Testimony Submitted by Brian Garst
Director of Government Affairs
Center for Freedom and Prosperity

To the House Ways and Means Committee Hearing on
"The Need for Comprehensive Tax Reform to Help American Companies Compete in the Global Market and Create Jobs for American Workers"
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Thank you for the opportunity to share my views with you. My name is Brian Garst, and I am the Director of Government Affairs at the Center for Freedom and Prosperity, an Alexandria, Virginia based, 501(c)(4) citizen organization that lobbies Congress and the Administration on tax competition, financial privacy and fiscal sovereignty.

The Committee is examining how the tax code burdens U.S. corporations and leaves them uncompetitive in the global market. The tax code as constructed often taxes the same capital two, three or even four times, which severely impacts savings and investment. Reforming the tax code to instead promote savings and investment would help improve competitiveness of U.S. corporations, boost economic growth, and create American jobs.

My testimony will focus on two fundamental flaws in the current approach to taxation, as well as identify several future problem areas based on current or pending laws and regulations.

More information on the following is also available at our website: http://freedomandprosperity.org.

High Corporate Tax Rate

High corporate rates are a burden on investors, consumers and workers, and furthermore discourage U.S. corporations from creating American jobs. Following the Tax Reform Act of 1986, the U.S. for a time had a low corporate tax rate compared to other developed nations. But other nations quickly caught on to the fact that low corporate tax rates are necessary for economic growth, and have since been cutting their rates. The U.S. has simply failed to keep up.

Today, the U.S., when combining state and federal taxes, has the second highest statutory corporate tax rate among OECD nations.[1] The highest rate is held by Japan, which has pledged to reduce their rate by 5%[2], thus leaving the U.S. soon to hold the dubious distinction of having the highest level of destructive corporate taxation. Although this is bad news, the statutory rate does not tell the entire picture. Effective marginal tax rates take into account rules for depreciation and additional features of the tax code that influence where corporations choose to invest. When comparing effective marginal

1 OECD Tax Database, Table II.1 – Basic (non-targeted) corporate income tax rates. http://www.oecd.org/document/60/0,3343,en_2649_34533_1942460_1_1_1_1,00.html#C_CorporateCaptial
2 "Japan Will Cut Corporate Income Tax Rate," New York Times, December 13, 2010. http://www.nytimes.com/2010/12/14/business/global/14yen.html

tax rates, international trends again leave U.S. corporations increasingly uncompetitive.[3]

The obvious consequence of comparatively high rates is that many corporations choose to forgo investing and expanding in the U.S. in favor of more hospitable jurisdictions. But high corporate rates also negatively impact the economy irrespective of international rates, especially when combined with other taxes on capital – such as the capital gains, dividends and estate taxes. These taxes reduce investment by raising the cost of capital, and thus the amount of return that must be seen before justifying new investments. Lower investment means fewer jobs and smaller paychecks for American workers.

For more, see CF&P's video on corporate taxes:

The Need to Cut the Corporate Income Tax to Make America More Competitive
http://freedomandprosperity.org/2007/videos/cut-the-corporate-income-tax/

Worldwide taxation

The U.S. taxes income earned in other jurisdictions. If U.S. corporations are taxed by a local jurisdiction at less than the federal statutory rate of 35%, the U.S. expects to receive the difference. Foreign companies competing in the same jurisdictions are not similarly hobbled, leaving American companies at a severe disadvantage. The U.S. is one of only a handful of countries that use a worldwide tax system.

The worldwide tax system also adds considerable complexity to the tax code, and accounts for a large share of corporate compliance costs. Deferral of U.S. taxes until profits are repatriated provides some temporary relief – though there is talk from the Administration of doing away with even that – but it has the exact opposite effect of what good tax policy ought to promote, which is greater investment in the U.S. Rather than encourage corporations to reinvest in the U.S., it rewards them for keeping profits overseas. The net impact of this system is that many corporations have simply chosen to relocate their headquarters to other nations, and multi-national corporations are less likely to be created in the U.S. The next Microsoft is now more likely to be created overseas than within American borders.

It's worth pointing out that the worldwide tax system is not simply a burden on business. It also applies to labor, and so harms Americans who work overseas and who, because they face double taxation on their labor beyond a certain exemption known as the Section 911 exclusion, cannot compete for top level executive positions. Yet some quixotically want to end this exemption, which would result in a brain drain as many talented American workers would simply choose to abandon their citizenship.

Foreign Account Tax Compliance Act

The Foreign Account Tax Compliance Act (FATCA) was passed in 2010 as part of the Hiring Incentives to Restore Employment Act. FATCA will require all foreign financial institutions to enter disclosure compliance agreements with the U.S. Treasury, or face a 30% withholding on U.S. accounts. While final FATCA regulations are still being written in the lead up to the implementation date of

3 Robert Carroll, "Comparing International Corporate Tax Rates: U.S. Corporate Tax Rate Increasingly Out of Line by Various Measure," Tax Foundation, Fiscal Fact No. 143, August 2008. http://www.taxfoundation.org/files/ff143.pdf

January 1, 2013, it is already clear that the new reporting regime will place such burdens on foreign financial institutions that many will decide to stop taking U.S. clients and disinvest in the U.S. economy. In fact, a number have already started doing just that. In addition to leaving Americans living abroad without banking options, the reduced capital stock will also negatively impact U.S. corporations and workers.

Nonresident Alien Deposit Interest Reporting

On the other side of the coin from FATCA, which burdens Americans overseas and the foreign financial institutions which serve them, a recently proposed IRS regulation (REG-146097-09) would burden American financial institutions and drive foreign investors out of the U.S. market. Although Congress has repeatedly decided not to tax foreign deposit interest earned in the U.S., for the specific reason of making the U.S. an attractive destination for foreign capital, the IRS has taken it upon themselves to require reporting of this information so that it may be shared with foreign governments. The impact will be the same as if Congress sought to tax the interest directly – a flight of capital from the U.S.

For many foreign investors, the U.S. is not simply a good investment. It is also a safe haven from corrupt or venal governments, and criminal gangs which would seek to threaten depositors and their families with extortion, blackmail or kidnapping. If the IRS chooses to legislate the U.S. into no longer being an attractive destination for flight capital, these foreigners will take their investments elsewhere.

According to the Commerce Department, foreigners have over $10 trillion passively invested in the American economy, with nearly $3.6 reported by U.S. banks a securities brokers.[4] While not all of this capital would be at risk, if even a portion of it were to be lost it would have a negative impact on American jobs and the economy.

For more, see the CF&P's informational website and video on the proposed regulation:

IRS's Information Sharing Regulation
http://freedomandprosperity.org/issues/irs-information-sharing-regulation/

The IRS Running Amok: Forcing American Banks to Put Foreign Tax Law Above U.S. Tax Law
http://freedomandprosperity.org/2011/videos/the-irs-running-amok/

Targeting Tax Havens is the Wrong Approach

Some in Congress – along with international organizations heavily subsidized by U.S. tax dollars, such as the OECD – look at fiscal deficits and see a need to squeeze more tax revenues out of corporations and citizens alike. They target so-called tax havens, while ignoring that the world's biggest tax haven is within the United States, believing that they somehow represent a threat to American fiscal soundness. Nothing could be further from the truth.

Low-tax jurisdictions, which we should remember have the same right to determine their own fiscal

4 Florida U.S. House delegation letter to President Obama. http://freedomandprosperity.org/files/NRAreg/FL-Delegation.pdf

policy as we have ours, actually benefit the global economy.[5] Through tax competition, these jurisdictions help to promote good tax policy. Without competitive pressure to reduce tax rates, politicians would tax and spend excessively and cripple economic activity. The very fact that this hearing is taking place is indication that there are competitive pressures to maintain competitive tax rates and promote economic growth. And in the long run, greater economic growth would also mean higher tax revenues.

Anti-tax haven crusaders at the OECD in in the U.S., who tend also to be advocates of bigger government and higher taxes, throw around phony numbers such as a supposed $100 billion in lost U.S. tax revenue to low-tax jurisdictions. But this figure was long ago debunked when it was determined to be based off an estimate concocted by former Democratic staffer Jack Blum. When former House Majority Leader Dick Armey asked CRS to get the methodology for the number, Blum confessed that, for all intents and purposes, he made it up.[6]

Rather than easing the burdens and challenges which leave U.S. companies at a competitive disadvantage, those who routinely attack so-called tax havens would have us increase them. This is the wrong approach.

For more, see CF&P 's three-part video series on tax havens:

The Economic Case for Tax Havens
http://freedomandprosperity.org/2008/videos/the-economic-case-for-tax-havens/

The Moral Case for Tax Havens
http://freedomandprosperity.org/2008/videos/the-moral-case-for-tax-havens/

Tax Havens: Myths vs. Facts
http://freedomandprosperity.org/2008/videos/tax-havens-myths-vs-facts/

Conclusion

The identified initiatives, which fail to recognize the diminishing returns that come from pursuing every last drop of potential tax revenue, should be abandoned. Rather than attacking tax competition, the U.S. should lead by example and recognize that tax competition promotes good tax policy by providing a check on the excesses of politicians.

The better solution is to replace the worldwide tax structure with a territorial system. This would level the playing field for U.S. corporations and citizens alike, increase exports, employment and competitiveness, and also reduce the dead weight costs of tax compliance. Corporate tax rates should also be lowered significantly. The ideal corporate tax rate is zero, but simply reducing it to a level that is more competitive with other developed nations would benefit U.S. corporations, their workers and investors, and the American economy as a whole.

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5 For more see “Tax Havens: Myth Versus Reality” by Dan Mitchell. http://archive.freedomandprosperity.org/Papers/th-myths/th-myths.shtml

6 Congressional Research Service Memorandum, “Reported Estimate of U.S. Tax Revenue Lost through Use of Tax Havens,” July 23, 2001. http://archive.freedomandprosperity.org/Papers/blum-crs-ltr.pdf