Committee on Ways and Means
The Global Tax Environment and
Implications for International Tax Reform

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Testimony of Raymond J. Wiacek
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There is a general consensus that the United States should reform its tax system as applied to corporations acting globally. The issues presented are difficult, however, and there has not been a consensus on how to proceed. In the meantime, U.S. multinationals are taxed at high rates and on a worldwide basis, decreasing their competitiveness versus foreign corporations. These foreign competitors seek the same things we do -- they seek sales that might otherwise be ours, customers that might otherwise be ours, jobs that might otherwise be ours, and communities that sparkle like ours when our corporations prosper. So our competitiveness is important.

Equally important, the world doesn't wait. Globalization accelerates, the BEPS project gains momentum, the EU state aid cases inflame, and the world lurches toward a new tax system not always in our interest.

Here are some of the features of the global tax environment relevant to tax reform:

1. Rate disparity. This is the most oft cited feature of our international tax system -- our rates are very high. Yes, other countries may have a VAT, to which our companies might reply that we have state income taxes. But this is side chatter, because our rates are high, period. In contrast to our rate of 35%, for example, the United Kingdom's rate is 20%, already scheduled to go to 18% by 2020. And the United Kingdom taxes profits earned on intellectual property at

15%, scheduled to reduce to 10%. This is the United Kingdom, mind you -- our "cousins" -- not Cayman or Gibraltar. The United Kingdom understands the importance of tax rates in the competition for jobs and investment.

2. Worldwide versus territorial taxation. This is the other well known feature of our system that is at odds with the rest of the world. We subject profits earned outside the United States to taxation, and other countries do not. Other countries prefer to have a national "champion" competing internationally on their behalf, free of home country taxation. These foreign champions are already formidable competitors -- we have no monopoly on brains or ambition -- but they are certainly abetted in their competition against us by low tax rates and territorial taxation.

3. Politics. We have our own, of course, but it cannot be overlooked that taxation, particularly international taxation, is political everywhere. The current debate about international taxation might be traced to 2012 and the United Kingdom, when the Government of David Cameron began a public attack on Amazon, Apple, and Starbucks. The U.K. Government proclaimed at the time that, "Whilst what these companies have done is technically legal, it is immoral." Legal is legal, and should not be modified by technically, particularly by a Government in a parliamentary system with the absolute power to change the law. But one suspects the attack had other purposes. It was publicized only a few days before that Government introduced another austerity budget, calling for further cuts in education, rent subsidies, and the like. The implication was that further sacrifice by British citizens might have been avoided if only American multinationals had paid their taxes. Members of the Government even called for a boycott of Starbucks, further diverting attention from the United Kingdom's

slow recovery from the 2009 financial crisis. The attack was later extended to Google, another U.S. multinational. Obviously, U.S. multinationals do not vote.

On the other hand, the United Kingdom asserts that international tax planning can go too far. It is a big supporter of BEPS, and has put international taxation on the G-20 and G-7 agendas. So the United Kingdom has low rates intended to attract companies from the United States and elsewhere -- it even has a patent box -- but it also supports BEPS and tells its citizens that American companies are the boogey men. This is clever politics indeed. The United Kingdom embraces low rates and the competition for international business, while publicly crusading against the results.

4. The international tax system is outdated. The U.S. Internal Revenue Code was written in the last century. It is in many ways a physical code, a bricks and mortar code, a widget code. Where is the factory? From what warehouse was the widget shipped? These are among the relevant questions in a world where the biggest return is to the IP, not factories or warehouses. Buying software, for example, now entails sending one's credit card number electronically to a server of unknown location, receiving a password in return, entering that password, and receiving from the cloud the electrons constituting the software. There is nothing physical in this transaction. There is not even a disk or thumb drive. So questioning this transaction in accordance with existing Code principles -- where did title to the product pass -- is difficult. Can it matter where in its orbit the cloud satellite was at the time of "delivery"? Does it matter where the server that sends the password is located? Can India tax the transaction, as it has claimed in similar cases, because the server is there?

The mention of India requires mention of another feature of our Code that much of the world thinks is outmoded. Our Code is based in large part on so-called residence taxation. Where is the residence, the location, of the corporation that did the research, patented the outcome, made the product, and shipped it to a foreign customer? The answer to the residence question is most often the United States, or another Western country. It is rarely India, or Mexico, or Brazil. So these countries argue that taxation should be source based, at least in part.

Source taxation asks what is the source of the order, the source of the check that pays for the product. Countries in favor of source taxation argue that if they did not supply the customer, "the market," there would be no revenue to the corporation resident in the United States. These countries also argue that, absent source taxation, they would realize little tax revenue from international transactions. The BEPS project supports source taxation, as discussed below. The point here is that our current Code conflicts with the views (and politics and needs) of much of the world.

5. BEPS. The OECD's base erosion and profit shifting initiative is well known. In a series of 15 papers, the OECD is recommending fundamental changes to most important features of international taxation. For example, BEPS legitimizes source taxation, treating "the market" as an important contributor to profit. This will allocate taxable profit away from residence-based systems like the United States to less developed "market" countries. This also will give Congress less money to work with as it contemplates reforming our international rules.

Another BEPS proposal would require multinationals to report to *each* country in which they do business their revenue, expenses, profits, and taxes for *every* country in which they do business. There are privacy concerns, obviously, and there is particular concern where privacy

intersects with politics -- for example, where an American multinational proves useful as a scapegoat. Aside from politics, the breach of privacy might be cultural, as in Scandinavia, which believes in more transparency than most in tax matters. Or the privacy breach might come by way of a hacker, a wiki leaker.

BEPS flew below the radar screen for some time, because its proposals must be adopted country-by-country. In a sense, BEPS was viewed as advisory. But even where the United States does not adopt a proposal, what happens when other countries do? International taxation by definition involves the rules of at least two countries. No one country -- including the United States -- is ever in control. So post BEPS, one country may use residence taxation and insist on the privacy, by country, of tax returns. And another may push source taxation and demand extraterritorial tax returns. No country is likely to adopt all of the BEPS proposals, but most countries will adopt the proposals advantageous to them. Germany has already announced the proposals it considers priorities, and other countries are already complaining. Moreover, BEPS proposals will be selectively adopted by non-OECD countries. In fact, BEPS proposals are being cited already, before adoption, in selected countries on selected issues. For example, in tax audits outside the United States source taxation is already cited as the basis for proposed additional taxation. After all, it is the latest international norm as established by the OECD's BEPS project.

This is not the place to review BEPS proposal-by-proposal. Instead, one might ask what does BEPS mean overall. First, it means a decade or more of turmoil as the international tax system is reformed through the OECD, differently by country. The international tax system may have been outmoded and in need of change, but there is no gainsaying the uncertainty and disparate impact that will follow the opening of this Pandora's Box.

Second, BEPS means that the foreign tax burdens borne by U.S. multinationals will increase. The most basic objective of BEPS is to increase taxation of multinationals, and to skew that increase "more fairly" to countries other than the United States. In this regard, BEPS is big brother to the British attack on American multinationals. To maintain U.S. competitiveness, this in turn will increase the need for rate relief, perhaps territoriality.

Third, BEPS tells us the United States should get on with it. BEPS is out of the gate and galloping down the backstretch, but it has not turned for home. There are already divisions between the liberal and socialist officials at the OECD and in Brussels and the more center right governments now charged with adopting the BEPS proposals. BEPS is not done, and there is still time for the United States to put a stamp on the process.

6. State Aid. The EU forbids member states from granting subsidies and other "state aid" on a selective basis to attract business. This prohibition is administered under EU competition (antitrust) laws. (If the United States had such a rule, it might be considered an unfair trade practice under the jurisdiction of the Federal Trade Commission.) Tax credits and tax abatements can be considered such subsidies. Because international taxation is complex, American multinationals often get rulings from the Governments involved as to whether their plans are legal and compliant. That is, they disclose their plans in advance and get the written blessing of the relevant countries. The EU is now claiming that these rulings, granted by sovereign nations, constitute illegal state aid. The EU is ordering the countries involved to assess ten years of back taxes on the companies with the rulings. The United States has protested that this action seems directed solely at American companies. The EU has rejected this. The joke now is that, because of the U.S. protest, the next state aid case will certainly involve a EU company. But not a U.K. company, and certainly not before the United Kingdom votes whether

to leave the EU. And not a German company, with Germany ascendant in the EU. Maybe a Greek or Portuguese company, along with the Americans. Politics would seem to be at work here. With EU effectiveness in question over immigration and other issues, and with a populist attack on global businesses fanned by various national leaders, the state aid cases are perfect. But what about the rule of law? How can an American company the operations of which are admitted to be legal and which has a binding written agreement from the relevant government approving those operations be taxed, retroactively?

7. Shrinking U.S. companies and the loss of jobs and community. Some say that whether a corporation is based in the United States or abroad does not make much difference, because that corporation will still do business in the United States as the largest market in the world. That sentiment is wrong. When U.S. business that was done by a U.S. company is instead done by a more competitive foreign company, the local economy is harmed. When a U.S. company is acquired by a foreign corporation, the fact that the U.S. company is now a subsidiary controlled abroad harms the local economy. To posit otherwise is like telling a Member now in the minority but who was in the majority -- maybe even a veto proof majority -- that it doesn't matter, because he or she is still a Member.

My firm started over a hundred years ago in Cleveland, and we long represented Firestone, headquartered in Akron. We still represent Bridgestone Firestone, a great company headquartered in Tokyo. But when it came time to decide which plants to close and which to expand, that decision was made in Tokyo. The effect on Akron was evidenced by an article published just this Sunday in the New York Sunday Times. The article discussed the hundreds and hundreds of abandoned and decaying houses in Akron. These houses were built and Akron

had prospered because, per the Times, Akron was "once the tire capital of the world." No more. And no longer are there Little League teams called the "Radials" or the "Firestone 500s."

I am from Michigan and we Michiganders all wish Fiat Chrysler great success. But Sergio Marchionne is not Lee Iacocca. That's perhaps a flippant way of making the point, but it makes the point.

It is also true that when a large multinational cannot compete, many, many smaller companies around it are harmed. We all praise how these companies are the job generators, and it's true. But most of them are part of the supply chain of a multinational, or provide goods and services to the employees of that multinational. These businesses may employ a number of your constituents, and the owner may be a mainstay in your district. But most such businesses are ultimately dependent on the "big guy." Just ask the businessmen of Connecticut about GE's move to Boston.

The point is that competition, and its consequences, are real. Competitiveness is not just the "c" word, used in testimony on tax reform. When we are outcompeted, we are harmed, and that harm multiplies throughout the community. We can be outcompeted for a number of reasons. Another country may infringe our IP, management in the United States may be insufficiently nimble, environmental rules may be too lax in the competing country, or a competitor may simply invent something before us. But one should never omit from this list a non-competitive tax system burdening our champions and at odds with much of the world.

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Thank you for inviting me to testify. I hope what I've said proves useful. It is based on almost 40 years of hands-on experience as a tax lawyer at the international law firm of Jones Day, with some 20 years as the head of Jones Day's global tax practice.