Business Roundtable℠

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Taxing American Corporations in the Global Marketplace

The Case for Corporate Tax Reform

April 2011

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The Road to Corporate Tax Competitiveness

"We know what it will take for America to win the future. We need to out-innovate, we need to out-educate, we need to out-build our competitors. We need an economy that's based not on what we consume and borrow from other nations, but what we make and what we sell around the world. We need to make America the best place on Earth to do business… Another barrier government can remove is a ***burdensome corporate tax code with one of the highest rates in the world****."*

-President Barack Obama,
February 7, 2011

Business Roundtable's Perspective:

Business Roundtable has been encouraged by President Obama's commitment to energize the U.S. economy by making America and its corporations more competitive, as well as the President's pledge to reform an anti-competitive U.S. corporate tax system. The President is right when he points out that **U.S. companies face one of the highest tax rates in the world**. <u>We also have an uncompetitive international tax system in need of a new direction</u>.

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The Road to Corporate Tax Competitiveness

The manner in which America taxes its corporations on both domestic and international activities has a significant impact on their ability to compete globally and, in turn, on the ability of American workers to succeed in the global economy.

The U.S. tax system has become an outlier among developed nations in terms of:

- ***A significantly higher corporate rate*** *than in other advanced economies, and*
- *An international system of taxation that taxes foreign earnings remitted to the United States by American companies at* ***significantly higher rates than faced by their foreign competitors****.*

These factors disadvantage American companies as they seek to compete with their foreign-headquartered competitors in markets around the world.

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The Importance of Staying Competitive

- **With 95 percent of the world's population living outside the United States**, American corporations must be able to operate on a level playing field with their foreign-headquartered competitors.

- **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 chains and the spending by their employees and their suppliers. (Business Roundtable, *The United States Economy Depends on Worldwide American Companies*, July 2009.)

- The typical American company with international operations buys **$3 billion in goods and services from more than 6,000 American small businesses**. Cumulatively, worldwide American companies purchased $1.52 trillion in supplies and services from U.S. small businesses in 2008. (Matthew J. Slaughter, *Mutual Benefits, Shared Growth: Small and Large Companies Working Together*, September 2010.)

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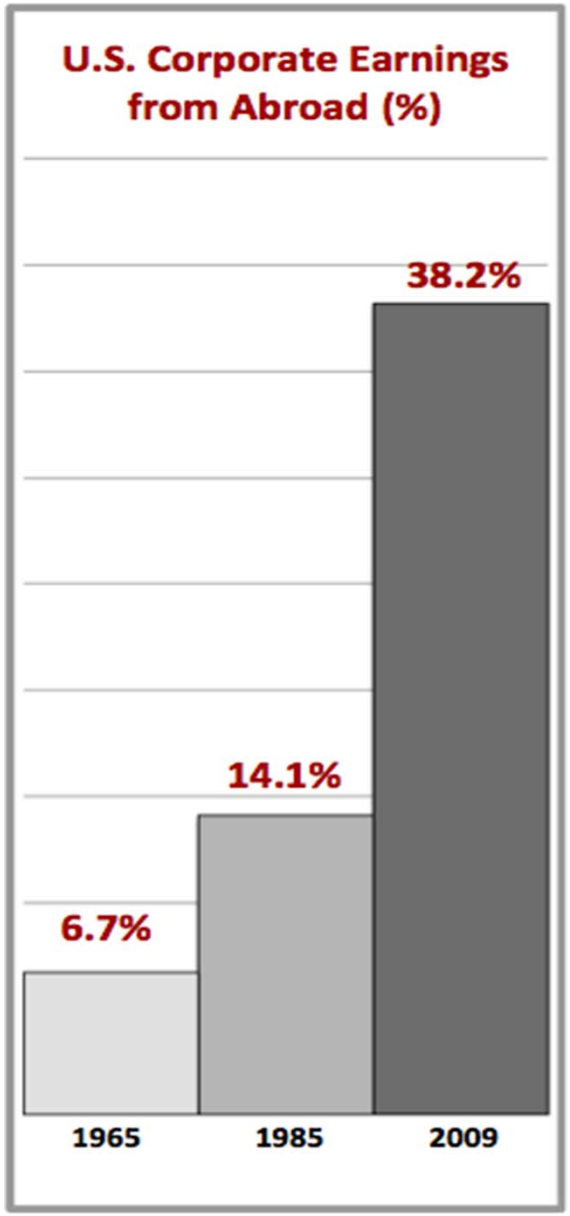
An Integrated World Economy

- Cross-border investment has grown more than five-times faster than global production—from less than six percent of the world's output in 1980, to a peak of 35 percent of world GDP in 2007.

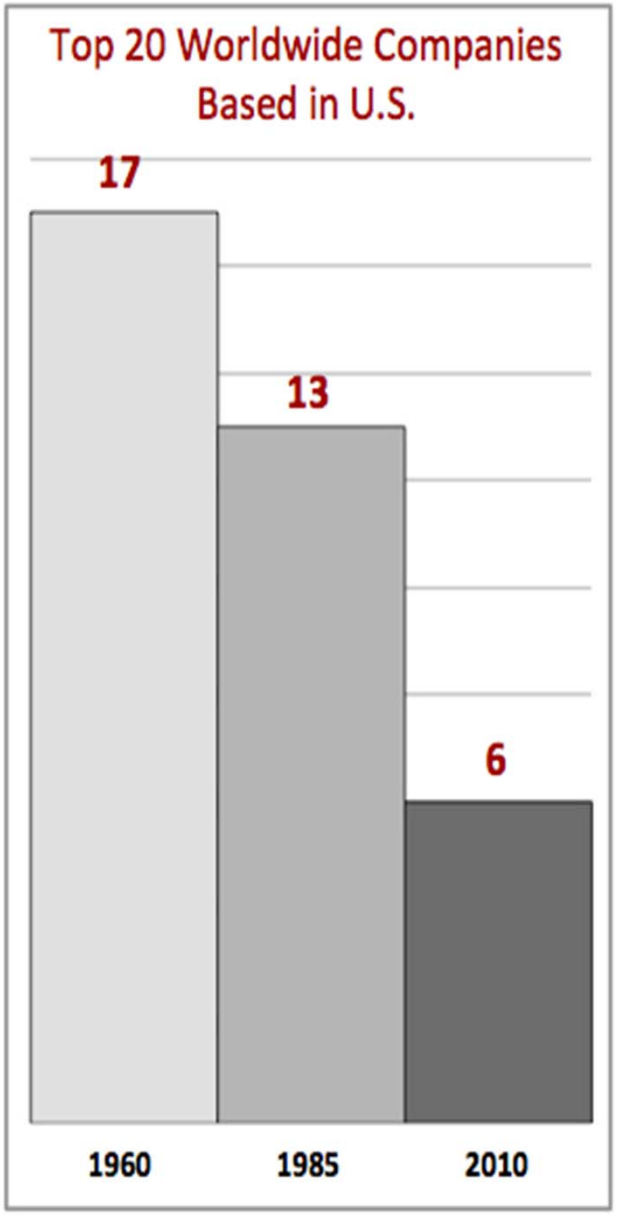
- Over the past 45 years, exports by American corporations have more than doubled as a share of the size of the total economy, and **the share of worldwide profits of American corporations attributable to foreign earnings has risen nearly six-fold—to nearly 40 percent by 2009**.

- In 2009, American companies in the Standard & Poor's 500 reporting foreign earnings had more than 55 percent of worldwide income earned outside the United States.



International Competition on the Rise

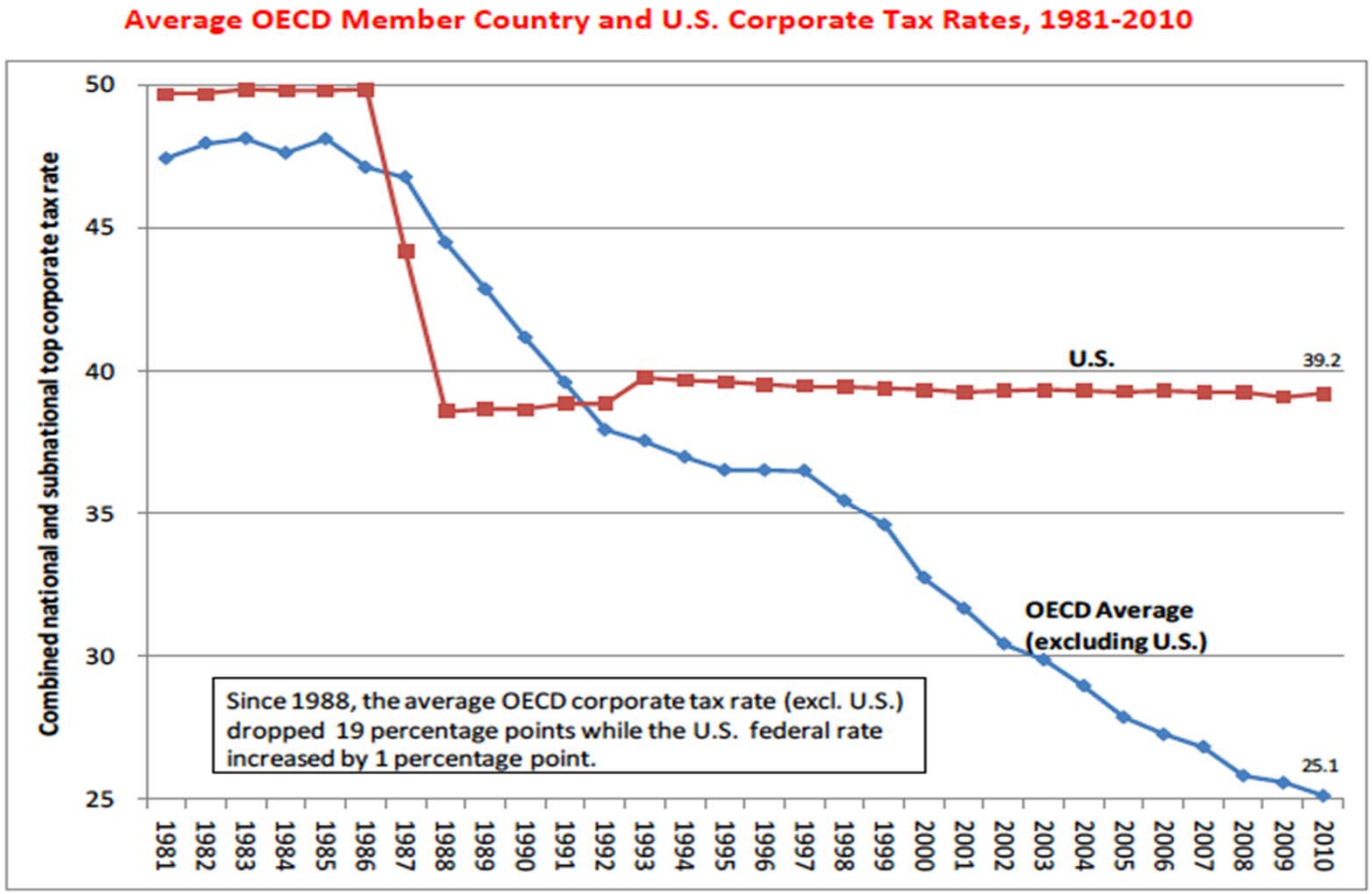
- American companies today account for less than one-fourth of all cross-border investment in the world, down from about 40 percent in the early 1980s.
  - ✧ In other words, cross-border investment of foreign companies is now **three times greater** than that of American companies.
- The impact is evident. Measured by total sales, **just six of the largest 20 companies in the world were American companies in 2010, down from 13 in 1985 and 17 in 1960**.



U.S. Taxes Out of Sync with Competitor Nations

Most developed nations have responded to increased international competition and to the increasing importance of cross-border investment by removing tax obstacles to international commerce.

- ***The U.S. tax system has not kept pace with this need to adjust to new international realities.***



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.

U.S. International Tax System an Outlier

- If American companies and their workers are to remain competitive with foreign-headquartered firms, they cannot continue to face corporate tax rates on domestic and foreign earnings that are **10 to 20 percentage points higher** than those of their closest competitors.
  - ✧ Canada has enacted phased tax reductions that will lower its rate to about 25% in 2012.
  - ✧ The UK has announced phased tax reductions that will lower its rate to 26% in 2011 and 23% by 2014.

The international trend overwhelmingly is for lower taxes on corporations and the territorial treatment of foreign earnings.

A Territorial System

- The United States is one of the few remaining advanced economies that taxes its companies on foreign earnings from active business operations when remitted home.
  - ✧ This practice actually discourages repatriation of profits that can benefit the U.S. economy.
- 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.
  - ✧ The United Kingdom and Japan both adopted territorial tax systems in 2009 as a way to help their companies compete—and grow their economies.
- The U.S. economy benefits from international sales by U.S. firms, yet placing additional taxes on foreign-earned income – that U.S. competitors are NOT faced with paying – creates a competitive imbalance for U.S.-based firms.
  - ✧ Foreign operations stimulate exports for U.S.-produced goods and services into the local market, increase investment and production in the United States, and increase employment for American workers at home.

26 OECD Countries Use Territorial Tax Systems

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 income taxation through territorial tax system[1]	Australia, Austria, Canada, Czech Republic, Denmark, Estonia, Finland, Hungary, Iceland, Luxembourg, Netherlands, New Zealand, Portugal, Slovak Republic, Spain, Sweden, Turkey, United Kingdom		100% exemption
	Norway		97% exemption
	Belgium, France, Germany, Italy, Japan, Slovenia, Switzerland		95% exemption
Worldwide Tax Systems	**OECD Countries with Worldwide Tax Systems**		
	Country	**2010 Tax Rate[2]**	
Worldwide system of income taxation with deferral and foreign tax credit	Chile	17.00%	0% exemption
	Greece	24.00%	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, income tax treaty status, and/or the source country tax rate).

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

A Level Playing Field for U.S. Companies

- American companies currently face significantly higher corporate tax rates than virtually every other developed economy.

- American companies are also taxed domestically on foreign income – which most competitors are not.

To level the playing field for U.S. companies – and enhance U.S. economic growth and job creation – the United States must reform its corporate tax system to include a significantly lower corporate rate and the adoption of a territorial-type system for international tax.