Business Roundtable[SM]

Corporate Tax Reform – The Time is Now

Summary Version

Submission to House Committee on Ways and Means
Tax Reform Working Groups

April 15, 2013

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Statement on Comprehensive Tax Reform

The Business Roundtable supports comprehensive tax reform of both the individual and corporate income tax systems to improve economic growth and provide for a simpler and more efficient tax system. The Business Roundtable commends the ongoing tax reform efforts of the Ways and Means Committee, led by Chairman Dave Camp (R-MI) and ranking member Sander Levin (D-MI); the Senate Finance Committee, led by Chairman Max Baucus (D-MT) and ranking member Orrin Hatch (R-UT); and the Administration led by President Barack Obama and Treasury Secretary Jack Lew.

Based on the expertise of Business Roundtable CEOs, this primer on tax reform is limited to an analysis of the corporate income tax system and the changes needed to update the corporate income tax to allow American companies to be competitive in markets both at home and abroad and return economic growth and job creation to the United States. The Business Roundtable supports corporate tax reform that is revenue neutral within the corporate sector, thereby ensuring that any reforms to the corporate tax system are financed strictly through broadening of the corporate income tax base. Given the need for the U.S. tax system to be competitive with the tax systems of our major competitors, all corporate revenues from base-broadening measures and loophole closing should be used only for corporate reform.

Corporate Tax Reform — The Time Is Now
Summary Version

It has been more than 25 years since the last comprehensive review of the U.S. tax system, which culminated in the Tax Reform Act of 1986. Since then, the economies of the United States and the world have changed in important ways. New technologies, emerging economies and falling trade barriers have significantly increased global cross-border investment and trade over this period, while increasing economic competition. At the same time, the U.S. tax law has become even more complex and burdensome for U.S. businesses and has failed to adapt to changes in the global economy.

With the nation still recovering from the worst recession in generations — and job creation and economic growth needed to put millions of Americans back to work — now is the time for a comprehensive review and reform of the nation's 100-year old tax system.

Tax reform is needed to modernize the tax system to meet the competitive demands of the 21st century and to restore economic growth in the United States. This primer sets forth a summary of the problems with the current corporate tax system and reasons for the Business Roundtable's recommendations for revenue-neutral corporate tax reform providing a competitive corporate tax rate and a modernized international tax system.

I. TAX REFORM FOR JOB CREATION AND ECONOMIC GROWTH

Job creation and rising real wages are the signs of a healthy economy. Yet today, almost four years since the end of the 2007–09 recession, nearly 3 million fewer Americans have a job, and millions more are seeking employment. And for those with a job, real median wages have shown little or no growth for more than a decade.

The U.S. corporate tax system is hindering private-sector growth and job creation precisely at the time we need economic growth to get the economy back on track. Corporate income taxes are widely recognized as the most harmful form of taxation for economic growth. While all corporate tax systems inhibit growth, the U.S. corporate tax system is the least competitive of all corporate tax systems in the developed world.

The United States has the highest corporate tax rate among advanced economies and is one of the few advanced economies that imposes a second round of taxes when foreign earnings are remitted home, which discourages the investment of these earnings in the United States.

A modernized U.S. tax system with competitive corporate tax rates and competitive international tax rules would increase business investment undertaken in the United States. Job growth and higher wages for American workers would be achieved through these reforms; together, lower corporate tax rates and updated international tax rules would spur new investment at home, ensure that American companies are competitive in expanding foreign markets and allow American companies to bring back their foreign earnings for use in the United States.

Revenue-neutral corporate tax reform can modernize our tax system and help reinvigorate job growth and economic expansion. The Business Roundtable urges Congress to undertake comprehensive tax reform this year.

II. A COMPETITIVE CORPORATE TAX RATE

Today, the combined federal and state corporate tax rate in the United States is 39.1 percent, higher than that of any other Organisation for Economic Co-operation and Development (OECD) country and 14 percentage points higher than the 25 percent average rate of other OECD countries in 2012 **(Exhibit 1)**.

When the United States last undertook tax reform in 1986, the federal corporate tax rate was reduced from 46 percent to 34 percent, and the United States went from having one of the highest tax rates among developed countries to one of the lowest. Since that time, however, most countries — in an effort to encourage job growth and investment in their economies — have been reducing their corporate tax rates. In fact, of the 34 countries in the OECD, 32 have a lower corporate tax rate today than they did in 1988, after the 1986 tax reform was fully phased in. Only the United States and one other country — Chile — have a higher rate than they did in 1988.

Since 1988, the average OECD corporate tax rate has dropped more than 19 percentage points, while the U.S. federal rate has increased one percentage point to 35 percent **(Exhibit 2)**.

A number of recent proposals have called for a lower U.S. corporate tax rate, including:

- President Obama's *Framework for Business Tax Reform* (February 2012);
- House Ways and Means Chairman Dave Camp's (R-MI) discussion draft (October 2011);
- The recommendations of the co-chairs of the President's National Commission on Fiscal Responsibility and Reform, former Senator Alan Simpson and former White House Chief of Staff Erskine Bowles (December 2010);

Exhibit 1. OECD Combined National and Subnational Corporate Tax Rates

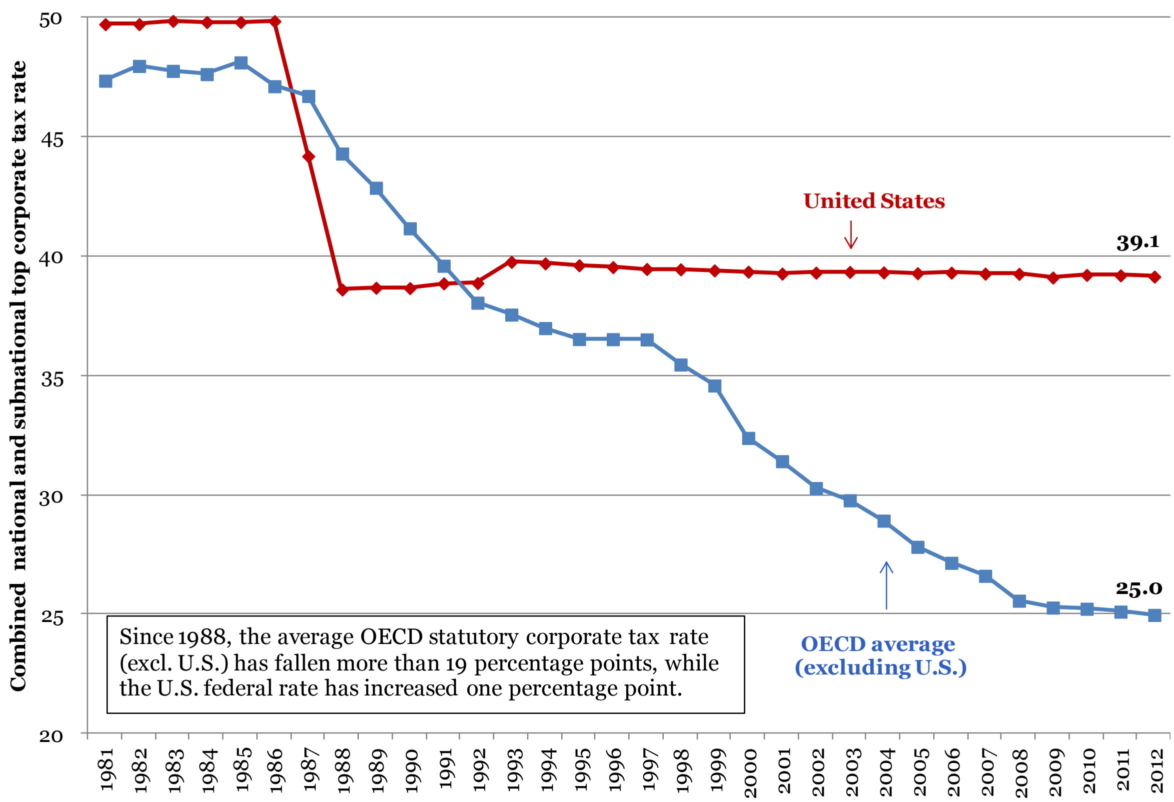
Rank in 2012		Rate in 2012	Enacted or proposed reductions, 2013–2015
1	**United States**	**39.1**	
2	**Japan**	38.0	35.6
3	**France**	34.4	
4	**Belgium**	34.0	
5	**Portugal**	31.5	
6	**Germany**	30.2	
7	**Australia**	30.0	
8	**Mexico**	30.0	28.0
9	**Spain**	30.0	
10	**Luxembourg**	28.8	
11	**New Zealand**	28.0	
12	**Norway**	28.0	
13	**Italy**	27.5	
14	**Sweden**	26.3	22.0
15	**Canada**	26.1	
16	**Austria**	25.0	
17	**Denmark**	25.0	22.0
18	**Israel**	25.0	
19	**Netherlands**	25.0	24.0
20	**Finland**	24.5	20.0
21	**Korea**	24.2	
22	**United Kingdom**	24.0	20.0
23	**Switzerland**	21.2	
24	**Estonia**	21.0	20.0
25	**Chile**	20.0	
26	**Greece**	20.0	
27	**Iceland**	20.0	
28	**Turkey**	20.0	
29	**Czech Republic**	19.0	
30	**Hungary**	19.0	
31	**Poland**	19.0	
32	**Slovak Republic**	19.0	
33	**Slovenia**	18.0	15.0
34	**Ireland**	12.5	
	OECD average, excluding U.S.	**25.0**	

Source: OECD Tax Database (2012). Japan 2012 tax rate, Slovenia 2012 tax rate, and enacted or proposed reductions from current publications.

- The recommendations of the Bipartisan Policy Center task force co-chaired by former Senator Pete Domenici and Alice Rivlin (November 2010); and

- Senator Ron Wyden's and Senator Dan Coats' Bipartisan Tax Fairness and Simplification Act (April 2011).

Exhibit 2. U.S. and Average OECD Statutory Corporate Tax Rates, 1981–2012



Source: OECD Tax Database (2012).
The current U.S. rate is based on the 35 percent federal tax rate and average state taxes of 6.36 percent. Since state taxes are deductible from federal taxes, the net combined tax rate is 39.1 percent.

A lower U.S. corporate tax rate would make the U.S. economy more competitive.

A lower corporate tax rate would make the U.S. economy more internationally competitive, increase U.S. jobs and investment, and improve the efficiency of the tax system.

At present, the high U.S. corporate tax rate discourages investment in the United States by both American and foreign corporations. The high tax rate reduces the return on investments, effectively making it more costly to invest in the United States.

A lower corporate tax rate would have its greatest impact on attracting mobile, high-return investments, frequently based on research-intensive, innovative technologies. Increases in these investments would lead to particularly large productivity gains. Higher worker productivity in turn would benefit the economy through higher wages, higher incomes and a rising standard of living over time.

A lower U.S. corporate tax rate also would reduce other inefficiencies in the tax system. A lower corporate tax rate reduces the tax bias favoring the use of debt finance over equity finance and reduces tax disparities in depreciation and capital cost recovery rules that prevent an efficient allocation of corporate capital across diverse assets. A more efficient allocation of capital results in greater output — and thus greater gross domestic product (GDP) — for any given amount of total investment.

The Burden of the Corporate Income Tax Falls on Individuals

Because the corporate income tax is collected from corporations rather than from individuals, a common misperception is that the tax is borne by corporations. However, corporations are merely legal entities. The burden of the tax must fall on individuals in some manner in their role as workers, consumers and savers. How exactly the burden is shared among individuals in these roles has been a matter of long-standing economic study.

Workers can bear a portion of the corporate income tax because the tax reduces corporate investment. Less investment results in fewer workers, with less productivity, who in turn earn lower wages than they would have earned in the absence of the tax. A number of recent studies find that workers bear between half and three-quarters of the burden of the corporate income tax, with one study by the Congressional Budget Office finding that workers bear slightly more than 70 percent of the corporate tax burden.

Effective Tax Rates in the United States Are Also Higher Than in Other Countries

It is sometimes questioned whether the high statutory corporate tax rate in the United States also results in a high *effective tax rate* on income earned in the United States.

Effective tax rates can be computed in a number of ways, but they differ from statutory rates by taking into consideration other provisions of the tax system, such as deductions, exclusions and credits, that affect the total amount of tax paid.

Some commentators have incorrectly claimed that U.S. effective tax rates on corporate income are below average since U.S. corporate income tax collections are a smaller share of GDP than the average of other OECD countries. However, this calculation ignores the larger pass-through sector in the United States relative to other advanced economies. Pass-through entities, such as sole proprietors, partnerships and S corporations, are not taxed under the corporate income tax; rather the owners of these entities pay tax on their business income directly under the individual income tax. Business income earned by pass-through entities in the United States has increased rapidly over the past 25 years, and it has averaged more than 60 percent of all business income in the 10 most recent years (2001–10), up from less than 30 percent in the 1980s. With such a substantial share of U.S. business income earned outside the corporate sector, comparisons of corporate tax collections relative to GDP in the United States and other countries are misleading.

Researchers directly examining effective tax rates on corporate income generally find that the U.S. effective tax rate is among the highest in the world. Several recent studies have compared cash effective tax rates, marginal effective tax rates and financial statement effective tax rates in the United States and other countries. These studies conclude that U.S. effective tax rates are often the highest or second highest among advanced economies and, depending on the particular measure, five to 10 percentage points higher than the average of other advanced economies.

III. A COMPETITIVE INTERNATIONAL TAX SYSTEM

Large and growing world markets present enormous opportunities for America's businesses and their workers. With 95 percent of the world's population and 80 percent of the world's purchasing power located in markets outside the United States, growth at home requires successful engagement in world markets. And with 95 percent of the world's population growth forecast to be in rapidly growing developing countries, the need for American companies to grow and sell abroad will increase, and competitive pressures will only intensify.

Advances in telecommunications, lower costs of transport, falling trade barriers and the adoption of market-based economies throughout the world have brought the world's populations closer together while heightening economic competition. Despite the increased importance of foreign markets to the U.S. economy, our tax system has not kept pace with these changes, and America's market share in foreign markets has been declining.

Today, U.S. international tax rules are an outlier among developed countries and impede the ability of American companies to enter foreign markets on competitive terms and return those profits for investment in the U.S. economy.

America benefits from global engagement

Successful global engagement requires that American companies be competitive both at home and abroad and not be disadvantaged by U.S. tax rules.

The U.S. economy benefits from the foreign operations of American companies. Foreign operations can increase the demand for U.S. exports of other goods and services that are complementary to the local operations, including high-value components manufactured in the United States. Growth in global sales also increases the return to American companies undertaking research and development and management activities in their headquarters operations in the United States, including engineering, finance, marketing, logistics and other high-paying jobs. As a result, growing foreign operations can lead to growth in U.S. employment, investment and exports.

American parent companies with international operations employed 22.8 million workers in the United States in 2010 and, including their supply networks and the spending by their employees, supported more than 63 million U.S. jobs. U.S. employment by American parent companies accounted for more than two-thirds of their worldwide employment. The average annual compensation paid in 2010 by American parent companies to their American workers was $70,700, compared with $52,900 for U.S. businesses without foreign operations.

Be there to sell there. American companies compete in foreign markets through U.S. exports of goods and services and foreign investment — whether through joint ventures, foreign acquisitions or the establishment of new facilities.

American companies operate abroad to serve foreign customers. More than 90 percent of the sales by foreign subsidiaries of American companies are to foreign customers rather than for the U.S. market. Localized foreign operations allow American companies to tailor their products to local needs and tastes and overcome transportation cost barriers that otherwise would make their products noncompetitive. A range of services provided by American companies can be performed only locally, including construction, utilities, retail trade and financial services.

Gaining access to natural resources. Natural resource industries, including mining, oil and natural gas, must locate operations where the resources can be obtained. The United States benefits when American companies develop these resource deposits.

U.S. international tax rules are an outlier among advanced economies

Unlike most OECD countries, the United States taxes American companies on their business income earned in foreign countries. Under the U.S. worldwide system, U.S. tax is assessed on active business earnings when they are brought back to the United States as dividends, with a tax credit for foreign income taxes paid in the country where the income was earned. The U.S. system thus imposes a second round of tax on foreign earnings, equal to the difference between the U.S. rate and the foreign rate on the remitted earnings. As a result, American companies pay tax on their international income twice — once in the foreign country where the earnings arise and then again when the earnings are brought back to the United States.

In contrast, 28 of the 34 OECD countries (and all other G-8 countries) use territorial tax systems under which active business earnings returned home as dividends are subject to little or no additional home-country tax **(Exhibit 3)**. Of the 28 OECD countries with territorial tax systems, 20 countries exempt 100 percent of qualifying dividends, while eight countries exempt between 95 and 97 percent of the qualifying dividends from domestic taxation. The 95 to 97 percent exemption typically results in a home-country tax rate of about 1 percent on the foreign dividend.

Exhibit 3. OECD Countries with Territorial and Worldwide Tax Systems

Territorial Countries			Worldwide Countries
1. Australia	11. Greece	21. Portugal	1. Chile
2. Austria	12. Hungary	22. Slovak Republic	2. Ireland
3. Belgium	13. Iceland	23. Slovenia	3. Israel
4. Canada	14. Italy	24. Spain	4. Korea
5. Czech Republic	15. Japan	25. Sweden	5. Mexico
6. Denmark	16. Luxembourg	26. Switzerland	**6. United States**
7. Estonia	17. Netherlands	27. Turkey	
8. Finland	18. New Zealand	28. United Kingdom	
9. France	19. Norway		
10. Germany	20. Poland		

A reformed international tax system would benefit the U.S. economy

Countries have responded to the growing importance of cross-border investment by adopting territorial tax systems to strengthen, attract and retain the headquarters operations of multinational corporations. Under a territorial tax system, companies can compete on a level playing field with other companies in foreign markets and bring their foreign earnings home to invest in their domestic economies. Reforming the U.S. international tax system to provide similar rules for American companies would enhance the global competitiveness of American-headquartered companies and strengthen the U.S. economy by removing barriers to returning foreign earnings for investment in the United States.

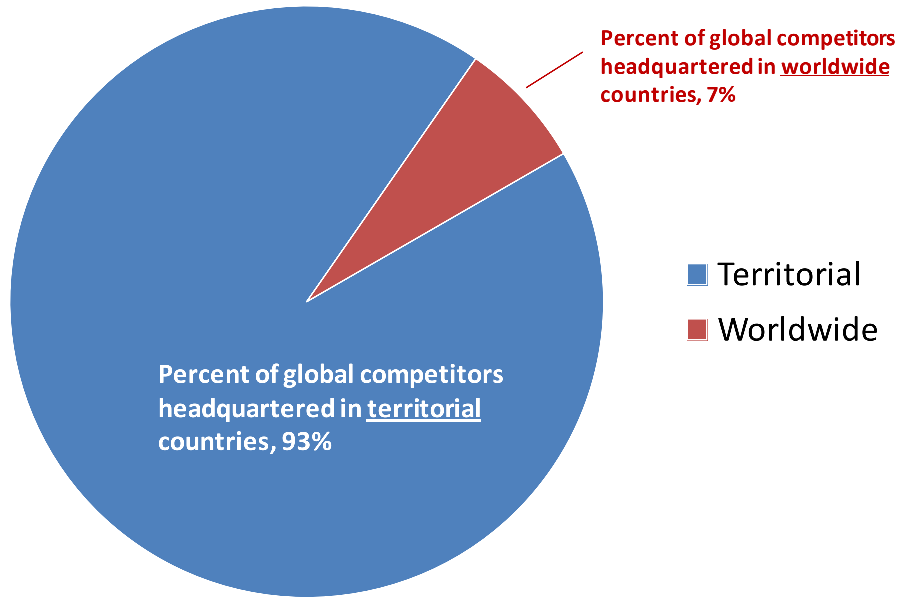
Proposals for modernizing U.S. international tax rules by moving in the direction of a market-based territorial tax system have been made by House Ways and Means Committee Chairman Dave Camp and several commissions established by President Obama and his Administration, including:

- President Obama's National Commission on Fiscal Responsibility and Reform (Simpson-Bowles);
- President Obama's Export Council;
- President Obama's Council on Jobs and Competitiveness;
- The Advanced Manufacturing Partnership Steering Committee of President Obama's Council of Advisors on Science and Technology; and
- The Secretary of Commerce's Manufacturing Council.

Increased global competition makes U.S. corporate tax policy more important than ever. American companies need an internationally competitive tax system to compete on a level playing field with their competitors from around the world in markets at home and abroad.

Wherever American companies compete abroad, they are now virtually certain to be competing against foreign companies that have more favorable tax rules. Within the OECD, 93 percent of the non-U.S. companies in the Global Fortune 500 in 2012 are headquartered in countries that use more favorable territorial tax systems — up from 27 percent in 1995 — and all of these countries have a lower home-country corporate tax rate **(Exhibit 4)**.

Exhibit 4. Global Competitors of American Companies Predominantly Headquartered in Territorial Countries
Headquarters location of non-U.S. OECD companies in the Global Fortune 500, 2012



Source: Fortune (2012).

Corporate tax rules that hinder the competitiveness of American companies disadvantage American workers.

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A modernized international tax system providing a market-based territorial tax system would allow American companies to compete in foreign markets on equal terms with their foreign competitors. In addition, these reforms would allow American companies to bring back their foreign earnings for investment in the U.S. economy without facing a tax penalty.

Under current law, foreign earnings are effectively "locked out" of the United States, since American companies face a tax as high as 39.1 percent if the earnings are brought home. An estimated $1.7 trillion in accumulated foreign earnings was held by the foreign subsidiaries of American companies in 2011. If only half of that amount came back to the United States in response to enactment of a market-based territorial tax system, the funds freed up for use at home would exceed the increased government spending and tax relief provided under the 2009 American Recovery and Reinvestment Act. In addition to the immediate return of billions of dollars of past foreign earnings upon enactment, a market-based territorial tax system also would encourage American companies to bring back future foreign earnings for investment in the United States.

Some have raised concerns that the adoption of a "pure" territorial system could result in a loss of U.S. jobs or tax revenue if U.S. activities or income was shifted offshore. However, a movement toward territorial rules would allow American companies to be more competitive in foreign markets and increase incentives to invest earnings in the United States, both of which would lead to an increase in U.S. jobs. Further, a reduction in the U.S. corporate tax rate and continued application of transfer pricing and controlled foreign corporation (CFC) rules would limit incentives and the ability to avoid U.S. tax on U.S. income. To the extent necessary, the adoption of a market-based territorial system could be accompanied by a review of transfer pricing and CFC rules to further safeguard against any incremental shifting of income from the United States to low-tax countries resulting from the territorial system. Any such safeguards should be designed to minimize both the adverse impact on the competitiveness of American companies and any increase in compliance and administrative burden.

IV. FISCALLY RESPONSIBLE CORPORATE TAX REFORM

A reformed corporate tax system — with a competitive tax rate and competitive international tax rules and without temporary and uncertain provisions — would result in greater economic growth and job creation for the United States. Such a system would promote the competitiveness of the United States by allowing businesses to compete on a level playing field with each other and with their foreign competitors around the world.

To ensure that corporate tax reform benefits the economy without increasing the deficit, the Business Roundtable supports revenue-neutral corporate reform that includes appropriate base-broadening measures as part of comprehensive reform that would provide a competitive corporate tax rate and a more modern and competitive international tax system. Accounting for the pro-growth effects of these reforms, such reform will increase economic growth and generate additional tax revenues. Implementation of comprehensive reform should include transition rules to minimize taxpayer uncertainty while legislation is being formulated and to avoid retroactive taxation.

Overall rate reduction is generally more efficient than targeted incentives

Partly to incentivize certain activities as well as to alleviate the adverse impacts of the high U.S. corporate tax rate, policymakers have introduced over the years a wide range of special provisions, typically in the form of enhanced deductions or tax credits that operate to reduce the rate of tax on specified business activities. While such provisions reduce the overall rate of tax on qualifying activities, they are viewed by many as less efficient from an economy-wide perspective than a broadly applicable across-the-board incentive or overall rate reduction. This is because narrowly targeted incentives divert resources away from other valuable business activities that may generate higher pretax returns and greater value for consumers.

Base-broadening reforms that use the revenues from limiting or repealing special targeted deductions and credits to provide for lower tax rates would improve economic efficiency and economic growth.

Tax expenditures

To the government, the cost of providing special tax incentives comes in the form of reduced corporate income tax collections. The staff of the Joint Committee on Taxation (JCT) estimates that in 2012 more than 80 separate special provisions, or “tax expenditures,” each accounted for more than $50 million in reduced corporate income tax revenue.

The JCT has provided preliminary estimates of the tax revenue that could be raised through the elimination of 21 corporate tax expenditures on domestic commerce as part of tax reform that provided a lower statutory corporate tax rate. The JCT estimates that repeal of these provisions would provide sufficient revenue to reduce the corporate tax rate to 28 percent in a revenue-neutral manner.

Base-broadening tax reform

Economic growth and job creation would be enhanced through corporate tax reform providing a reduced statutory tax rate and a competitive market-based territorial tax system. The experience of other countries suggests that the cost of these reforms is at least in part self-financing, as the added economic growth increases tax revenues. Some studies have concluded that significant rate reduction can be achieved without reducing tax revenue.

To the extent required, appropriate base-broadening reforms that limit tax expenditures and other special provisions can ensure that corporate tax reform does not result in a reduction in tax revenues. The use of any specific provision as part of revenue-neutral tax reform must carefully weigh the economic benefits achieved through the other components of tax reform. Further, because increases in the corporate income tax adversely affect economic growth, any base-broadening provisions should be kept to the minimum necessary to provide for corporate rate reduction and improving the competitiveness of the U.S. international tax system.

V. CONCLUSION

Corporate tax reform done right can grow the economy by increasing domestic investment and increasing the competitiveness of American companies in global markets. A faster growing U.S. economy will produce more and better paying jobs both now and for future generations of Americans.

The problems with our current corporate tax system are well known, and the reforms that are needed are clear. The U.S. corporate tax system has failed to keep pace with the changing global economy over the past 25 years, with the last comprehensive restructuring of the tax system occurring in 1986. Today the U.S. corporate tax system is an outlier at a time when capital is more mobile and the world's economies are more interconnected than at any time in history.

Our current tax system discourages capital investment in the United States and impairs the ability of American companies to compete abroad. The United States has the highest corporate tax rate among advanced economies and is one of the few remaining advanced economies to maintain a worldwide tax system. It is the least competitive tax system among advanced economies — when we should be striving to make it the most competitive. The end result of this tax system is a more slowly growing economy, resulting in fewer jobs and lower wages for American workers.

Tax reform to improve economic growth and job creation in the United States should at a minimum result in a tax system that is as competitive as the tax systems of our trading partners. A competitive corporate tax rate and a competitive market-based territorial tax system like those of other OECD countries will promote investment in the United States and provide a level playing field for American-based businesses to compete globally, and together provide the basis for enhancing and sustaining U.S. economic growth and job creation.

Additional Reading

For additional information and references, see the complete companion version of this Business Roundtable publication at businessroundtable.org.