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How U.S. International Tax Policy Impacts American Workers, Jobs, and Investment

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before the

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The 46 members of the Alliance for Competitive Taxation are: 3M, Abbott Laboratories, ADP, Alcoa Corporation, American Express Company, Bank of America Corp., Boston Scientific Corp., Carrier Global Corp., Caterpillar Inc., Cisco Systems, Inc., The Coca-Cola Company, Corteva Inc., Danaher Corporation, Dell Technologies, Inc., The Dow Chemical Company, DuPont, Eli Lilly and Company, Emerson Electric Co., Exxon Mobil Corporation, General Electric Company, General Mills Inc., Google, Inc., The Home Depot Inc., Honeywell International Inc., IBM Corporation, International Paper Company, Johnson & Johnson, Johnson Controls, Inc., JPMorgan Chase & Co., Kellogg Company, Kimberly-Clark Corp., MasterCard Inc., McCormick & Company, Inc., Morgan Stanley, Oracle Corporation, Otis Worldwide Corp., PepsiCo, Inc., Procter & Gamble Co., Prudential Financial Inc., Raytheon Technologies Corp., S&P Global Inc., State Street Corporation, Texas Instruments, Inc., United Parcel Services, Inc., Verizon Communications Inc., and The Walt Disney Company.

How U.S. International Tax Policy Impacts American Workers, Jobs, and Investment

The Alliance for Competitive Taxation (ACT), a coalition of leading American companies from a wide range of industries, welcomes this opportunity to submit testimony on the importance of maintaining a globally competitive U.S. corporate tax system to help restore U.S. economic growth, good jobs, and rising wages for American workers.[1]

This hearing is taking place as the economy continues to recover from the worst recession since the Great Depression. Job losses as of February 2021 were 9.5 million – more than all the jobs lost at the worst point of the 2008-2009 recession.

A strong recovery means not only returning these Americans to work but also creating new well-paying job opportunities for the nearly 5 million people who would have joined the labor force in 2020 and 2021 if economic growth had continued at its pre-pandemic pace.

We are American companies committed to doing our part to support the country and the communities where we operate. We look forward to our factory floors and offices returning to full capacity, our purchasing managers filling the order books of our suppliers, and “help wanted” signs hanging in every storefront.

We support the goal of Congress and the Administration to return the economy to a position of strength as soon as possible. But a tax increase on employers now would inevitably slow economic growth. For many companies, it would dampen plans to expand hiring; for others, it would slow re-hiring. Reduced demand for workers and stalled investment would suppress wages.

A tax increase would withdraw funds from the economy at a time that is already precarious and would directly counter the federal government’s actions to inject funds into the economy. As we seek to recover millions of lost jobs, now is the worst time to raise corporate taxes.

It took six years to restore employment to its pre-recession level following the last recession. America cannot risk any actions that would slow the present recovery.

We urge you to consider the benefits to a strong economic recovery, built on the success of American businesses. We believe America can be the best place in the world for a company to expand its workforce, increase wages, undertake new capital investment, develop new technologies, and manage a global enterprise. But higher taxes now on America’s employers, especially taxes that make it harder for American companies to compete in global markets, would put a sustainable recovery at risk.

Key Points:

1. Raising taxes during a recession is a recipe for a stagnant economy. Raising taxes on *employers* during a recession will slow the re-hiring of workers.
2. Competitive U.S. tax policy has been a bipartisan priority for decades because it creates jobs and boosts wages for American families.
    - Prior to the pandemic, real wage growth was increasing at a faster rate than it had in decades, unemployment reached 50-year lows, and companies were hiring and

[1] For more on the Alliance for Competitive Taxation, see https://ACTontaxreform.com/.

making new investments in the United States. In the absence of the pandemic, strong wage growth and employment gains were forecast to have continued.[2]

3. Corporate income taxes, like any other business cost, factor into a company's decisions to hire workers and invest in plant and equipment. Higher corporate taxes will lead to less cash available for paying wages and investing in capital. Less investment ultimately results in reduced productivity and lower wages for American workers, and less output for American consumers to enjoy. Higher corporate taxes also may result in lower returns for the company's shareholders, including the retirement plans of millions of workers and retirees. Finally, raising corporate taxes can also result in higher prices for the company's products, straining the budgets of low- and middle-income families at a time when funds are already tight.
    - Studies show that workers bear a significant share of the corporate tax burden through lower wages.[3] The Joint Committee on Taxation, the Congressional Budget Office, and the U.S. Treasury Department all agree in this assessment.[4]
    - The portion of the corporate income tax burden on shareholders affects not just the top 1%, but the more than 50% of American families who hold stock either directly or in their IRAs and 401(k)s.[5] State and local government and private pension plans across the country – those of nurses, schoolteachers, police officers and firefighters – all depend on sustained returns from their stock market investments.
4. Raising taxes on income earned abroad by U.S. companies will not increase domestic employment. The foreign operations of American companies *create* jobs for American workers, they do not *displace* jobs for American workers.
    - The foreign operations of U.S. companies give American workers access to global markets to sell the goods and services they produce at home. Nearly 90% of the goods and services produced by the foreign operations of American companies are sold to foreign customers – sales that might not be possible without these operations.[6]

[2] In its January 2020 economic projections, the Congressional Budget Office wrote "Solid economic growth and continued strength in labor demand are projected to keep the unemployment rate low and drive employment and wages higher in 2020." CBO's median run forecast projected employment "to remain above its maximum sustainable level over the next five years, supporting relatively robust wage growth during that time." Congressional Budget Office, The Budget and Economic Outlook: 2020 to 2030, January 2020, p. 29.
[3] See, for example, Clemens Fuest, Who Bears the Burden of Corporate Income Taxation?, European Tax Policy Forum Policy Paper, 2015; Juan Carlos Suárez Serrato and Owen Zidar, Who Benefits from State Corporate Tax Cuts? A Local Labor Markets Approach with Heterogeneous Firms, American Economic Review, 2016; Clemens, Andreas Peichl, and Sebastian Siegloch. 2018. Do Higher Corporate Taxes Reduce Wages? Micro Evidence from Germany. American Economic Review, 2018.
[4] The Joint Committee on Taxation assumes 25% of the corporate income tax is borne by workers (Modeling the Distribution of Taxes on Business Income, JCX-14-13, October 16, 2013); CBO also assumes 25 percent of the corporate income tax is borne by workers (The Distribution of Household Income and Federal Taxes, 2008 and 2009, Congressional Budget Office, July 2012, p. 24); and Treasury assumes 18% of the corporate income tax is borne by workers (Distributing the Corporate Income Tax: Revised U.S. Treasury Methodology, Office of Tax Analysis, Technical Paper 5, May 2012).
[5] Federal Reserve Board, Changes in U.S. Family Finances from 2016 to 2019: Evidence from the Survey of Consumer Finances, September 2020.
[6] Bureau of Economic Analysis, Worldwide Activities of U.S. Multinational Enterprises: Preliminary 2018 Statistics, Table E.1.

- U.S. multinational companies account for the majority of U.S. exports of goods and services, creating millions of jobs throughout the U.S. supply chain.[7]
- Foreign operations also create economies of scale that support additional investment in plant and equipment and more research and development at home, resulting in more jobs and higher wages for American workers.[8]

5. The current tax system does not advantage American companies over their foreign competitors, nor does it encourage U.S. companies to invest abroad rather than at home.
    - The United States is the only country to subject the active foreign earnings of its companies to a minimum tax, a tax that their foreign-headquartered competitors do not have to pay. This puts American companies – and workers – at a disadvantage in global markets compared to their foreign counterparts.
    - The ability to deduct domestic expenditures on equipment and machinery immediately, a provision that was adopted at the same time as the foreign minimum tax, favors investment in the United States, spurring greater investment at home.
6. Recent estimates of profit shifting are greatly overstated.
    - Data used in profit-shifting studies pre-date implementation of both (i) the minimum tax on foreign income adopted in 2017, which was not fully effective for most companies until 2019, and (ii) the base erosion and profit shifting ("BEPS") measures recommended by the OECD in 2015 and adopted by countries in recent years.
    - Moreover, some of these studies rely on data that treat operating income earned in one country as earned by holding companies located in another country, resulting in a misattribution of the source of income and in some cases a double counting (or more) of the income earned abroad by U.S. companies. The improper use of these data overstates earnings where the holding company is located, typically a country that does not tax dividends from a related company, and gives the false appearance of low-taxed income in these countries.[9]

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[7] U.S. Census Bureau, Annual Trade Highlights; Bureau of Economic Analysis, Worldwide Activities of U.S. Multinational Enterprises: Preliminary 2018 Statistics, Table I.R 1.; BEA, A Profile of U.S. Exporters and Importers of Services, 2017.

[8] Mihir Desai, C. Fritz Foley and James R. Hines, Jr., "Domestic Effects of the Foreign Activities of U.S. Multinationals," American Economic Journal: Economic Policy, February 2009.

[9] The Bureau of Economic Analysis explains with respect to its data on multinational companies, "Because the balance sheet statistics reflect the cumulative balance sheets of each foreign affiliate (both the top and lower tiers), ownership in lower-tier affiliates results in 'double (or more) counting' in the aggregate statistics. The income statement is similarly affected." (Bureau of Economic Analysis, "How are BEA's statistics on the activities of U.S. multinational enterprises (MNEs) affected by the complex corporate structures of MNEs?," available at: https://www.bea.gov/help/faq/1402.) With respect to country-by-country data, the Joint Committee on Taxation cautions that "there could be some double counting of dividend income in the profits line," which will lead to an understatement of the effective tax rate of the company (Joint Committee on Taxation, U.S. International Tax Policy: Overview and Analysis (JCX-16-21), March 19, 2021.) The OECD makes a similar caution (OECD, Important Disclaimer Regarding the Limitations of the Country-By-Country Report Statistics, July 2020). For an analysis, see Jennifer Blouin and Leslie Robinson, Double counting accounting: How much profit of multinational enterprises is really in tax havens? May 20, 2020, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3491451.

I. Raising taxes on employers during a recession will place economic recovery at risk

Coming on the heels of the worst recession since the Great Depression, the economy is still fragile, and the path forward is uncertain. While no tax should be raised during a recession, taxes on employers would have particularly harmful consequences.

The economy depends on America's employers – whether small businesses or large employers – to help restore and expand the economy by rehiring millions of workers, boosting wages, increasing purchases from their suppliers, and making new investments. Raising taxes on employers now would pull resources out of the economy and would put a strong and sustainable economic recovery at risk.

No one can know for sure the path of the virus or the path of recovery, and raising taxes now with the expectation of an economic recovery soon is unnecessarily perilous. The Federal Reserve Board's own projections show it believes the risk of slowing the economic recovery are high enough that it does not intend to raise interest rates before 2024 at the earliest.

Federal Reserve Board Chairman Jerome Powell has emphasized the need for caution before the economy returns to full employment. "The economic recovery remains uneven and far from complete, and the path ahead remains uncertain," Powell explained earlier this month. "The economy is a long way from our employment and inflation goals, and it is likely to take some time for substantial further progress to be achieved."

Chairman Powell has also said that now is not the time to worry about the deficit, the appropriate time "will be when the economy is back to full employment and taxes are rolling in and we're in a strong economy again."

II. Competitive U.S. tax policy has been a bipartisan policy because it creates jobs and boosts wages for American families

For decades there has been bipartisan support for lowering the corporate tax rate to an internationally competitive level and modernizing the outdated U.S. international tax rules.

Bipartisan proposals for reform highlighted that the United States had fallen behind by standing still. Over three decades, other countries had lowered their corporate tax rates and adopted territorial tax systems. These changes provided a more attractive environment for job-creating investments and made companies headquartered in those countries more globally competitive. By 2017, the U.S. corporate tax rate was the highest in the developed world, and the United States was the only G7 country that taxed the repatriation of foreign business income.

High corporate taxes reduced investment in the United States and resulted in slower growth in wages for American workers. As explained by the OECD, the corporate income tax is the greatest deterrent to economic growth of all taxes:

> "Corporate income taxes are the most harmful for growth as they discourage the activities of firms that are most important for growth: investment in capital and productivity improvements."[10]

At the same time, a disadvantageous U.S. international tax system made it harder for U.S. companies to compete in foreign markets. Less success in foreign markets for U.S. companies reduced demand for their products and services and resulted in fewer jobs for American workers. Announcements of

[10] OECD, Tax Policy Reform and Economic Growth, 2010, p. 22.

major companies looking to leave the United States regularly made newspaper headlines and affected communities in every state.[11]

<u>Following tax reform, the U.S. economy was strong</u>

Pre-pandemic, the economy was strong and income gains were shared throughout the workforce:

- Real wages grew 4.9% for the two years 2018-2019, the fastest two-year growth rate in real earnings since 1998-1999. This compares to no real wage growth over the two previous years, 2016-2017.[12]
- Wage growth was greater for those on the factory floor and in nonsupervisory roles than for their managers from the start of 2018 to the end of 2019, reversing prior trends.[13]
- Unemployment reached a 50-year low of 3.5% in 2019.[14]
- Investment by companies in plant and equipment and research and development was strong. Real business investment in equipment and R&D grew at 5.6% and 12.1%, respectively, in the two-year period 2018-2019, faster than in the two preceding years.[15]
- Bureau of Economic Analysis data show that in 2018, the most recent year for which data are available, U.S. companies with global operations grew faster in the United States than they did abroad – growing their employment, capital expenditures in property, plant and equipment, and R&D investment faster in the United States than they did abroad.[16]
- Companies that had moved their headquarters from the United States through acquisitions prior to 2017 began to return as the United States established more competitive tax rules.[17]
- And the CBO forecast wage growth would continue to be strong.[18]

Increases in corporate taxes would jeopardize a fragile economic recovery.

III. Corporate income taxes ultimately affect people in their roles as employees, suppliers, customers, and investors – and these people will be worse off by increasing corporate taxes

Corporations are legal entities in which ordinary individuals participate in their roles as workers, consumers, and savers as retirement plan participants, mutual fund investors and direct shareholders. Studies show that workers bear a substantial share of the corporate tax burden through lower wages, although the precise amount varies from study to study.[19] One effect of the corporate income tax is to

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[11] See, for example, Kate Linebaugh and Liz Hoffman, "U.S. Firms Pack Up for Tax Benefits," Wall Street Journal, May 12, 2014; Hester Plumridge and Peter Loftus, "Inversion Frenzy Rocks Drug Sector," Wall Street Journal, June 21, 2014; Dana Mattioli, "Acquirers Plot Escape from a Turn on Taxes," Wall Street Journal, July 7, 2014; Liz Hoffman and Hester Plumridge, "Race to Cut Taxes Fuels Urge To Merge," Wall Street Journal, July 15, 2014; Tom Fairless and Shayndi Raice, "In Inversion Deals, U.K. Is a Winner; Location, Language, Lifestyle Are Draws as U.S. Companies Buy Firms Abroad," Wall Street Journal, July 28, 2014; Emily Chasan, "Companies are Running the Numbers on Potential Tax Inversions," Wall Street Journal, August 26, 2014. For an analysis, see Congressional Budget Office, "An Analysis of Corporate Inversions," September 2017.

[12] Bureau of Labor Statistics, Employed full time: Median usual weekly real earnings: Wage and salary workers: 16 years and over [LES1252881600Q].

[13] Bureau of Labor Statistics, series for "Average Hourly Earnings of Production and Nonsupervisory Employees"[CES0500000008] and "Average Hourly Earnings of All Employees" [CES0500000003].

[14] Bureau of Labor Statistics, series for unemployment [LNS14000000].

[15] Bureau of Economic Analysis, Table 5.3.6. Real Private Fixed Investment by Type, Chained Dollars.

[16] Bureau of Economic Analysis, "Activities of U.S. Multinational Enterprises, 2018," News Release BEA 20- 40, August 21, 2020.

[17] Amanda Athanasiou, Inverters Return to the U.S., and Not Just for the Tax Rate, Tax Notes Federal, August 19, 2019.

[18] Congressional Budget Office, The Budget and Economic Outlook: 2020 to 2030, January 2020, p. 29.

[19] For example, Suárez Serrato and Zidar (2016) estimate workers bear 30-35% while Clemens, Peichl, and Siegloch. (2018) estimate 50%. See footnote 1 for complete references.

discourage productivity-increasing investments in equipment and technology. With labor less productive, employer demand for workers declines, and their wages fall. The Joint Committee on Taxation, the Congressional Budget Office, and the U.S. Treasury Department all agree with this assessment.[20]

A recent OECD survey concludes "empirical estimates suggest that it [the corporate tax] is borne only partially by capital owners and often at least as much by workers in the form of lower wages."[21]

If half of the corporate tax burden is borne by workers, that implies a $100 billion corporate tax increase – approximately the revenue raised over 10 years from a one percentage point increase in the corporate tax rate – would reduce the wages of U.S. workers by $50 billion.

The portion of the corporate income tax burden that falls on shareholders affects not just the top 1% but harms the more than 50% of American families who hold stock either directly or through their IRAs and 401(k)s.[22] In addition, state and local government and private pension plans across the country – those of nurses, schoolteachers, police officers, and firefighters – all depend on sustained returns from their stock market investments.

Across the 59 million workers with 401(k) accounts, more than 90% have some investment in equities, and 82% had at least 40 percent of their account balances invested in equities in 2018.[23] Among 401(k) participants in their 20s, nearly three-quarters had more than 80 percent of their account balances invested in equities.

The Treasury Department estimates that between the portion of the corporate income tax borne by workers and the portion borne by direct and indirect investment in equities, the poorest half of all families on average face a larger tax burden through the corporate income tax than they do from the individual income tax.[24] A corporate income tax hike will hurt those struggling the most.

Corporate earnings distributed as a dividend to taxable shareholders currently are subject to a top federal combined corporate and individual tax rate of 39.8%.[25] Under the campaign proposal of President Biden, this would increase by nearly 50 percent to 59.2%.[26] Taking into account average state income tax rates, corporate earnings distributed as a dividend to taxable shareholders currently are subject to a top combined federal and state tax rate of 47.5%.[27] Under the campaign proposal of President Biden, the top combined federal and state tax rate on corporate earnings would increase to 65.4% based on average state income tax rates – taking nearly two-thirds of the return on corporate investments. This combined U.S. tax rate on dividends would be the highest among the 37 countries

[20] The Joint Committee on Taxation and Congressional Budget Office assume 25% of the corporate income tax is borne by workers, while Treasury assumes 18% is borne by workers. See references in footnote 2.

[21] Anna Milanez, Legal tax liability, legal remittance responsibility and tax incidence: Three dimensions of business taxation, OECD Taxation Working Papers No. 32, 2017.

[22] Federal Reserve Board, Changes in U.S. Family Finances from 2016 to 2019: Evidence from the Survey of Consumer Finances, September 2020.

[23] Employee Benefit Research Institute, 401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2018, March 4, 2021.

[24] Office of Tax Analysis, U.S. Treasury Department, Distribution of Tax Burden, Current Law, 2019.

[25] This is computed under current law as a top federal corporate tax rate of 21% and a top federal individual tax rate on dividend income of 23.8%, 39.8% = (.21 + (1-.21)(.238)).

[26] This is computed under current law as a top federal corporate tax rate of 28% and a top federal individual tax rate on dividend income of 43.4% (39.6% plus the 3.8% net investment income tax) under the Biden campaign proposal, 59.2% = (.28 + (1-.28)(.434)).

[27] OECD Tax Database, 2020 rates, https://stats.oecd.org/Index.aspx?DataSetCode=TABLE_II4.

in the OECD. And the top combined tax rate on corporate earnings would surpass 70% in California and New York City.[28]

The corporate income tax also may fall on consumers. One recent study estimates that approximately one-third of the burden of corporate income taxes is borne by consumers in the form of higher prices for goods produced by corporations.[29] The study found a greater impact on prices of products "commonly purchased by households with lower incomes relative to those purchased by high-income households."

While studies will differ on the precise incidence of the corporate income tax, it is clear that the burden ultimately falls on people in all income ranges.

IV. Raising taxes on income earned abroad by U.S. companies will not increase domestic employment. The foreign operations of American companies *create* jobs for American workers, they do not *displace* jobs for American workers.

Most foreign operations of U.S. companies serve foreign markets. The most recent government data show that approximately 90% of the sales of goods and services by the foreign operations of U.S. companies are to foreign customers.[30] Some foreign operations are required due to local content requirements, while others reduce costs of transportation and tariffs. Access to natural resources also drives location decisions.

Many foreign operations are the result of the acquisition of a foreign company. These acquisitions often provide new technology, patents, and knowhow that can be adopted globally by the acquiring company, boosting its productivity.

Research has shown that the foreign activities of U.S. businesses allow them to expand their investment and employment at home. This is because the foreign activities open up new markets for the company and boost its productivity, all of which increase the demand for its U.S. activities and make its U.S. operations more valuable.

One study based on data of U.S. manufacturers finds that increases in sales by a company's foreign affiliates lead to an increase in its U.S. exports and domestic R&D.[31] The study also finds a strong positive relationship between a company's foreign employment and its domestic employment: for every 10-percent increase in foreign employment by a U.S. company, on average, U.S. employment increases by 6.5%. Given that U.S. multinational companies employ twice as many workers in the United States as they do abroad, this implies that an increase of 100 workers abroad is associated with an increase of 129 workers in the United States. A recent study of European companies finds that an increase in their use of foreign high-skilled R&D workers leads to an increase in their domestic research employment.[32]

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[28] This assumes a 28% federal corporate tax rate and a top individual federal tax rate of 39.6% under the Biden campaign proposal, along with OECD assumed average state tax rates for corporations of 6.03% (before deductibility) and for individuals of 5.43%. In New York City and California, individuals are subject to a top tax rate of 12.7% and 13.3%, respectively. The current law 3.8% net investment income tax is assumed to be retained under the Biden campaign proposal.

[29] Scott R. Baker, et al. "Corporate Taxes and Retail Prices." Working Paper 27058, National Bureau of Economic Research, April 2020.

[30] Bureau of Economic Analysis, Worldwide Activities of U.S. Multinational Enterprises: Preliminary 2018 Statistics, Table E.1, https://apps.bea.gov/international/xls/usdia2018p/Part-II-E1-E17.xls .

[31] Mihir Desai, C. Fritz Foley and James R. Hines, Jr., "Domestic Effects of the Foreign Activities of U.S. Multinationals," American Economic Journal: Economic Policy, February 2009.

[32] Laura Abramovsky, Rachel Griffith, and Helen Miller, Domestic Effects of Offshoring High-skilled Jobs: Complementarities in Knowledge Production, Review of International Economics, 2017.

Subjecting the foreign operations of U.S. companies to higher taxes than their foreign-headquartered rivals would make it more difficult for U.S. companies to compete.

A tax disadvantage imposed on U.S.-headquartered companies results in their foreign assets being less valuable when owned by an American company than when owned by a foreign company. As a result, U.S. companies may lose out in bidding for foreign acquisitions.

These lost foreign acquisitions have been called "invisible inversions" by Professor Hines, as they have the same economic effect as a U.S. company moving its headquarters overseas: the U.S. business sector is smaller than it otherwise would be, resulting in reduced demand for U.S. workers and lower wages.[33]

Imposing taxes on the foreign operations of U.S. headquartered companies that their foreign competitors do not equally bear will decrease the ability of U.S. companies to compete in foreign markets, and lead to losses in U.S. employment, investment and R&D that support the foreign operations of U.S. companies.

V. The current tax system does not advantage American companies over their foreign competitors, nor does it encourage U.S. companies to invest abroad rather than at home

Current law aims to allow U.S. companies to be competitive with their foreign-headquartered rivals. It neither advantages them over their competitors nor encourages U.S. companies to invest abroad rather than in the United States.

U.S. corporate rate reduction still left the U.S. with an above average tax rate

The combined U.S. federal and state corporate tax rate at 25.8% is more than two percentage points higher than the average of other OECD countries.[34] Among the 37 OECD countries, the U.S. corporate tax rate is 12th highest. Current law does not advantage U.S. companies over their foreign competitors, it merely reduced the prior law tax disadvantage. In contrast, the 28% corporate tax rate proposed by President Biden would give the United States the highest corporate tax rate in the OECD.[35]

GILTI does not advantage U.S. companies over foreign companies

Regarding international income, current law has been referred to as a "quasi-territorial" tax system – a territorial-type system for dividends combined with a foreign minimum tax to protect the U.S. tax base from income shifting. The foreign minimum tax – the global intangible low-taxed income ("GILTI") provision – can be loosely described as applying a "top up" tax to active foreign business income that is taxed by foreign countries at a rate below 13.125%. While it is beyond the scope of this testimony to provide a detailed explanation of GILTI, practitioners observe that U.S. companies with average foreign tax rates above 13.125% still have to pay GILTI tax.[36]

The United States is the only advanced economy that imposes a minimum tax on active foreign business income.[37] And while discussions are taking place within the OECD on a model

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[33] Statement of James R. Hines, Jr., U.S. Senate, Committee on Finance, How U.S. International Tax Policy Impacts American Workers, Jobs, and Investment, March 25, 2021.
[34] OECD Tax Database, 2020 rates, https://stats.oecd.org/Index.aspx?QueryId=78166.
[35] Together with average state tax rates, a 28% federal tax rate combined with average state tax rates would be a combined tax rate of 32.3%.
[36] Richard Rubin, "Tax Changes Hit Overseas Profits of Some U.S. Companies," Wall Street Journal, March 27, 2019.
[37] Other countries often tax passive income meeting certain conditions, as the United States also does.

foreign minimum tax, the OECD Secretariat has described GILTI as tougher than the model the OECD is considering.[38]

An increase in the rate of tax under GILTI would only further disadvantage U.S. companies relative to their foreign-headquartered competitors.

The GILTI deduction for a 10% normal return on depreciable assets does not encourage foreign investment over U.S. investment

GILTI provides an exclusion of a 10% return on foreign tangible investments in plant and equipment. This provides territorial-like treatment for these earnings. The rationale for the exclusion is to allow U.S. companies to compete on an equal playing field with their foreign rivals on the "ordinary" or "normal" return to these investments. But unlike the territorial tax systems of other countries, the U.S. tax law does not exempt from U.S. tax any "above normal" returns on foreign investments. Instead, these above normal returns are subject to tax under GILTI.

While the location of high-return investments may be sensitive to tax rates, companies are unlikely to make a business decision to move investments that earn a low or normal return from the United States to another country on the basis of tax differences. Locational decisions for these lower return investments are swamped by factors such as operational costs, transportation and logistics.

More importantly, the structure of GILTI *provides no tax incentive* to move low or normal return investments from the United States. Under current law, domestic investment in most plant and equipment is eligible for 100% expensing – providing an immediate deduction for the full cost of the investment.[39] Expensing is equivalent in present value to exempting the normal return of the investment from taxation. Thus, the normal return to these investments is exempt in the United States. If the same investment is made abroad, its income will be taxed at the rate of the foreign country. As a result, the U.S. tax system favors investment of these assets in the United States if there is any foreign tax on the earnings of the investment.

The Joint Committee on Taxation reached a similar conclusion on the effect of post-2017 tax law:

> "The macroeconomic estimate projects an increase in investment in the United States, both as a result of the proposals directly affecting taxation of foreign source income of U.S. multi-national corporations, and from the reduction in the after-tax cost of capital in the United States due to more general reductions in taxes on business income."[40]

Data published by the Bureau of Economic Analysis for 2018, the most recent year available, show that U.S. companies with global operations *increased* their U.S. capital investment, U.S. employment, U.S. compensation, and U.S. R&D at a faster rate than in their foreign subsidiaries. Domestic capital investment for these companies grew by 8.3% while that of their foreign affiliates grew by 0.4%. In addition, U.S. multinational companies' growth in domestic capital investment, employment, value added, and R&D was above their 20-year average in 2018, and growth abroad in these factors was below their 20-year average.[41]

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[38] OECD, Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint, 2020, p. 19.
[39] Investment in new and used equipment and structures with a tax life of 20 years or less is eligible for expensing.
[40] Joint Committee on Taxation, Macroeconomic Analysis of the Conference Agreement for H.R. 1, The "Tax Cuts and Jobs Act, JCX-69-17, December 22, 2017.
[41] Bureau of Economic Analysis, "Activities of U.S. Multinational Enterprises, 2018," News Release BEA 20- 40, August 21, 2020, and historical data available at https://apps.bea.gov/iTable/index_MNC.cfm.

There is no empirical evidence to suggest that GILTI or the deduction for a 10% normal return have resulted in U.S. companies investing abroad rather than in the United States.

VI. The U.S. should protect its tax base, but estimates of revenue losses from income shifting are vastly overstated, do not reflect current law, and therefore should not give rise to a disproportionate policy response

Taxpayers rightfully owe U.S. tax on their U.S. income and the United States should enforce its laws to ensure that taxpayers cannot shift income earned in the United States to other jurisdictions. The most effective deterrent to income shifting is a competitive U.S. tax rate. Post 2017, the corporate tax rate is at a more competitive level and multiple new provisions have been added to prevent taxpayers from shifting income offshore, including:

- The new foreign minimum tax, GILTI
- A new base erosion and anti-abuse tax ("BEAT"), designed to attack related-party payments from the United States
- A tough new limitation on the deductibility of net interest expense
- New anti-hybrid rules to prevent a mismatch between deductions and income in cross-border payments, and
- New anti-inversion penalties for a company that inverts.[42]

In addition, current law provides a lower rate on foreign-derived domestic income (FDII), intended to provide an incentive to attract and retain intangible property in the United States.

Similarly, other countries are implementing measures as recommended under the OECD Base Erosion and Profit Shifting project, including the European Union's two Anti-Tax Avoidance Directives.

Little new data exist to examine the effect of these rules on income shifting. The Joint Committee on Taxation recently analyzed 2018 country-by-country data, covering companies with tax years ending between July 2018 and June 2019.[43] Unfortunately, as noted by the Joint Committee on Taxation, the country-by-country data are known to suffer from double counting of income – the same income can be reported multiple times due to the income of lower-tier foreign subsidiaries potentially being included in the income of higher-tier subsidiaries, making these data problematic for assessing income shifting.[44]

The 2018 data, the most recent available, also capture only a portion of the effect of the current law GILTI provision, as many companies have foreign affiliates with tax years that were not subject to GILTI until 2019. BEAT also phased in beginning in 2018 at a 5% tax rate, increasing to 10% in 2019. Revenue raised by BEAT not only includes direct tax payments under BEAT but also

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[42] New anti-inversion penalties include recapture of rate relief on previously unremitted foreign earnings, inclusion of cost of goods sold payments under BEAT, taxing dividends of such companies at ordinary rates, and increasing the excise tax on stock compensation paid to top executives of such companies.
[43] Joint Committee on Taxation, U.S. International Tax Policy: Overview and Analysis (JCX-16-21), March 19, 2021.
[44] As noted by Martin Sullivan, "Under the country-by-country reporting regulations, reported profit in a country may or may not be a multiple of the actual profit generated in that country. Using this data as reported makes effective tax rates appear low and profit levels appear high. So what looks like a profit-shifting problem might be nothing at all." (Sullivan, Economic Analysis: Are Country-by-Country Reports Worthless?, Tax Notes International, Jan 13, 2020). The OECD also notes that "it is likely that profits in the current iteration of the CbCR statistics are overstated, in some cases potentially substantially." (OECD, Important Disclaimer Regarding the Limitations of the Country-By-Country Report Statistics, July 2020).

additional corporate income tax paid by companies that avoid related-party transactions that would give rise to BEAT. Only the former is directly observable.

Some researchers have used earlier year releases of country-by-country data to estimate income shifting, but the double counting of income makes these data unreliable for this purpose.[45] Bureau of Economic Analysis data, properly used, can avoid the double counting of income but instead may misallocate income from the lower-tier subsidiary that generated the earnings to higher-tier holding companies. This misallocation is one reason for the disproportionate reported earnings in tax havens, where such holding companies are often located.[46]

Accounting professors Jennifer Blouin and Leslie Robinson have examined the misallocation of income in Bureau of Economic Analysis data and call it a "fatal flaw" in the work of researchers unaware of how this affects the reported location of income. As an example, they consider the findings of Professor Kimberly Clausing, the current U.S. Treasury Deputy Assistant Secretary for Tax Analysis. Blouin and Robinson estimate that corrected for misallocation of income, losses to the United States are *one-tenth* the amount estimated by Clausing.[47]

Unfortunately, even this estimate likely overstates the amount of income loss to the United States. Clausing's methodology assumes the "excess income" of low-tax countries was predominantly earned in the United States rather than in other high-tax foreign countries in which U.S. companies operate; it is not based on any tracing of actual transactions between low-tax countries and the United States or other countries.[48] It also ignores the stricter controlled foreign corporation rules of the United States than other countries.[49] Legitimate, related-party transactions that would be permitted to reduce taxes in high-tax foreign countries would fail to reduce U.S. tax when conducted between the United States and a foreign affiliate due to U.S. Subpart F rules.

Critical decisions on tax policy should not be made on the basis of inaccurate data, nor on data that does not yet allow one to assess the effectiveness of recently enacted anti-base erosion provisions in the United States and other countries. Raising taxes on the foreign operations of U.S. companies on income attributable to functions, assets, and risks actually located outside the United States instead will make U.S. companies less competitive in the foreign markets they serve, hurting American workers in the process.

[45] The UK government blocked the OECD from publishing UK country-by-country data, citing the "distortive effect of the inclusion of intragroup dividends," which the government stated "compromise how representative and comparable the aggregate CbC [reporting] data is for U.K. multinational groups." Stephanie Soong Johnston, U.K. Blocking OECD From Posting Aggregated CbC Reporting Data, Tax Notes International, May 11, 2020.

[46] See references in footnote 7.

[47] Jennifer Blouin and Leslie Robinson, Double counting accounting: How much profit of multinational enterprises is really in tax havens? May 20, 2020, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3491451.

[48] Clausing assumes two-thirds of the income in low-tax countries is shifted from the United States. See, Kimberly Clausing, Profit Shifting Before and After The Tax Cuts And Jobs Act, June 2020, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3274827.

[49] Professor Hines notes that stricter U.S. rules and better enforcement than other countries imply less income is reallocated from the United States relative to that from other countries. (Statement of James R. Hines, Jr., U.S. Senate, Committee on Finance, How U.S. International Tax Policy Impacts American Workers, Jobs, and Investment, March 25, 2021.)