately harm U.S. workers and the U.S. economy.

In contrast to the perception of some that the foreign operations of American companies displace American workers, strong foreign operations of American companies have been

[3] Additional provincial level taxes also generally apply in Canada and are set by each province. For example, the Ontario provincial corporate income tax rates were 12 percent in 2010. These rates are scheduled to decline in 2011, 2012, and 2013, reaching 10 percent in 2013.

shown to increase exports from the U.S., increase investment in the U.S., and increase U.S. wages and U.S. employment.[4]

As our member companies can attest, the foreign subsidiaries of American companies serve as export platforms for U.S.-produced goods and services into foreign markets. The foreign operations of American companies expand employment of American workers by increasing the demand for U.S.-produced goods and services for export, including supplies of intermediate goods and services, ranging from raw materials to a broad range of services, research and development, design, marketing, finance, and logistics.

But the current U.S. tax system diminishes the ability of American-owned businesses to serve these foreign markets relative to companies headquartered elsewhere. As foreign-headquartered companies expand abroad, it is *their* domestic economies that receive the benefits of increased demand for their products and services. And as these foreign-headquartered companies expand and become stronger abroad, they also become stronger competitors in *our* U.S. domestic market. As a strong believer in market economics, I welcome every strong competitor whether domestic or foreign-headquartered -- but we should not seek to tip the balance in a fair competition by disadvantaging American companies through our own tax rules that limit their ability to grow and expand.

As shown below (**Table 2**, next page), the combination of a high U.S. corporate tax rate and an unfavorable international tax system results in American companies facing the highest tax rate in the OECD on foreign earnings remitted home. Twenty of the 27 OECD countries with territorial tax systems have a 100 percent exemption on foreign dividends remitted home resulting in no additional home country tax. The other seven territorial countries exempt from 95 percent to 97 percent of foreign dividends from taxation. For example, a Japanese company repatriating foreign earnings from one of its foreign subsidiaries would face approximately a 2 percent tax on such remittances (i.e., 5 percent of the dividend taxed at approximately 39.5 percent), the highest tax rate of any territorial country.

Of the seven OECD countries that tax worldwide income, the United States has the highest tax rate at 39.2 percent. The other six OECD countries without territorial tax systems -- Chile, Ireland, Israel, Mexico, Poland, and South Korea -- have much lower tax rates and, excluding Ireland (which has a 12.5 percent tax rate), undertake little foreign investment (together accounting for less than 2 percent of the world's outward foreign direct investment in 2009).

Our major trading partners have adopted tax systems that give their multinational companies the most competitive access to consumers in every market in the world and the ability to return foreign earnings for reinvestment in their home country without facing additional tax. In just the past two years, both Japan and the United Kingdom have switched to territorial tax systems. They have explicitly chosen these territorial systems to improve the competitiveness of their economies and provide more and better paying jobs for their workers.

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[4] See, for example, Mihir Desai, C. Fritz Foley, and James R. Hines, Jr., "Domestic Effects of the Foreign Activities of US Multinationals," American Economic Journal: Economic Policy, February 2009.

Table 2.--OECD Home Country Method of Tax on Foreign-Source Dividends

Method of Taxation	Countries		Dividend Exemption Percentage
Territorial Tax Systems	**OECD Countries with Territorial Tax Systems**		
Exempt foreign-source dividends from domestic taxation through territorial tax system[1]	Australia, Austria, Canada, Czech Republic, Denmark, Estonia, Finland, Greece, Hungary, Iceland, Luxembourg, Netherlands, New Zealand, Portugal, Slovak Republic, Spain, Sweden, Switzerland,[2] Turkey, United Kingdom		100% exemption
	Norway		97% exemption
	Belgium, France,[3] Germany, Italy, Japan, Slovenia		95% exemption
Worldwide Tax Systems	**OECD Countries with Worldwide Tax Systems**		
	Country	**2010 Tax Rate**[4]	
Worldwide system of taxation with foreign tax credit	Chile	17.00%	0% exemption
	Ireland	12.50%	0% exemption
	Israel	25.00%	0% exemption
	Korea	24.20%	0% exemption
	Mexico	30.00%	0% exemption
	Poland	19.00%	0% exemption
	United States	**39.21%**	0% exemption

[1] In general, territorial tax treatment providing exemption of foreign-source dividends depends on qualifying criteria (e.g., minimum ownership level, minimum holding period the source country, and/or the source country tax rate).

[2] The effective exemption may be reduced by up to 5% as a proxy for general and administrative expenses.

[3] The exemption percentage is at least 95%, but can be higher.

[4] Refers to generally applicable tax rate, including surcharges, of combined central and sub-central government taxes.

Source: Business Roundtable, "Roadmap for Growth"

Conclusion

Since the last comprehensive reform of corporate taxes took place over 25 years ago in 1986, the world has changed. American companies and American workers face a far more competitive global economy. But these changes have also brought opportunities for American companies who are now able to reach consumers in every part of the world, greatly expanding the market for American-made goods and services.

We now need to make sure the United States has a tax system that is in keeping with the more globally competitive environment we face today. American companies produce the most innovative products in the world and -- given a level-playing field -- will go head-to-head against any competitor. But if we are handicapped by an uncompetitive corporate tax system, we will slow the growth of the U.S. economy to the benefit of our competitors.

On behalf of Business Roundtable, I look forward to working closely with this Committee, the Congress, and the Administration to develop bipartisan proposals for a competitive corporate tax system consistent with the realities of today's global markets. A competitive corporate tax system will result in more and better paying jobs, attract and increase U.S. investment, and set the nation on a path for strong and sustained economic growth.