Tax Reform: Advancing America in the Global Economy

EXECUTIVE SUMMARY

OCTOBER 2015
Tax Reform Will Boost U.S. Growth, Jobs, Wages and Competitiveness

In *Tax Reform: Advancing America in the Global Economy*, Business Roundtable compared the U.S. corporate tax system to those of America’s economic competitors.

**U.S. Corporate Tax Policy Is Out of Step**

- **14.4 percentage point higher tax rate:** At 39 percent, the U.S. statutory corporate tax rate is the highest among Organisation for Economic Co-operation and Development (OECD) nations and more than 14 percentage points higher than the OECD 24.6 percent average.

- **Higher than in 1988:** The United States is one of only two OECD countries with a higher statutory corporate tax rate than during the Reagan Administration.

- **Out of sync:** The United States is the only G7 country with a worldwide tax system on foreign earnings. All of the other G7 countries and 28 of 34 OECD nations use territorial tax systems.

**It Is Anticompetitive, Stunts Growth and Hurts Workers**

- **28 percent decline in top U.S.-headquartered companies:** In the face of strong competition from foreign-headquartered companies with more favorable rules, 28 percent fewer U.S.-headquartered companies were in the Global Fortune 500 in 2014 than in 2000.

- **Up to 2.6 percent reduction in gross domestic product (GDP):** The failure of the United States to keep the corporate tax rate competitive reduces GDP by 1.5 to 2.6 percent.

- **As much as 75 percent of corporate tax burden borne by workers:** Workers bear up to 75 percent of the corporate tax burden through lower wages — the indirect cost of the U.S. corporate tax system.

**Tax Reform Would Boost U.S. GDP, Wages and Investment**

In the long run, all Americans would benefit from reforms like those proposed in the 2014 Camp plan.

- **3.1 percent long-term GDP increase.**

- **6.1 percent after-tax wage boost** for American workers.

- **6.8 percent investment jump** from businesses.

Learn more about policy solutions and get the facts at brt.org.
Business Roundtable CEOs lead companies with $7.2 trillion in annual revenues and nearly 16 million employees. Member companies comprise more than a quarter of the total market capitalization of U.S. stock markets and invest $190 billion annually in research and development (R&D) — equal to 70 percent of total U.S. private R&D spending. Our companies pay more than $230 billion in dividends to shareholders and generate more than $470 billion in sales for small and medium-sized businesses annually. Business Roundtable companies also give more than $3 billion a year in charitable contributions.

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Tax Reform

Advancing America in the Global Economy

EXECUTIVE SUMMARY
Statement on Comprehensive Tax Reform

Business Roundtable supports comprehensive tax reform for individuals and all businesses to improve economic growth and provide for a simpler and more efficient tax system. Business Roundtable commends the ongoing efforts to advance tax reform by the House Ways and Means Committee, led by Chairman Paul Ryan (R-WI) and ranking member Sander Levin (D-MI); the Senate Finance Committee, led by Chairman Orrin Hatch (R-UT) and ranking member Ron Wyden (D-OR); and the Administration, led by President Barack Obama and Treasury Secretary Jacob Lew. Business Roundtable urges Congress and the Administration to make tax reform a top priority for legislative action.

Based on the knowledge and experience of most Business Roundtable CEOs, this primer on tax reform focuses on the corporate income tax system and the changes needed to update the corporate income tax to allow American companies and their workers to be competitive in markets both at home and abroad and improve U.S. economic growth, which will result in higher wages and increased job creation in the United States.

Business Roundtable supports modernization of the corporate tax system, including setting a corporate tax rate at a competitive 25 percent rate and adopting a modern international tax system, financed through broadening of the corporate income tax base and other corporate offsets. 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 should be dedicated to establishing a modern, internationally competitive corporate tax code.

It has been nearly 30 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 recent recession compounding the impacts of decades of stagnant wage growth, our nation cannot afford to continue to be held back by an out-of-date and inefficient tax system. It is time for Congress and the Administration to act with urgency. Tax reform is needed to modernize the tax system to meet the competitive demands of the 21st century and promote the ability of America to succeed in the global economy.

This primer sets forth a summary of the problems with the current tax system and reasons for Business Roundtable’s recommendations for fiscally responsible corporate tax reform that provides a competitive corporate tax rate and a modernized international tax system.
I. Tax Reform For Higher Wages, Better Jobs and Increased Economic Growth

Economic growth is the means by which Americans achieve rising living standards. Corporate income taxes are 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 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 in the United States. These reforms would result in increased job growth and higher wages for American workers. 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.

Failure to modernize our tax system would result in a continuing loss of U.S. competitiveness in the global economy, a continuing loss of U.S.-headquartered companies and increased sales of U.S. business assets to foreign-headquartered companies, and a more slowly growing economy with less opportunity for American workers. This is why Business Roundtable believes modernization of our nation’s tax system must be an urgent priority.

Fiscally responsible corporate tax reform can modernize our tax system and help reinvigorate job growth and economic expansion. Business Roundtable urges Congress to undertake comprehensive tax reform. America cannot afford to wait any longer.
II. A Competitive Corporate Tax Rate

Today, the combined federal and state corporate tax rate in the United States is 39 percent, higher than that of any other Organisation for Economic Co-operation and Development (OECD) country and 14.4 percentage points higher than the 24.6 percent average rate of other OECD countries in 2015 (Figure 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.

The average OECD corporate tax rate has dropped more than 19 percentage points over this period, while the U.S. federal rate has increased 1 percentage point to 35 percent, and the U.S. combined federal and state tax rate has increased to 39 percent (Figure 2).

President Obama, House Ways and Means Chairman Paul Ryan, Senate Finance Committee Chairman Orrin Hatch, and ranking members Representative Sander Levin and Senator Ron Wyden have all called for tax reform that lowers the corporate tax rate. Corporate rate reduction is included in the bipartisan recommendations of the Senate Finance Committee Tax Reform Working Group on Business Income. Recent tax reform proposals that would reduce the corporate tax rate include:

- President Obama’s Fiscal Year 2016 Budget (February 2015) and Framework for Business Tax Reform (February 2012);
- Former House Ways and Means Chairman Dave Camp’s Tax Reform Act of 2014 (February 2014);
Then-House Budget Chairman Paul Ryan’s FY2015 House Budget Resolution; and

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

A lower corporate tax rate would make the U.S. economy more internationally competitive; increase U.S. jobs, wages 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, making investing in the United States more costly and less desirable.

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 sought-after 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. For any given amount of investment, a more efficient allocation of capital results in greater output, meaning more economic growth and more jobs.
Box 1

**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 (CBO) finding that workers bear more than 70 percent of the corporate tax burden.

The Joint Committee on Taxation, the CBO and the Treasury Department each assess that a portion of the corporate income tax is borne by labor. Treasury Department analysis, while assuming that less of the corporate tax burden falls on workers than many academic studies, still finds that lower- and median-income families on average face a greater burden from the corporate income tax than the individual income tax.

Box 2

**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.

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 gross domestic product (GDP) than the average of other Organisation for Economic Co-operation and Development 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 past 15 years, 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, 5 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 more than 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 growth in the world’s population 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, improvements in infrastructure, 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. They prevent American companies from entering foreign markets on competitive terms and discourage the return of 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 support the growth of U.S. employment, investment and exports.

American parent companies with international operations employed 23.1 million workers in the United States in 2012 and, including their supply networks and spending by their employees, supported nearly 72 million U.S. jobs. U.S. employment by American parent companies accounted for nearly two-thirds of their worldwide employment. The average annual compensation paid in 2012 by American parent companies to their American workers was $76,538, 34 percent higher than the $57,291 paid by other U.S. businesses.

**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 first and foremost to serve foreign customers. Approximately 90 percent of the sales by foreign subsidiaries of American companies are to foreign customers rather than to the U.S. market. Localized foreign operations allow American companies to tailor their products to local needs and tastes and
overcome transportation cost and trade 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 G7 countries) use territorial tax systems under which active business earnings returned home as dividends are subject to little or no additional home-country tax. 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 (Figure 3). The 95 to 97 percent exemption typically results in a home-country tax rate of about 1 percent on the foreign dividend.

**Figure 3**

**OECD Countries with Territorial and Worldwide Tax Systems**

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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 permanently removing barriers to returning foreign earnings for investment in the United States.

A detailed proposal for modernizing U.S. international tax rules in the direction of the territorial tax systems used by other OECD countries was included in the 2014 tax reform legislation introduced by then-Chairman of the House Ways and Means Committee Dave Camp.

Five separate commissions established by President Obama and his Administration also have supported a movement to a territorial tax system, 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 fiercest global competitors 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, 90 percent of the non-U.S. companies in the Global Fortune 500 in 2014 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 (Figure 4).

### Figure 4
**Global Competitors of American Companies Predominantly Headquartered in Territorial Countries**
*Headquarters location of non-U.S. OECD companies in the Global Fortune 500, 2014*

- Percentage of global competitors headquartered in territorial countries: 90%
- Percentage of global competitors headquartered in worldwide countries: 10%

Corporate tax rules that hinder the competitiveness of American companies disadvantage American workers and undermine the strength of the U.S. economy.

A modernized international 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 percent if the earnings are brought home. At least $2.3 trillion in accumulated foreign earnings was held by the foreign subsidiaries of American companies in 2014. Permanently unlocking these funds and future foreign earnings so that they could be reinvested in the United States without penalty would result in increased U.S. investment and job creation.

Some have proposed funding new government spending with a one-time mandatory repatriation of foreign earnings at a reduced tax rate without a permanent reform of our international tax system. A temporary change in tax law enacted in 2004 provided a reduced tax rate of 5.25 percent for qualifying repatriations. An estimated $362 billion was repatriated by corporations under this temporary provision. However, a temporary repatriation measure does not solve the ongoing competitive disadvantage faced by American companies in foreign markets, as future earnings would still be subject to additional U.S. tax upon repatriation. Only a permanent modernization of U.S. international tax rules can both address the competitive disadvantage faced by American companies and permanently eliminate the lockout effect.

**Modern Territorial Tax Systems Increase Competitiveness and Protect the Tax Base**

Concerns have been expressed that the adoption of a territorial tax system could provide American companies an incentive to shift U.S. activities offshore or would lead to a loss of the U.S. tax base.

The widespread and growing adoption of territorial tax systems by countries throughout the developed world should be a reassurance that these tax systems offer beneficial advantages. Only two countries — Finland and New Zealand — have ever switched from a territorial tax system to a worldwide tax system. Both countries found the experiment to be a failure and subsequently switched back to territorial tax systems.

U.S. adoption of territorial rules similar to those of other countries 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 modern international tax 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.
One must be careful that proposals intended to protect against a loss of the U.S. tax base are not so broad that they affect the ability of American companies to compete against foreign companies not encumbered by such restrictions. For example, proposals adding an additional layer of tax to income earned in foreign countries with innovation boxes, tax incentives or other competitive tax policies may simply disadvantage American companies competing in foreign markets. The “minimum tax” proposed in the President’s Fiscal Year 2016 Budget is an example of such an anti-competitive measure. The proposed tax would apply broadly to foreign income, without any test of whether such income is related to U.S. activities. Such a tax is effectively a U.S. headquarters tax as it would apply only to U.S.-headquartered companies but would exempt companies with headquarters overseas.
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, Business Roundtable supports corporate reform that is financed through appropriate base-broadening measures and other corporate offsets to provide a competitive corporate tax rate and a modern and competitive international tax system. Done properly, such reform will increase economic growth and thereby generate additional tax revenues.

**Overall Rate Reduction**

Partly to incentivize certain activities as well as to alleviate the adverse impacts of the high U.S. corporate tax rate, Congress has enacted a wide range of provisions, typically in the form of enhanced deductions or tax credits, which reduce the effective tax rate on specified business activities. While such provisions lessen the burden on qualifying activities, they are viewed by many as less efficient from an economywide perspective than a broadly applicable across-the-board incentive or an overall rate reduction. This is because narrowly targeted incentives divert resources 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 targeted deductions and credits to provide for lower tax rates would improve economic efficiency and economic growth.

**Tax Expenditures**

The Joint Committee on Taxation (JCT) and the Treasury Department identify any tax provision in the form of a credit, deduction or exclusion as a tax expenditure when it is being used as an alternative to other policy instruments, such as spending programs. The staff of the JCT identified more than 70 such provisions that each provided corporate tax savings of at least $50 million in 2014.

**Base-Broadening Tax Reform**

Economic growth and job creation would be enhanced through business tax modernization providing a competitive statutory tax rate and a competitive international tax system. The experiences of other countries suggest 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 can ensure that corporate tax reform is undertaken in a fiscally responsible manner. The repeal or limitation of any provision as a revenue offset for beneficial changes in tax reform must carefully weigh the economic costs and benefits of such changes. 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 a competitive corporate rate and a competitive international tax system.
V. Conclusion

Corporate tax reform done right will 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 30 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. The U.S. corporate tax system is the least competitive among advanced economies — when we should be striving to make it the most competitive. The end result 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 modern international 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. Together these reforms will provide for enhanced U.S. economic growth, with higher wages and greater employment opportunities for American workers.

Now is the time for Congress and the Administration to act.

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