Dissenting Views on H.R. 4520, FSC/ETI

The bill reported by the Committee is the fourth legislative proposal from Chairman Thomas addressing the World Trade Organization ruling concerning the FSC/ETI export related tax benefits. The only consistent theme in all of those proposals has been the inclusion of tax incentives for companies to move operations and jobs offshore.

- The first proposal, H.R. 5095 from the 107th Congress, was introduced almost two years ago. It included large domestic tax increases to finance $86 billion of overseas tax benefits. As a result, the bill was never scheduled for markup.

- The second bill, H.R. 2896, was introduced a year later on July 25, 2003. The fiscal cost of that bill ($128 billion over 10 years) and the lack of any general domestic replacement for the FSC/ETI benefit meant that there were not sufficient votes in the Committee to report the legislation in its introduced form.

- Chairman Thomas' third proposal came when he announced his substitute in connection with the markup of H.R. 2896 on October 28, 2003. For the first time, the Chairman was willing to include elements of the bipartisan Crane-Rangel-Manzullo-Levin bill. Those modifications were sufficient to allow the bill to be reported on a straight party-line vote. However, the bill never was scheduled for Floor consideration, presumably because it did not have sufficient votes.

- Finally, the Chairman has brought forth a fourth version, essentially unchanged in its basic structure from the bill reported last year. The major significant change is the addition of extraneous items designed to buy votes.

At no time during the almost 2-year period that began with the introduction of his first bill did the Chairman attempt to bring the Committee on Ways and Means together on a bipartisan basis to reach a consensus on how to respond to the European challenge to our FSC/ETI program. The 2-year delay was not necessary and has resulted in U.S. products being subjected to European retaliatory tariffs. Congressmen Crane, Rangel, Manzullo, and Levin introduced legislation during that period, which demonstrated that a bipartisan consensus could have been reached on this issue, avoiding trade sanctions.

Now the Chairman has abandoned any pretext of justifying his approach to the FSC/ETI issue on policy grounds. He is adopting the crude and perhaps effective approach of simply buying the votes with unrelated, and, often, special interest provisions, many of which have never borne the scrutiny of a Committee hearing or markup.

We hope that those who are being offered blandishments to support the Chairman's bill will consider the following:

1. First, the blandishments being offered can quickly disappear in conference. There will be extraordinary pressure to shrink the size of the bill, because the Senate will insist that the bill be revenue neutral. Few should be surprised if the conference report reflects the priorities of the Chairman and does not include many of the ornaments being attached to the bill in order to buy votes.

2. Second, Members should not just focus on the blandishments being offered to buy votes. They should examine the rest of the Committee bill and make sure they would be comfortable defending its provisions. The Committee bill provides tremendous incentives for companies to move jobs offshore. Even its "domestic rate

cut" will reward companies that purchase cheap, imported parts or outsource services overseas. It permits companies to put profits above patriotism and move their corporate charters offshore for tax avoidance.

3. Third, while this bill includes some offsets, it still increases deficits over the next ten years by $34 billion. This number is deceptive, however, because the delayed effective dates and other accounting gimmicks indicate the long-term effect on the national debt will be much greater. In addition, some of the offsets, like authorizing the IRS to outsource collections to private debt collectors, are simply bad policy. It is bad enough to be promoting the off-shore outsourcing of American jobs through enhanced corporate tax subsidies. It is totally indefensible to pay for such subsidies by increasing deficits that have already proven a drag on our economy, and will eventually have to be paid through higher taxes on future generations of Americans.

4. Finally, Members should understand that farmers and other small businesses will be large losers if the Committee bill prevails. Both corporate and noncorporate taxpayers are eligible for export-related benefits under current law. As a result, the bill passed by the Senate and the amendment offered by Congressman Rangel provide across-the-board rate reductions for all domestic producers, whether organized as taxable corporations or as subchapter S corporations, partnerships, or sole proprietorships. Only the Committee bill limits the general rate reductions to corporations and it provides the largest rate reduction for the biggest corporations.

Following is an elaboration of some of the provisions in the Committee bill that make it a bad choice:

Committee Bill Provides Increased Incentives for Moving Jobs Offshore

Present Law

A recent study a study published by the American Enterprise Institute noted that our current international tax rules already provide significant incentives for U.S. companies to move jobs and operations offshore.. That study concluded that federal tax receipts would rise by $7 billion per year if the United States provided a tax exemption for the overseas business income of our multinationals.

The Joint Committee on Taxation reached a similar conclusion in a preliminary revenue estimate that indicated that such a territorial system would raise approximately $60 billion over 10 years.

Any doubt over the accuracy of those estimates was removed when the National Foreign Trade Council (a group of large, U.S.-based multinationals) issued a press report stating that moving to a territorial system "would put U.S. companies at a significant disadvantage in the global market."

These facts suggest that our current system, in many circumstances, provides a negative tax overseas, i.e., benefits greater than the exemption under a territorial system. The fact that U.S. multinationals oppose adoption of a territorial system is stark evidence of the liberal nature of our system.

The Congressional Research Service concluded that our current international tax rules provide incentives for U.S. firms to move overseas. In a recent report, they stated -

"We begin by looking at the incentive effects of the current U.S.-international system, with the deferral system and indirect foreign tax credit described above. Economic theory is relatively clear on the basic incentive impact of the system: it encourages U.S. firms to invest more capital than they otherwise would in overseas locations where local taxes are low. . . . Deferral poses an incentive for U.S. firms to invest abroad in countries with low tax rates over investment in the United States."

Committee Bill

The Committee reported bill provides a dramatic increase in the incentives to move offshore. Moreover, the bill deliberately attempts to hide the size of the tax cuts on offshore operations through delayed effective dates.

When the bill is fully effective, the annual cost of the international benefits is approximately $5 billion. The Committee bill almost doubles the size of the negative tax overseas.

Though billed as reform, a number of the international provisions do not constitute reform, they include some very large overseas benefits and a larger number of small special interest provisions.

The Committee bill provides some new, significant tax benefits that would encourage companies to move jobs and operations offshore. Following are examples.

A. Increased Cross-Crediting

The Committee bill (sec. 303) reduces the number of foreign tax credit baskets to two. This may seem like a technical change, but it would cost over $1 billion per year, and increase incentives to move offshore.

The provision repeals current law limitations on cross-crediting, i.e., using taxes paid in one country at rates exceeding U.S. rates to offset U.S. tax on income from other countries.

The provision effectively subsidizes high-tax foreign countries. Companies could locate in a high-tax country and have the United States government bear the cost of that country's tax above the U.S. rate if they also have income in low-tax countries.

Companies would receive no tax advantage from locating in the United States rather than a higher tax country overseas, since they could use the higher foreign taxes to reduce tax on other income.

Also, the provision creates incentives to shift operations from the United States into low-tax jurisdictions to take advantage of the cross-crediting.

B. Liberalized Deferral

The Committee bill (sec. 311) contains modifications to subpart F (anti-deferral regime) that would also increase incentives to move jobs offshore.

The modifications would permit amounts earned by one offshore subsidiary to be reinvested in any other location (other than the United States) without tax.

The modifications also would permit U.S. companies to avoid tax on their income from operations in developed countries through earnings stripping transactions. This would provide a substantial incentive to move offshore; companies could get the benefits of operating in a developed country without tax.

If U.S. companies can get the benefits of low tax rates for investments located in high-tax countries, one economist suggested that the Untied States is "likely to lose capital and jobs, as well as all of the taxable profits associated with them."

The Committee bill also includes a series of narrowly targeted benefits for companies operating overseas, such as benefits for overseas commodity traders, companies leasing aircraft overseas, and security dealers.

Thomas Bill's Domestic Manufacturing Benefit is Deeply Flawed

1. Small Corporations and Unincorporated Small Businesses Need Not Apply.

The bipartisan H.R. 1769 would provide an effective 10% across the board rate reduction for <u>all corporations</u>, regardless of size, engaged in domestic manufacturing. The Senate bill extends the rate reduction to businesses, like subchapter S corporations, partnerships, farms, and other proprietorships not subject to the corporate tax. Extension of the rate cut to those businesses was among the improvements to H.R. 1769 that were included in the amendment that Congressman Rangel offered in the Committee.

In contrast, Chairman Thomas' "manufacturing rate cut" provides its largest benefit to large corporations and little or no benefit to other corporations or businesses. According to the nonpartisan Joint Committee on Taxation, 82% of all profitable corporations do not have incomes large enough to benefit from the rate adjustment contained in the Committee bill. The Committee rate reduction does not apply to businesses that are not taxed as corporations. Therefore, all subchapter S corporations, partnerships, farms and other proprietorships engaged in manufacturing activities will receive no rate adjustment whatsoever from the Committee bill.

Again, we would like to emphasize that 82% of all profitable corporations will receive no tax benefit from the Committee bill because they are too small. No business engaged in manufacturing, but not organized as a taxable corporation, will receive any benefit. All of those businesses, regardless of size or organizational structure, would receive a tax reduction under Congressman Rangel's amendment.

2. Alternative Minimum Tax (AMT) Clawback.

Republicans have often described the corporate alternative minimum tax as the "anti-manufacturing tax." That rhetoric is fairly hypocritical when one views the substance of the Committee's manufacturing tax cut.

The Committee bill reduces the regular tax on manufacturing income but not the minimum tax. As a result, all corporations affected by the minimum tax under current law will receive no benefit from the rate reduction contained in the Committee bill. Other manufacturers may find that the name of the tax they pay has changed, but the amount stays the same. The Committee bill promises a three-point rate reduction, but some corporations will find that much, if not all, of their rate reduction is taken back by the corporate minimum tax. Capital-intensive manufacturers will be among those most adversely affected by this aspect of the Committee bill.

In contrast, the Senate bill and the amendment offered by Congressman Rangel provides an effective 10% across the board reduction in both corporate and minimum tax rates. **No portion of the benefit promised in those proposals will be clawed back through the minimum tax.**

3. Tax Incentives for Outsourcing Labor Force and Parts

The Committee bill will provide substantial tax benefits for the income of domestic companies that is attributable to outsourcing technical and administrative services overseas, or is that is attributable to cost-savings from using cheap imported parts. If a domestic manufacturer is able to reduce its cost by conducting research, testing, computer programming, or other service functions overseas, it will receive a rate reduction for the income resulting from those cost savings. If a domestic manufacturer assembles a product in the United States using cheap imported parts, it will receive a rate reduction for the income resulting from the cost-savings. **Effectively, even the portion of the Committee bill which is advertised as helping U.S. manufacturers provides incentives for outsourcing overseas.**

Last Thursday, The Wall Street Journal published an article which gives an idea of how large the potential loophole in the Committee bill may be. It described how auto manufacturers were forcing their suppliers to outsource parts manufacturing overseas. All of the cost savings from that offshoring will receive tax benefits under the Committee bill.

This aspect of the Committee bill is deliberate, not accidental. The provision passed by the Senate and the amendment offered by Mr. Rangel, both contain provisions designed to ensure that the "U.S. manufacturing benefit" only be allowed for income earned from productive activities in the United States. Both of those proposals explicitly make clear that income resulting from offshoring will not be eligible for the new rate reduction. It is difficult to understand what could motivate Republican members of this Committee to endorse a proposal incentivizing offshoring.

Previously, most of the jobs moved by U.S. companies overseas were manufacturing jobs. Now, increasingly, we are seeing U.S. companies moving technical work, computer programming, call centers, and other service jobs to take advantage of cheap labor rates overseas. That trend will be accelerated by the tax benefits provided by the Committee bill for income resulting from the cost saving of hiring cheaper foreign labor.

For example, if a software company hires foreign computer programmers to produce parts of its software because of lower wage rates overseas, it will receive a rate reduction for the cost saving so long as the final computer program is assembled in the United States. Manufacturers that move call centers or technical assistance services overseas similarly will get rate reductions for the income derived by hiring cheap, foreign labor. Importers of cheap foreign goods will receive benefits if there is some assembly here.

Patriotism Just Has to Take A Back Seat to Profits

A spokesperson for a major accounting firm which was promoting the tax avoidance device of moving the corporate charter offshore was asked whether there was any downside to these transactions. The response was stark. The spokesperson suggested that the 9/11 tragedies placed an emphasis on patriotism. That concern was dismissed with the statement that the profits from the transaction were so large that "the patriotism issue needs to take a back seat."

The Thomas bill is totally consistent with the view expressed by that person. It contains no meaningful restrictions on the ability of corporations to move their corporate charters offshore for tax avoidance purposes. The Bush Treasury Department representative at the markup acknowledged that the Committee bill did little to stop these transactions. Remarkably, he supported the bill anyway, arguing that the Bush Administration opposes "putting up walls" that prevent businesses from moving their corporate charters offshore.

Committee Bill Imposes Costs on State and Local Governments to Fund Corporate Tax Benefits

Increasingly, the Bush Administration, and the Republican Congress, have increased the burdens on State and local governments. They have imposed new mandates without providing needed resources. Some of the tax policies promoted by the Bush Administration have had the indirect impact of increasing the burden of State and local taxes.

Budget crises faced by State and local governments have caused some of them to engage in leasing transactions from which they receive some monetary benefits. We recognize that many of these transactions are abusive, and that the amount received by the State and local government is a relatively small portion of the overall federal revenue loss. Therefore, we would support reform in this area, but cannot support the Committee bill that merely increases the burden on State and local governments, and makes no attempt to replace the benefit.

IRS Use of Private Collectors for Federal Tax Debts

The bill's provision to "privatize" IRS debt collection should be an affront to taxpayers nationwide. Federal tax collection is and should continue to be the job of the IRS and the Department of Treasury – it is an inherently governmental function. The collection of Federal taxes should not be a profitable business venture for corporate America looking to expand their debt collection market share. The very notion of unleashing a small army of bill collectors on the taxpayers of this Nation should give major pause to everyone.

The Committee bill specifically rewards private debt collectors up to 25% of amounts collected from taxpayers. It is offensive and a failure of responsibility for the Committee to give companies and their employees – who are not directly accountable to the Treasury

Department Secretary and IRS Commissioner – "a bounty" for getting money from taxpayers. The IRS's earlier project to use private debt collectors resulted in numerous violations of the Fair Debt Collection Act and was abandoned, in large part, because the companies were not able to collect taxes from the taxpayers assigned to them – cases having large and old tax delinquencies. Now, the Treasury Department plans to give these firms small and recent cases so they can make profit. This "cherry picking" means that private tax collectors will be able to work on average taxpayer cases – those who, in fact, filed a return in 2001, 2002 or 2003 and were unable to enclose a balance due check of $40 - $600.

Clearly, the IRS could do this collection work if it had more resources. The Republican Leadership just plain refuses to give the IRS the resources is needs and wants to do its job of properly administering our tax laws. There is no question that the IRS could efficiently and effectively collect additional taxes due and do so for about 3-5% of the amount collected. The notice and letter machines, the telephone lines, the know-how, the entire process is there and ready to go at the IRS. All that is needed are staff and resources to do the work under the existing system. Why would we pay someone 25% of a $1,000 tax bill for making a phone call or sending a letter to a taxpayer, when the IRS could send that same letter or make that same phone call at little cost?

The proposal is unfair, inefficient, and a threat to taxpayer confidentiality. The fact that the provision specifically prevents a lawsuit against the United States in the event a taxpayer is abused by a tax collection company clearly shows that the Committee's plan does include taking responsibility for how the private debt collection plan turns out.

Dissenting Views on H.R. 4250, FSC/ETI

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