Congress of the United States
U.S. House of Representatives
COMMITTEE ON WAYS AND MEANS
1102 LONGWORTH HOUSE OFFICE BUILDING
(202) 225-3625
Washington, DC 20515-6348
http://waysandmeans.house.gov

May 6, 2004

Oppose Expansion of Tax Benefits for Exporting U.S. Jobs

Dear Colleague:

I would like to call your attention to the attached article recently published by the Wall Street Journal. The article makes it clear that our current international tax rules encourage the export of U.S. jobs. Our current rules provide benefits greater than a total tax exemption for the overseas income of our multinationals.

Proposals to further liberalize our tax rules overseas will only increase the current incentives for exporting U.S. jobs. Those proposals must be resisted.

Sincerely,

Charles B. Rangel
Ranking Democrat

U.S. Overseas Tax Is Blasted

Study Says the Levy Isn't Worth the Cost to Implement

By JOHN D. MCKINNON

Washington

THE U.S. SYSTEM for taxing overseas profits of American companies is so riddled with loopholes and credits that the government would collect $6 billion more each year if it stopped trying to tax those profits altogether, according to a new estimate by congressional tax experts.

The assessment comes as U.S. companies, particularly those with big foreign operations, face increasing scrutiny and criticism for skirting U.S. taxes and moving production abroad.

Current law aims to tax the profits of U.S. companies no matter where they are earned. But plenty of foreign profits escape taxation because the complex U.S. system allows so many breaks, including deductions for interest on loans funding operations abroad and credits for taxes paid to foreign governments.

Global U.S. companies routinely use those deductions and credits to reduce their overall tax burdens. In essence, the U.S. tax code gives them more in tax breaks for foreign operations than it collects in revenues, according to the estimate by the Joint Committee on Taxation, the nonpartisan scorekeeper on taxes for Congress.

"The fact that you get this result absolutely proves the system is broken," said economist Gary Hufbauer of the Institute for International Economics, a Washington think tank supported in part by corporations. "It's a mess."

France, Germany and some other countries use more of a "territorial" approach that taxes companies only on profits made within that country. In that system, there aren't any taxes on profits from overseas operations—and thus no need for the deductions and credits that U.S. firms exploit so successfully to lower their overall burden.

Beyond the lost revenue, critics of the existing U.S. tax code say its loopholes, credits and deductions create incentives for companies to move operations overseas. A move toward a territorial system would remove that tilt, they say.

Bush administration officials contend that taxes aren't a big factor in U.S. companies' expansion overseas. "Ninety-five percent of the [global] population lives outside the U.S.," said Greg Jenner, acting assistant Treasury secretary for tax policy. "Frequently, in order to serve those markets, you've got to be there."

Corporate income taxes represent a smaller share of all U.S. taxes than they did a few decades ago. The Treasury expects to collect $168.7 billion in corporate income taxes this year, 9.4% of all federal receipts.

In the preliminary estimate that it described as "conservative," the Joint Committee on Taxation said that switching to a territorial system would yield the U.S. Treasury about $60 billion more over 10 years than the current system would raise. The current U.S. code collects about $50 billion over 10 years from multinationals' overseas income.

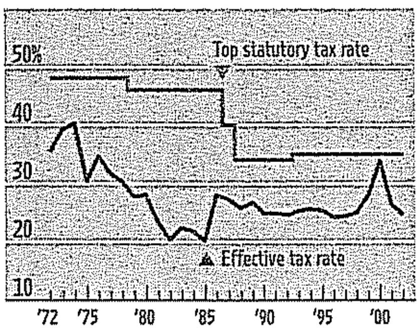
The new projection is similar to an estimate made three years ago that the Treasury would get an additional estimated $70 billion over 10 years, by Treasury economist Harry Grubert and John Mutti of Grinnell College in a study published by the conservative American Enterprise Institute. They added that a territorial system could boost U.S. job creation by reducing companies' "incentive to invest in low-tax jurisdictions."

"It is no longer a question of whether the U.S. tax code encourages the export of American jobs. We now know it does," said Rep. Charles Rangel of New York, senior Democrat on the House Ways and Means Committee. "The question is whether we are going to change this counterproductive policy."

Taxing Business

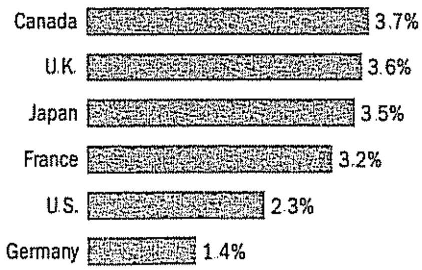
Falling rate

U.S. statutory corporate-income tax rate vs. effective tax rate



Lighter burden

Corporate income taxes as percent of gross domestic product



Sources: Congressional Research Service; OECD, 1999-2001 average

A territorial plan would be difficult to get through Congress. Many multinational companies likely would fight it because it would increase their tax bills. But Democrats, who requested the committee estimate, don't intend to offer a plan to switch to a territorial system. Instead, they are using the data to highlight shortcomings of the current corporate-tax system and to support Democratic presidential candidate Sen. John Kerry's tax proposals to discourage companies from moving production abroad.

Conservative antitax groups long have lobbied for a territorial tax system. In 2002, 20 such groups signed an appeal for a switch, citing "the common-sense notion that governments should tax only that income earned inside their borders."

If only domestic earnings are taxed, the U.S. Treasury would post $60 billion more in revenue over 10 years.

But Bush Treasury officials contend that a strict territorial tax system—like the one advanced by Messrs. Grubert and Mutti—would be so much tougher than European systems that it would hamper U.S. companies' global competitiveness. The administration backs simplified international-tax rules that could widen tax breaks on multinationals' overseas operations, for instance by making it easier to shift overseas earnings into tax havens.

U.S. tax breaks for overseas operations were crafted to expand international markets for U.S. goods. One big break is a credit for taxes that U.S. companies pay to foreign governments. Its purpose is to avoid double taxation of overseas profits. A second, critics say, is the U.S. system for deduction of expenses such as interest payments for overseas expansion. Supporters of the current system contend, however, that the net effect of the expense provisions is often to force companies to pay more tax than they should, because the deductions can reduce foreign-tax credits. A third allows U.S. companies to defer U.S. tax on overseas earnings until they repatriate the money. That often lets companies park overseas earnings in tax havens indefinitely.

Critics contend that the rise of offshore tax havens—along with the increased mobility of business operations—is throwing the U.S. system out of kilter and making these tax breaks vulnerable to abuse. Supporters of the current system counter that allowing American companies to avoid U.S. taxes in low-tax countries levels the playing field with foreign competitors that face no taxes back home.

Arranging for income to be earned in low-tax countries overseas brings an added bonus for companies' reported profits. Under accounting rules, a company that declares overseas earnings permanently reinvested outside the U.S. can avoid any charge against earnings to reflect U.S. taxes that would be owed when the money is brought home.

Mr. Kerry is proposing to limit companies' ability to defer U.S. taxes on foreign profits to raise about $12 billion a year that he would use to reduce the overall corporate-tax rate to 33.25% from 35%.

Under the current system, many companies find ways to pay less than 35%. The Congressional Research Service says companies, on average, paid less than 25% of profit in taxes in 2002. Eli Lilly & Co., for instance, used overseas operations in low-tax jurisdictions to reduce its effective global tax rate by 15.7 percentage points in 2003. Because of other factors, the company said its actual tax rate was 21.5%.

Lilly considers a variety of factors, including taxes, in deciding where to locate operations, spokesman Ed Sagebiel said.

"At a time in which many countries have adopted significantly lower corporate income-tax rates ... and chosen to not tax the foreign profits of their home-based multinationals, the United States must be very thoughtful about any proposed changes to U.S. tax laws to ensure they do not impede ... U.S.-based companies' ability to compete," he said.