Alliance for Competitive Taxation

Member Companies

3M
Abbott Laboratories
Alcoa Corporation
Bank of America Corp.
Boston Scientific Corp.
Caterpillar Inc.
The Coca-Cola Company
Danaher Corporation
The Dow Chemical Company
DuPont
Eli Lilly and Company
Emerson Electric Co.
Exxon Mobil Corporation
General Electric Company
General Mills Inc.
Google, 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
PepsiCo, Inc.
Pfizer Inc.
Procter & Gamble Co.
Prudential Financial Inc.
S&P Global Inc.
State Street Corporation
Texas Instruments, Inc.
United Technologies Corporation
United Parcel Service, Inc.
Verizon Communications Inc.
The Walt Disney Company

July 17, 2017

Honorable Orrin Hatch
Chairman, Senate Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, DC 20510-6200
By email: taxreform2017@finance.senate.gov

Re: Submission on Tax Reform: Internationally Competitive Corporate Income Taxation

Dear Senator Hatch:

In response to your June 16, 2017, request for stakeholder advice and comments on tax reform, the Alliance for Competitive Taxation (ACT) is submitting the attached paper on internationally competitive corporate income tax reform.

ACT is comprised of 39 leading American businesses from a diverse group of industries (www.ACTonTaxReform.com). Since 2012, ACT has supported comprehensive tax reform that lowers the corporate tax rate and establishes a modern, globally competitive tax system that aligns the United States with the rest of the world. PricewaterhouseCoopers LLP serves as a technical adviser to ACT.

Congress and the Administration have a once in a generation opportunity to update the U.S. corporate tax system to catch up to -- or leap ahead of -- global competitors with much lower corporate tax rates and modern international tax systems. If tax reform is to be successful in closing the competitive gap, the U.S. tax Code should no longer incentivize U.S. companies to invert, sell divisions, or be acquired by foreign-headquartered companies. ACT encourages the Committee to evaluate tax reform proposals using this criterion.

ACT member companies appreciate the intense efforts that Congress and the Administration are putting into moving tax reform legislation this year. We offer you our full support and assistance in achieving a globally competitive tax system.

Yours sincerely,

Alliance for Competitive Taxation

Attachment

cc: Mark Prater, Chief Tax Counsel, Senate Committee on Finance

COMPETITIVE CORPORATE INCOME TAX REFORM

Submission by the
Alliance for Competitive Taxation
to the
Senate Committee on Finance

EXECUTIVE SUMMARY

U.S. companies increasingly are competing in foreign markets, which account for over 95 percent of the world's population and over 75 percent of global purchasing power. For U.S. companies to succeed in the global marketplace, they must be able to provide goods and services that are competitive in terms of quality, innovation, and price.

Since the last major reform of the U.S. corporate income tax in 1986, the importance of foreign markets to the success of U.S. firms has grown and international competition from foreign-based companies has increased. Over this same period, other advanced economies have reduced their corporate tax rates and moved from worldwide to territorial tax systems. As a result, the U.S. corporate tax system has become an outlier among developed countries.

The out-of-step U.S. tax system is causing companies to lose ground in global markets. Between 1998 and 2016, the number of U.S. companies among the 500 largest companies in the world has declined by 25 percent. A loss of market share of U.S. companies adversely affects jobs at home that support their global operations. Economic research shows that when U.S. companies succeed abroad they increase employment, R&D, and exports at home.[1]

Reform of the U.S. tax system to bring it more in line with international norms would enhance the ability of U.S. multinationals to succeed in global markets and increase employment in the United States.

I. INTRODUCTION

Taxation is a key factor that affects the ability of U.S. corporations to compete in foreign markets. The U.S. tax system currently diverges in a number of important respects from the policies and practices of other major industrial countries to the competitive detriment of U.S. businesses. Tax reform that aligns the U.S. corporate tax system with international norms is essential to eliminating incentives for companies to move their headquarters, investments, and employment abroad.

This submission compares the U.S. tax rules with those of other OECD member countries, describes key corporate income tax reforms enacted in other G7 countries over the last decade, and discusses the economic consequences of a U.S. tax system that is out of step with the rest of the world.

II. COMPARISON OF U.S. AND OECD CORPORATE INCOME TAX SYSTEMS

A. Statutory Corporate Tax Rate

Corporate income is subject to both federal and state taxation with a deduction of state taxes allowed in computing the federal corporate tax. For 2017, the combined top U.S. corporate income tax rate was 38.9 percent taking account of the 35-percent federal rate and an average state rate of 6.0 percent. This is the highest combined corporate income tax rate among the 35 OECD member countries – more than

---

[1] Mihir A. Desai, C. Fritz Foley, and James R. Hines Jr., "Domestic Effects of the Foreign Activities of U.S. Multinationals," *American Economic Journal: Economic Policy*, 2009, 1:1, 181–203. Available at: https://www.aeaweb.org/articles?id=10.1257/pol.1.1.181

15 percentage points higher than the average for the other OECD countries (23.8 percent), and almost 11 percentage points higher than the average for the other G7 countries (28.0 percent) (see Table 1).

Many OECD countries have enacted or announced further corporate rate reductions, including: Australia, France, Greece, Israel, Luxembourg, Norway, and the United Kingdom, which is scheduled to reduce its current 19 percent corporate tax rate to 17 percent in 2020.

For the combined U.S. federal and state income tax rate to match the average for the other G-7 and OECD countries in 2017, the federal corporate tax rate would need to be reduced to 23.4 percent and 18.9 percent, respectively. After implementation of enacted and announced corporate rate reductions, the federal corporate tax rate would need to be reduced to 22.1 percent and 18.3 percent to match the average of other G7 and OECD countries, respectively.

The United States has not always had the highest corporate tax income rate among OECD economies. In 1988, as a result of the rate reduction made by the Tax Reform Act of 1986, the U.S. corporate rate was more than five percentage points *below* the OECD average. Since then, the other OECD countries have reduced their corporate tax rates by an average of over 20 percentage points, while the U.S. federal corporate tax rate has remained at 35 percent since 1993 (see Figure 1).

The high U.S. statutory corporate income tax rate has a number of adverse economic consequences in an increasingly global economy. First, it discourages both U.S. and foreign companies from locating their most profitable assets and operations inside the United States. Second, it encourages both U.S. and foreign companies to locate their borrowing in the United States, as the value of interest deductions is greater against a higher corporate tax rate. Third, it discourages U.S. multinationals from remitting foreign profits to the United States and being subjected to the higher U.S. corporate tax, leading foreign subsidiary earnings to be reinvested abroad rather than at home.

B. Effective Tax Rates

The effective corporate tax rate takes into account both the statutory tax rate and the breadth of the corporate income tax base. There are a number of ways to calculate effective tax rates, including prospective economic measures, such as marginal and average effective tax rates, and retrospective financial accounting measures, such as cash and book tax rates. Using a variety of measures, international comparisons of corporate effective tax rates generally find the U.S. corporate tax rate is higher than the average for various peer groups (see Table 2).

C. Intellectual Property Income

Since 2001, 17 countries have adopted intellectual property (IP) boxes including three of the G-7 countries (France, Italy, and the United Kingdom) and 14 of 35 OECD member countries. IP boxes are tax regimes that provide a reduced rate of tax — either through a separate schedule or special deduction — on income arising from the license or use of IP. In contrast to existing tax incentives for research and experimentation (R&E) that provide an income tax incentive at the front-end of the innovation process, IP boxes provide a back-end tax reduction for successful innovations. Of the 17 countries with IP boxes, 14 also provide front-end tax incentives in the form of research credits or “super” deductions, i.e., deductions of more than 100 percent of research costs.

D. Business Entity Choice

The high corporate income tax rate relative to the top individual income tax rate on ordinary income (35 percent as compared to 39.6 percent) and the widespread adoption of state LLP and LLC statutes are important reasons why the share of business income earned through passthrough entities (e.g., partnerships and S corporations), that are not subject to corporate-level tax, has increased by 32 percentage points, from 20 percent in 1980 to 52 percent in 2012 (see Figure 2). Corporate level taxation increasingly is limited to large, publicly-traded companies that, with limited exceptions, are not eligible for flow-through taxation under U.S. law.

A 2014 OECD survey of member countries found that the proportion of firms organized as entities subject to double taxation was lower in the United States than in any of the other countries for all firm size classes measured by turnover (see Figure 3). Every country except the United States reported over 75 percent of large firms (turnover in excess of €50 million) were subject to taxation at both the entity and personal level.[2]

E. Relief of Double International Taxation

The United States has a worldwide tax system under which U.S. domestic corporations are subject to U.S. income tax on both their domestic income and their foreign source income. Thus, a U.S. corporation is subject to taxation by the United States on all of its income regardless of where the income is earned. In general, active business income earned by foreign corporations that are owned by U.S. shareholders is not subject to U.S. income tax until remitted. Ten-percent shareholders are taxed on foreign dividends including foreign income taxes deemed paid with respect to these dividends and may claim a credit against U.S. tax on foreign source income, subject to various limitations, for foreign taxes (the foreign tax credit).

Unlike the United States, 29 of the 35 OECD member countries and all other G-7 countries, have adopted dividend exemption (so-called “territorial”) tax systems (see Table 3). Under these territorial tax systems, the active foreign income of foreign subsidiaries generally is taxed only by the country where it is earned, and it can be distributed to the parent company with little or no residual taxation. By contrast, under the U.S. worldwide system, foreign income is taxed by the country where it is earned and then by the United States (with a foreign tax credit) when the income is remitted to the United States.

There has been a pronounced shift over the last 25 years toward the use of territorial tax systems. In 1989, only 10 OECD member countries had territorial tax systems and just two of the G-7 countries (Canada and France) had such a system (see Figure 4). Today, 29 OECD countries and all other G-7 countries have adopted some form of territorial tax system. Notably, over this period, only two OECD countries switched from territorial to worldwide tax systems (Finland and New Zealand) and both countries subsequently switched back to territorial tax systems.[3]

As a result of these trends, U.S. multinationals now compete against foreign competitors that overwhelmingly are taxed under territorial systems. Within the OECD, 91 percent of the non-U.S. parented companies on the Global Fortune 500 list in 2016 were headquartered in countries that use territorial tax systems (Figure 5).

F. Allocation of Indirect Expenses

The U.S. rules for determining the source of income are unusual among OECD member countries in allocating and apportioning indirect domestic expenses, most importantly interest and R&D expenses, against foreign source income. As a result, when a U.S. company borrows money or conducts R&D in the United States, its foreign tax credit may be reduced.

In lieu of apportioning indirect expenses, eight of the 29 OECD countries with territorial tax systems exempt slightly less than 100 percent of foreign dividends, typically 95 percent (97 percent in Norway).

---

[2] OECD (2015), *Taxation of SMEs in OECD and G20 Countries*, OECD Tax Policy Studies, No. 23, pp. 26-27. Available at: http://dx.doi.org/10.1787/9789264243507-en.

[3] Source: PricewaterhouseCoopers, Evolution of Territorial Tax Systems in the OECD, The Technology CEO Council, April 2, 2013. Updated to reflect Latvia’s membership in the OECD. Available at: http://www.techceocouncil.org/clientuploads/reports/Report%20on%20Territorial%20Tax%20Systems_20130402b.pdf

G. Controlled Foreign Corporation (Anti-Deferral) Regimes

U.S. shareholders may be taxed on certain types of undistributed profits of a foreign corporation, in particular, under the so-called U.S. subpart F rules that apply to controlled foreign corporations (CFCs) and the passive foreign investment company (PFIC) rules.

The subpart F regime, enacted in 1962, applies to U.S. shareholders that own 10-percent or more of the voting stock of a CFC. Under this regime, 10-percent U.S. shareholders must include in their taxable income their respective shares of certain types of CFC income (collectively referred to as "subpart F income"), regardless of whether that income has been distributed. Assuming the ownership requirements are met, U.S. corporate shareholders of CFCs may claim a foreign tax credit for the underlying foreign income taxes incurred by the CFC on its subpart F income. When a CFC distributes income that has been taxed under subpart F, it is not taxed again by the United States.

Subpart F income has numerous components, the most important of which is foreign base company income. Foreign base company income includes foreign personal holding company income (which consists mainly of passive investment income) and foreign base company sales, services, and oil-related income (generally active business income).

Subpart F also requires a 10-percent U.S. shareholder to include in income its pro rata share of any investments in U.S. property by a CFC. For this purpose, a loan to a related U.S. corporation is considered an investment in U.S. property.

Unlike domestic subsidiaries, foreign subsidiaries, other than certain Mexican and Canadian subsidiaries, cannot be included in a U.S. consolidated return. Thus, any losses of foreign subsidiaries cannot be used to offset other profits of the U.S. group. Also, the dividends received deduction, which partially or completely relieves corporations from taxation on dividends from domestic subsidiaries, generally does not apply to dividends from foreign subsidiaries.

The potentially adverse competitive impacts of the relatively stringent U.S. CFC rules, have been mitigated by (1) the temporary enactment in 2006, and subsequent extensions, of the CFC look-through rules (which generally exclude from subpart F interest, dividends, rents, and royalties received from a related CFC and paid out of its active, non-subpart F income); (2) the active financial services income exception from subpart F; and (3) the issuance by the IRS in 1996 of entity classification ("check the box") regulations that allow eligible entities (including foreign entities) to elect to be treated as corporations or as fiscally transparent.

As of January 2014, 23 of the then-34 OECD member countries had some form of CFC regime (see Table 4). In general, the scope of these CFC regimes is more limited than the U.S. CFC regime. Most countries restrict their CFC regimes to passive income and do not have provisions comparable to the U.S. foreign base company sales, services, and oil-related income rules or the U.S. rules imposing current tax on foreign income invested in domestic property.

Currently 22 of the 28 EU member countries are also members of the OECD. On June 20, 2016, the European Council adopted an anti-tax avoidance directive (ATAD), which contains five legally binding measures that member states must apply no later than January 1, 2019.[4] One of the five ATAD measures is the requirement to enact CFC rules. EU member states may choose between one of two CFC regimes. One of these options excludes active business income for CFCs in the European Economic Area (or worldwide at the election of the member state). Under this option, current taxation is

[4] (EU) 2016/1164. Available at: https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package/anti-tax-avoidance-directive_en

imposed on specified (passive) CFC income with an exception for income related to substantive economic activity.[5]

III. RECENT CORPORATE TAX REFORMS IN OTHER G-7 COUNTRIES

A. United Kingdom

In 2009, the UK government replaced its worldwide tax system with a 100-percent dividend exemption (territorial) system.[6] Subsequently, HM Revenue and Customs and HM Treasury released the *Corporate Tax Road Map*, which set out a bold vision for a multi-year corporate tax reform package:

> "The Government wants to send out the signal loud and clear that Britain is open for business … . In recent years too many businesses have left the UK amid concerns over tax competitiveness. It's time to reverse this trend. Our tax system was once viewed as an asset. And it needs to be an asset again. That is why the Government is prioritising corporate tax reform. Responding to the concerns of business, the UK is headed for a more competitive, simpler, and more stable tax system in the future, creating the right conditions for business investment."[7]

Chancellor George Osborne's 2011 budget accelerated the reforms with the goal to "create the most competitive tax system in the G20."

Since 2009, the UK government has enhanced the competitiveness of its corporate tax system by:

- Lowering the corporate income tax rate seven percentage points, from 28 percent in 2010 to 19 percent in 2017, with a further reduction to 17 percent scheduled to occur in 2020.

- Extending the territorial system to foreign branches in 2011.

- Revising the UK CFC rules, effective in 2013, to be consistent with the territorial tax regime and focus more narrowly on foreign profits artificially diverted from the UK.

- Enacting a "patent box" system, effective in 2013, that phases in a 10-percent rate on patent related income.

- Adopting a 10-percent, non-incremental, refundable R&D credit.

In response to these corporate tax reforms, some multinationals returned to the UK and a number of other multinationals relocated their legal headquarters to the UK.

HM Revenue & Customs and HM Treasury (2013) used a computable general equilibrium model of the UK economy to simulate the long-term impacts of a reduction in the corporate tax rate from 28 percent in 2010 to 20 percent in 2015. Relative to the baseline forecast, the study estimated that the rate reduction

---

[5] The second option imposes current taxation on CFC income generated through assets and risks linked to significant people functions carried out by the taxpayer where the income arises from a "non-genuine" arrangement put in place to obtain a tax advantage. A non-genuine arrangement is one in which the CFC would not own the assets or have taken the risks which generate all or part of the income if it were not controlled by a company where the significant people functions relevant to the assets and risks are carried out and are instrumental to generating the income.

[6] EU law restrictions on dividend taxation, CFC regimes, and on tax barriers to corporate expatriation were influential in shaping UK corporate tax reform.

[7] HM Revenue & Customs and HM Treasury, Corporate Tax Reform: delivering a more competitive system, November 2010, p. 7. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81303/corporate_tax_reform_complete_document.pdf

would increase GDP by between 0.65 percent and 0.82 percent after 20 years, and that these growth effects would offset between 45 percent and 60 percent of the static revenue cost of the tax rate reduction.[8]

Other researchers used data on 61,738 UK-owned foreign affiliates in 2008 and 2009 to estimate the impact of the UK territorial tax system, which took effect in 2009.[9] The authors found that UK parents of foreign affiliates responded to the adoption of the territorial tax system by increasing repatriations (by an average of over $2 million per affiliate) and reducing foreign affiliate investment.

B. Japan

Effective in 2009, Japan replaced its worldwide tax system with a 95-percent exemption for dividends received by Japanese corporations from foreign subsidiaries. The Japanese Ministry of Economy, Trade and Industry had advocated adoption of a territorial system to encourage repatriation of foreign earnings to Japan with a key goal of increasing domestic investment.[10]

In 2010, Japan liberalized and clarified its CFC rules, notably including within the scope of these rules only CFCs with an effective tax rate of less than 20 percent, as compared to 25 percent under prior law.

In 2011, Japan enacted a corporate rate reduction of five percentage points, but simultaneously enacted a temporary 2.5 percentage point surtax to aid in reconstruction work from the March 2011 earthquake. Both changes took effect in April 2012, resulting in the combined national and local corporate rate declining from 40.69 percent to 38.01 percent. The temporary surtax was to be in place for three years, but in 2014 was repealed one year early. As a result, beginning in April 2014, Japan's corporate tax rate declined to 35.64 percent. Effective April 2017, Japan further reduced its corporate tax rate to 30.0 percent.

In 2017, the Japanese CFC rules were fundamentally revised taking into consideration the recommendations in the BEPS Action 3 Final Report. Under the new rules, effective for CFC tax years beginning on or after April 1, 2018, income earned by a CFC that satisfies the economic activity tests will not be subject to the CFC rules regardless of the corporate tax rate; however, passive income may be subject to the CFC rules when the corporate tax rate is less than 20 percent.[11]

One report studied the effect of the adoption of territorial tax systems in Japan and the UK on cross-border mergers and acquisitions. The report estimates that elimination of the worldwide tax system in Japan increased the number of international mergers and acquisitions with a Japanese acquirer by 31.9 percent.[12]

Another report analyzed the effects of the UK and Japanese adoption of territorial tax systems in 2009.[13] The authors found that as a result of the adoption of territorial taxation, both UK and Japanese firms

---

[8] HM Revenues & Customs and HM Treasury, Analysis of the dynamic effects of corporation tax reductions, December 5, 2013. Available at: https://www.gov.uk/government/publications/analysis-of-the-dynamic-effects-of-corporation-tax-reductions

[9] Peter Egger, Valeria Merlo, Martin Ruf, and Georg Wamser, "Consequences of the New UK Tax Exemption System: Evidence from Micro-level Data," CESifo, Working Paper no. 3942, September 2012. Available at: http://www.cesifo-group.de/DocDL/cesifo1_wp3942.pdf

[10] Todd Landau, Takaaki Tokuhiro, Kinjun Muraoka, and Shuta Kobayashi, "Japan issues proposed 2009 tax reforms," Journal of International Taxation, March 2009, pp. 15-19.

[11] PwC, "Amendments to CFC Rules by 2017 Tax Reform, Japan Tax Update, Issue 131, May 2017. Available at: https://www.pwc.com/jp/en/taxnews/pdf/jtu-20170530-en-131.pdf

[12] Lars P. Feld, Martin Ruf, Uwe Scheuering, Ulrich Schreiber, and Johannes Voget, "Effects of Territorial and Worldwide Corporation Tax Systems on Outbound M&As," Center for European Economic Research, Discussion paper no. 13-088, 2013. Available at: http://ftp.zew.de/pub/zew-docs/dp/dp13088.pdf

[13] Matteo Arena and George Kutner, "Territorial Tax System Reform and Corporate Financial Policies," December 2013. Available at: http://ssrn.com/abstract=2160954

accumulated less cash, increased distributions to shareholders, and reduced foreign investment; however, they did not find a significant impact on domestic investment.[14]

C. France

The French parliament on December 20 and 22, 2016 approved the Finance Act for 2017. Among other things, the 2017 Act progressively reduces the corporate income tax (CIT) rate from 33.33% to 28% by 2020.

IV. ECONOMIC EFFECTS OF OUT-OF-STEP U.S. TAX SYSTEM

With the highest corporate tax rate among OECD countries and a worldwide tax regime, the U.S. corporate tax system falls far outside international norms for advanced economies, with adverse consequences for the U.S. economy. This section discusses the effects of U.S. tax policy on (1) investment location, (2) headquarters location, and (3) economic growth.

A. Investment Location

Trapped cash

With the rapid growth in emerging market economies, the foreign share of U.S. multinational company earnings has increased. For all U.S. public companies, domestic and multinational, 48 percent of 2012 pre-tax book earnings was reported as coming from foreign sources.[15] The effect of U.S. tax law is to discourage companies from remitting these foreign earnings to, or investing them in, the United States, because doing so would result in imposition of U.S. tax at a federal rate of 35 percent, with an offset for associated foreign income taxes. As foreign income tax rates have fallen, the U.S. tax that would be incurred by repatriating foreign earnings has increased, in effect discouraging the repatriation of foreign income that is not currently needed for business purposes abroad.

One measure of the amount of earnings accumulated abroad that companies do not intend to repatriate or invest in the United States is the amount of income recorded on their financial statements as permanently or indefinitely reinvested abroad. Some of these earnings are reinvested abroad in active business assets, such as plant, property, and equipment, and some is invested in cash and equivalents.[16] Audit Analytics estimates that for the companies in the Russell 1000, permanently reinvested earnings reached $2.4 trillion in 2015, an increase of $1 trillion over the prior five years.[17] The Joint Committee on Taxation recently estimated that not previously taxed foreign earnings of all U.S. companies was $2.6 trillion in 2015.[18]

One consequence of the U.S. tax rules with respect to repatriated foreign earnings is that it is more attractive for U.S. multinationals to invest abroad than at home. For example, if a foreign subsidiary earns $100 million and distributes $80 million of earnings, after paying $20 million of foreign tax, to its U.S. parent, there would be just $65 million available to invest after paying $15 million of U.S. corporate tax (35 percent of $100 million less a credit for the $20 million of foreign tax). By contrast, the entire $80 million would be available to invest if used to expand abroad or acquire a foreign company. In this

---

[14] The global financial crisis, which occurred concurrently with the adoption of territorial tax systems in Japan and the UK, may have dampened domestic investment. Also, under the prior worldwide tax systems used in Japan and the UK, foreign subsidiary earnings could be lent to the parent company without triggering tax.
[15] PwC calculations based on Compustat data.
[16] Ben Casselman and Justin Lahart, "Companies shun investment, hoard cash," Wall Street Journal, Sept. 17, 2011.
[17] Audit Analytics, available at: http://www.auditanalytics.com/blog/indefinitely-reinvested-foreign-earnings-still-on-the-rise/.
[18] Joint Committee on Taxation, letter to Chairman Kevin Brady and Rep. Richard Neal, August 31, 2016, available at: https://waysandmeans.house.gov/wp-content/uploads/2016/09/20160831-Barthold-Letter-to-BradyNeal.pdf.

example, the U.S. tax system effectively provides a $15 million tax incentive for investing *outside* the United States.

Walter Galvin, the retired Vice Chairman of Emerson, testified about a real-life example of how the U.S. tax system encouraged foreign investment:

> "Last year, Emerson bought a company in the U.K. called Chloride for about $1.5 billion with cash we had earned abroad and kept abroad. We considered other options for that cash, such as bringing it to the U.S., but the U.S. tax code would charge us an extra 10 to 15 cents in taxes on every dollar. Where is our return higher? A dollar invested in the U.K. or 85 cents in the United States?"[19]

Academic research confirms that U.S. companies with foreign profits that would be subject to U.S. tax if repatriated are more like to invest abroad. Across a large sample of U.S. multinationals, one report found that both the probability and the number of foreign (but not domestic) acquisitions increases with the amount of foreign cash.[20] The authors also found that the stock market reaction to announced foreign acquisitions is more negative for firms with more locked out cash, suggesting that, "firms are both stockpiling cash and (poorly) investing overseas because U.S. policy hinders repatriation."

Intellectual property

The high profit margins associated with IP and the low costs of moving the situs of this property makes IP income highly responsive to statutory income tax rates. As a result of the extremely high statutory corporate income tax rate in the United States, U.S. and foreign companies have an incentive to locate their IP abroad, particularly in jurisdictions that have enacted IP boxes. Increasingly, these IP boxes include nexus requirements, which link tax benefits to local country R&D activities. As a result, U.S. and foreign companies have a tax incentive to locate R&D jobs as well as the economic ownership of IP in countries with IP boxes.

Moreover, U.S. companies that have located their IP abroad are discouraged by U.S. tax rules from manufacturing in the United States. If the IP is licensed by a related U.S. manufacturer, the royalty payments would currently taxed under the U.S. CFC rules. By contrast, if the related U.S. company operates as a contract manufacturer the foreign principal's inventory ownership may be viewed as investment in U.S. property and subject to tax under section 956. Moreover, U.S. manufacturing operations create a risk that the IRS will assert the foreign principal has a taxable U.S. presence and seek to tax a portion of its income. These risks are avoided if the manufacturing services are conducted outside the United States.

B. Headquarters Location

The attractiveness of the United States as a jurisdiction in which to locate the headquarters of a global company is markedly declining. Since 1998, the number of U.S.-headquartered companies in the Forbes 500 list of global companies has declined by over 25 percent, from 200 in 1998 to 147 in 2016 (see Figure 6). And, foreign acquisitions of U.S. companies were over three times greater than U.S. acquisitions of foreign companies measured by deal value in 2016 (see Figure 7).

The out-of-step U.S. tax system is a key reason why a foreign location is chosen as headquarters in a cross-border merger. The combination of a high U.S. corporate tax rate and a worldwide regime which taxes foreign income when remitted to the United States is an important disadvantage to the selection of

---

[19] Testimony of Mr. Walter J. Galvin before the Committee on Ways & Means, U.S. House of Representatives, Hearing on "How Business Tax Reform Can Encourage Job Creation," June 2, 2011. Available at: https://waysandmeans.house.gov/UploadedFiles/Galvin_testimony.pdf

[20] Hanlon, Michelle and Lester, Rebecca and Verdi, Rodrigo S., "The Effect of Repatriation Tax Costs on U.S. Multinational Investment," May 23, 2014 (Journal of Financial Economics, forthcoming). Available at SSRN: http://ssrn.com/abstract=2441529 or http://dx.doi.org/10.2139/ssrn.2441529.

the United States as headquarters. If the United States is chosen as the tax home of the merged entity, distributions to the ultimate parent company of foreign income would be subject to the U.S. repatriation tax – a tax that does not apply if the parent company is headquartered in a country with a territorial tax system. Moreover, by establishing legal headquarters in a country with a territorial tax system, the company will be better positioned as an acquirer of businesses.

Based on the experience of the UK and Japan, one study estimated that if the United States were to switch from a worldwide to a territorial tax system, the number of cross-border mergers and acquisitions in which the U.S. company was acquirer would increase by 17.1 percent.[21]

C. Economic Growth

A recent report by Laura D'Andrea Tyson and colleagues at the Berkeley Research Group analyzed the macroeconomic effects of eliminating most of the U.S. repatriation tax by adopting a 95-percent exemption for active foreign subsidiary earnings. The report estimated that such a territorial tax system (at the current U.S. corporate tax rate) would, on an ongoing basis, increase repatriations by $114 billion per year, increase U.S. GDP by $22 billion annually, and create an estimated 154,000 new jobs per year, with even larger effects during an initial transition from the current U.S. worldwide tax system.[22]

V. CONCLUSION

For far too long, the United States has been burdened with the highest corporate tax rate in the developed world and an outdated international tax system. A non-competitive corporate income tax system has led to both reduced U.S. investment and slower wage growth for American workers. Tax reform can reverse this decline by providing an internationally competitive corporate tax rate and a modern territorial tax system similar to that of other developed countries. These reforms will allow U.S. companies and their American workers to compete on a level playing field with their foreign-based competitors, both at home and abroad.

The stakes are high. Absent a competitive tax system, the trends over the last couple decades will continue: loss in the global market share of existing U.S. companies and redomiciliation of U.S. headquartered companies abroad due to inversions and foreign acquisitions. Unless these trends are reversed, the United States will lose high-paying jobs, research activities, and investment in plant and equipment.

[21] Feld et al. (2013), op cit.

[22] Eric Drabkin, Kenneth Serwin, Laura D'Andrea Tyson, "Implications of a Switch to a Territorial Tax System in the United States: A Critical Comparison to the Current System," Berkeley Research Group, October 2013. Available at: http://www.thinkbrg.com/media/publication/391_BRG_Implications%20of%20Territorial%20Tax_Nov2013.pdf

Table 1

Top Corporate Tax Rate (Federal plus State), OECD Countries, 2017

Rank	Country	Rate in 2017	Announced or enacted future tax rate
1.	United States	38.9	38.9
2.	France	34.4	28.9
3.	Belgium	34.0	34.0
4.	Germany	30.2	30.2
5.	Australia	30.0	25.0
6.	Mexico	30.0	30.0
7.	Japan	30.0	30.0
8.	Portugal	29.5	29.5
9.	Greece	29.0	26.0
10.	New Zealand	28.0	28.0
11.	Italy	27.8	27.8
12.	Luxembourg	27.1	26.0
13.	Canada	26.7	26.7
14.	Austria	25.0	25.0
15.	Chile	25.0	25.0
16.	Netherlands	25.0	25.0
17.	Spain	25.0	25.0
18.	Korea	24.2	24.2
19.	Israel	24.0	23.0
20.	Norway	24.0	23.0
21.	Denmark	22.0	22.0
22.	Sweden	22.0	22.0
23.	Switzerland	21.1	21.1
24.	Slovak Republic	21.0	21.0
25.	Estonia(1)	20.0	20.0
26.	Finland	20.0	20.0
27.	Iceland	20.0	20.0
28.	Turkey	20.0	20.0
29.	Czech Republic	19.0	19.0
30.	Poland	19.0	19.0
31.	Slovenia	19.0	19.0
32.	United Kingdom	19.0	17.0
33.	Latvia(2)	15.0	15.0
34.	Ireland	12.5	12.5
35.	Hungary	9.0	9.0
Unweighted average excl. US:			
	G7	**28.0**	**26.8**
	OECD	**23.8**	**23.2**
US federal tax rate to match:			
	G7	**23.4**	**22.1**
	OECD	**18.9**	**18.3**

Source: OECD Tax Database

(1) Distributed profits are subject to the 20% CIT at 20/80 of the net amount of profit distribution. Undistributed profits are exempt.

(2) A current proposal is being discussed that would replace the current CIT system with a split rate system similar to Estonia.

Figure 1

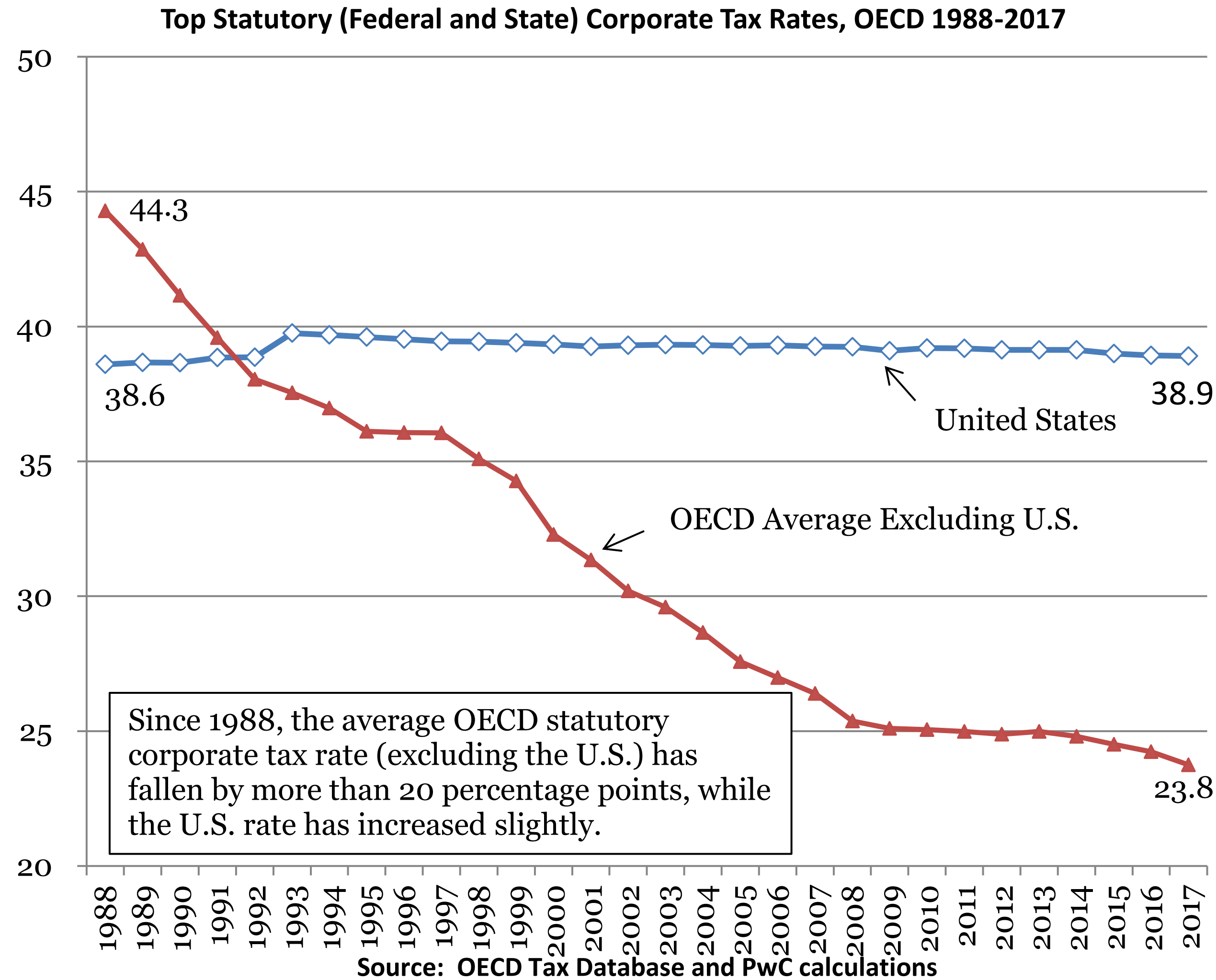

Top Statutory (Federal and State) Corporate Tax Rates, OECD 1988-2017
50
45
40
35
30
25
20
44.3
38.6
38.9
United States
OECD Average Excluding U.S.
23.8
Since 1988, the average OECD statutory corporate tax rate (excluding the U.S.) has fallen by more than 20 percentage points, while the U.S. rate has increased slightly.
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
Source: OECD Tax Database and PwC calculations

Table 2

Recent International Corporate Effective Tax Rate Comparisons

	European Commission		U. of Calgary	World Bank	NBER
ETR measure	**EATR**	**EMTR**	**METR**	**Cash Tax**	**Book Tax**
Year(s) of data	2015	2015	2015	2014	2006 to 2011
Number of countries/regions	35	35	45	189	21
US ETR	36.5%	34.3%	34.6%	28.1%	21.9%
Average ETR (excluding US)[a]	21.1%	16.0%	19.2%	16.2%	17.4%
US rank from top	2	3	5	16	2
US percentile ranking	**5.7%**	**8.6%**	**11.1%**	**8.5%**	**9.5%**

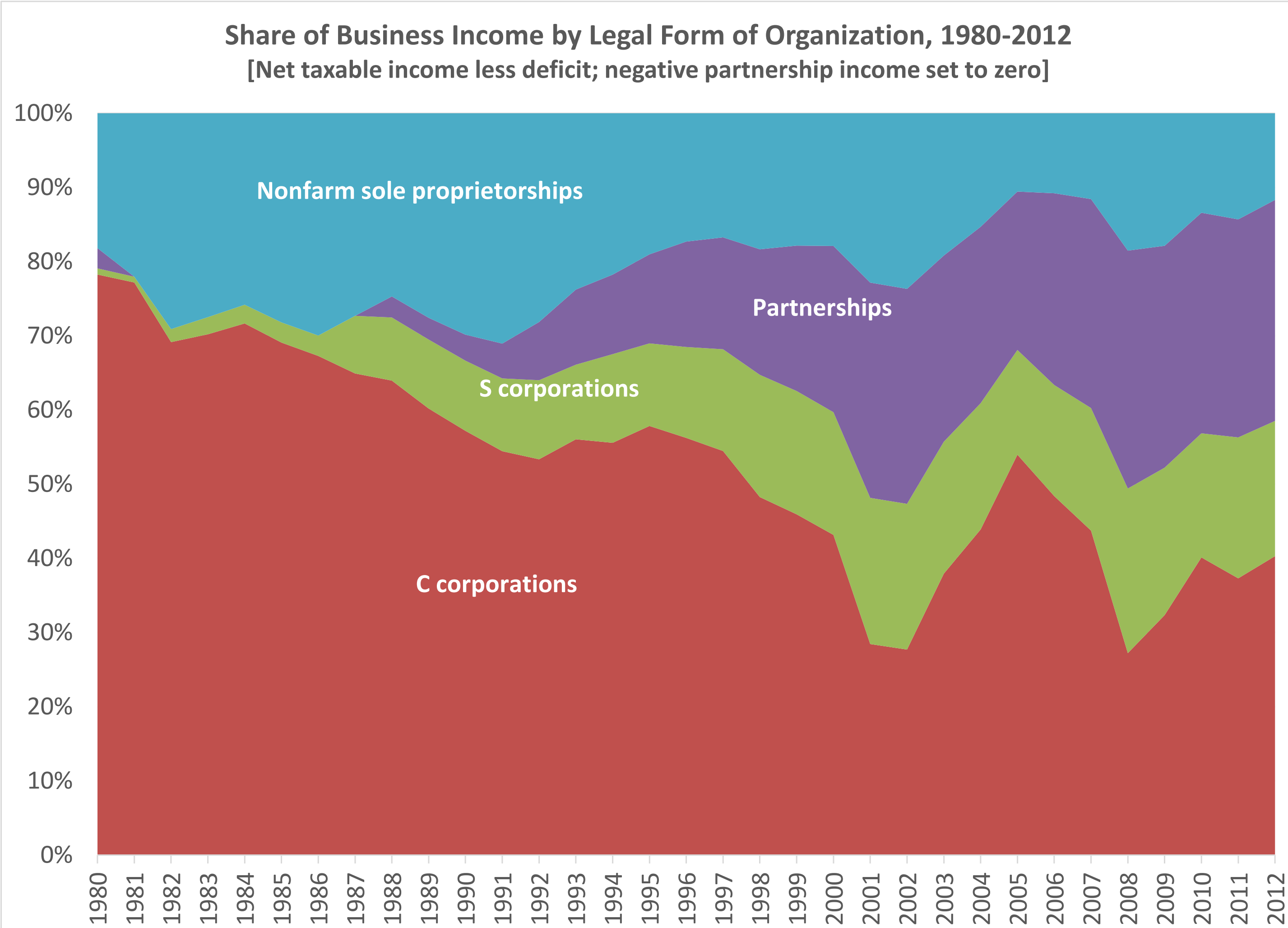
Note: Effective tax rate measure acronyms are: EATR for Effective Average Tax Rate, EMTR for Effective Marginal Tax Rate, and METR for Marginal Effective Tax Rate.

[a] Average ETRs are simple averages for the countries included in each study. The US average book tax ETR in the NBER study is 28 percent, and 21.9 percent after controlling for industry and other effects.

Sources:

1. Christoph Spengel, Dieter Endres, Katharina Finke, and Jost Heckemeyer, "Effective Tax Levels using the Devereux/Griffith Methodology: Intermediate Report 2015," *Centre for European Economic Research* (ZEW), Project for the EU Commission TAXUD/2013/CC/120, October 2015.
2. Jack Mintz, Philip Bazel, and Duanjie Chen, "Growing the Australian Economy with a Competitive Company Tax," *Minerals Council of Australia*, March 2016.
3. World Bank Group and PwC, *Paying Taxes 2016*, 10th Edition.
4. Kevin Markle and Douglas Shackelford, "The Impact of Headquarter and Subsidiary Locations on Multinationals' Effective Tax Rates," National Bureau of Economic Research, *Tax Policy and the Economy*, vol. 28, 2014.

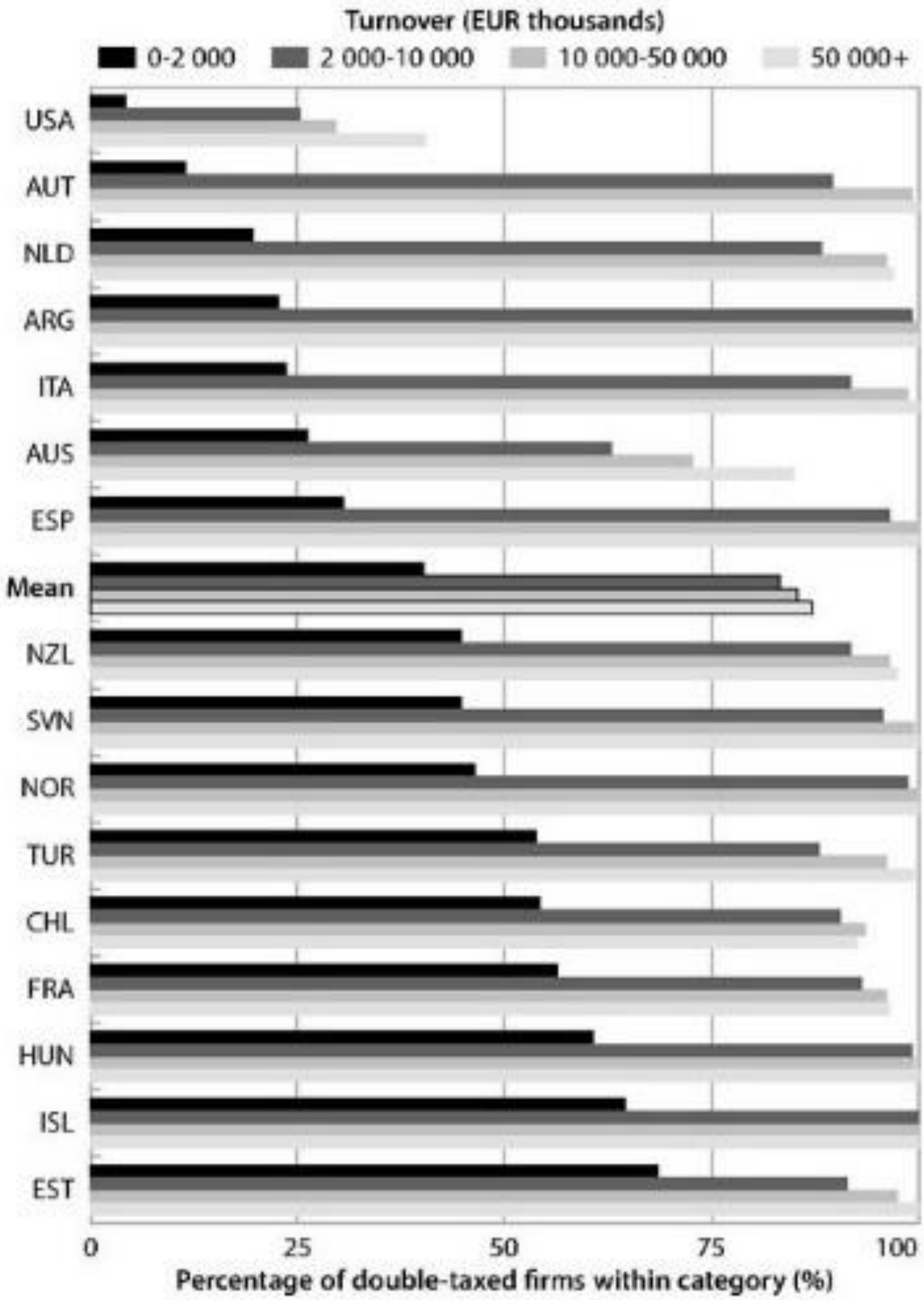
Figure 2



Source: IRS, Integrated Business Data, https://www.irs.gov/uac/soi-tax-stats-integrated-business-data

Figure 3

Proportion of Double-Taxed Entities by Firm Size, 2014



Source: OECD (2015), *Taxation of SMEs in OECD and G20 Countries*, OECD Tax Policy Studies, No. 23. Available at: http://dx.doi.org/10.1787/9789264243507-en

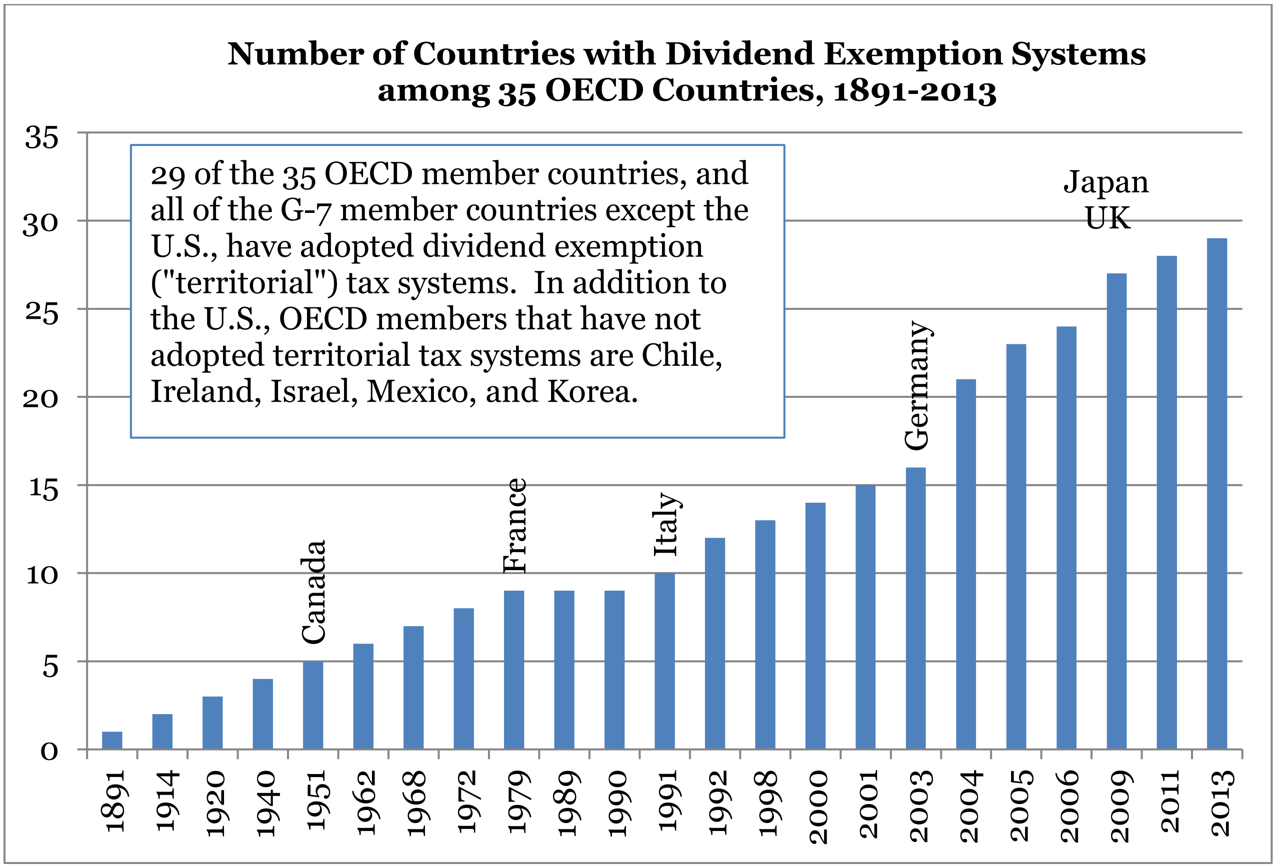
Table 3

OECD Countries with Territorial and Worldwide Tax Systems, 2017

Taxation of foreign subsidiary income	OECD Member Countries	Dividend exemption percentage
Territorial tax systems	Australia, Austria, Canada, Czech Republic, Denmark, Estonia, Finland, Greece, Hungary, Iceland, Latvia, Luxembourg, Netherlands, New Zealand, Poland, Portugal, Slovak Republic, Spain, Sweden, Turkey, United Kingdom	100%
	Norway	97%
	Belgium, France, Germany, Italy, Japan, Slovenia, Switzerland	95%
Worldwide tax systems	Chile, Ireland, Israel, Korea, Mexico, United States	none

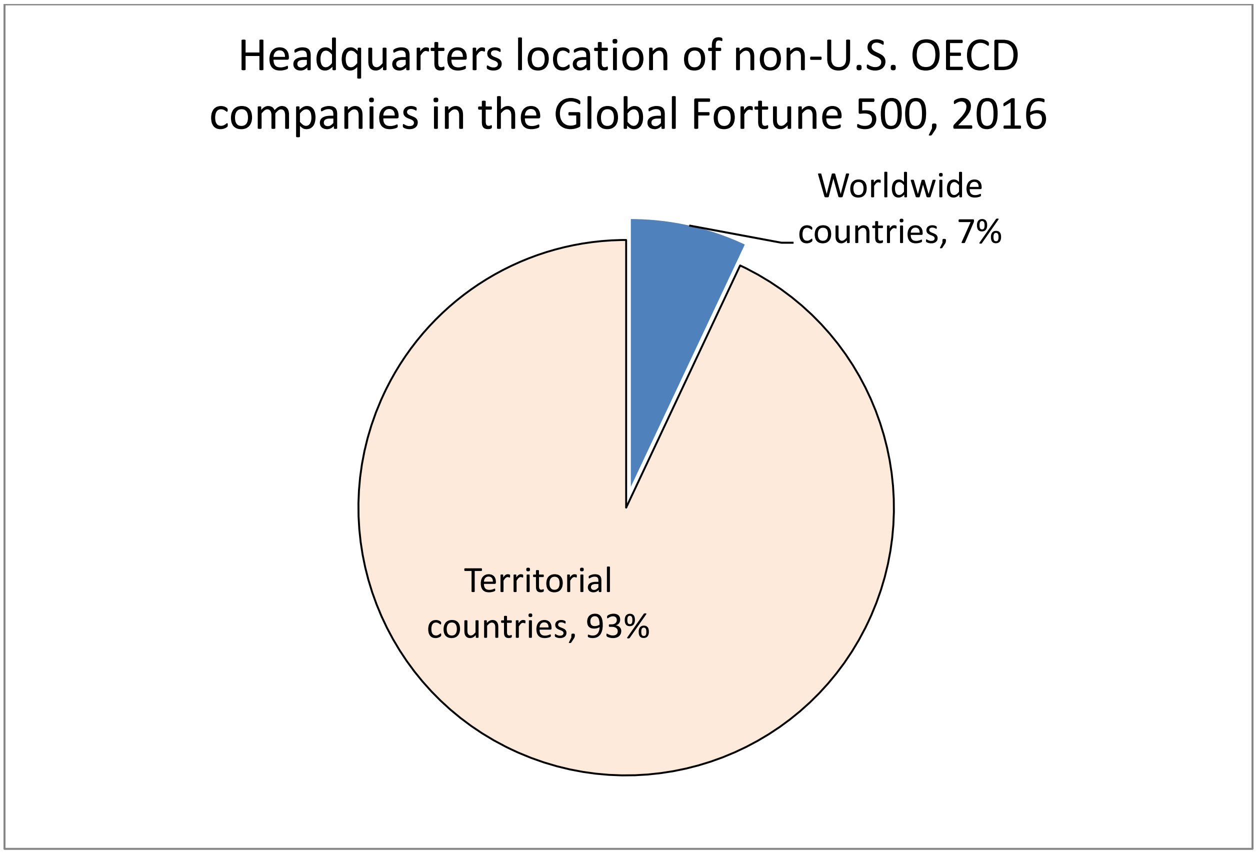
Source: PricewaterhouseCoopers, *Evolution of Territorial Tax Systems in the OECD*, The Technology CEO Council, April 2, 2013. Updated to include Latvia.

Figure 4



Source: Source: PricewaterhouseCoopers, *Evolution of Territorial Tax Systems in the OECD*, The Technology CEO Council, April 2, 2013. Updated to reflect Latvia's membership in the OECD.

Figure 5



Source: PwC analysis of the 2017 Fortune Global 500 list (http://fortune.com/fortune500/list/)

Table 4 Controlled Foreign Corporation Regimes in OECD Countries, January 2014

Country	CFC Regime	EU member
Australia	Yes	
Austria[1]	Alternate	Yes
Belgium	None	Yes
Canada	Yes	
Chile	None	
Czech Republic	None	Yes
Denmark	Yes	yes
Estonia	Yes	Yes
Finland	Yes	Yes
France	Yes	Yes
Germany	Yes	Yes
Greece	Yes	Yes
Hungary	Yes	Yes
Iceland	Yes	
Ireland	None	Yes
Israel	Yes	
Italy	Yes	Yes
Japan	Yes	
Korea	Yes	
Luxembourg	None	Yes
Mexico	Yes	
Netherlands[2]	Alternate	Yes
New Zealand	Yes	
Norway	Yes	
Poland	None	Yes
Portugal	Yes	Yes
Slovak Republic	None	Yes
Slovenia[3]	Alternate	Yes
Spain	Yes	Yes
Sweden	Yes	Yes
Switzerland	None	
Turkey	Yes	
United Kingdom	Yes	Yes
United States	Yes	
OECD member countries		**34**
No CFC regime		11
EU member with CFC regime		12
Non-EU member with CFC regime		11

[1] Austria's dividend exemption system excludes certain passive income.

[2] The Netherlands has a passive foreign investment company regime.

[3] Slovenia imposes withholding tax on payments for certain services and interest to persons established in certain low-tax jurisdictions.

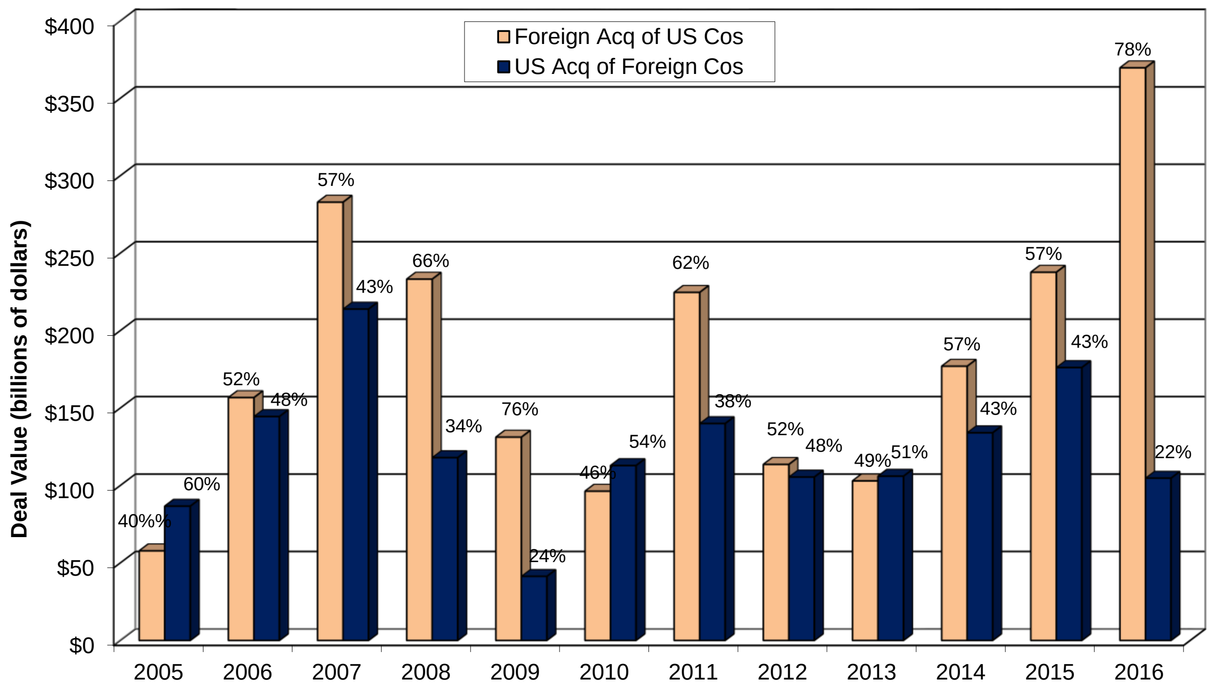
Source: Deloitte, *Guide to Controlled Foreign Company Regimes* , January 2014

Figure 6

Source: Forbes 500s List, 1999-2003; International 800 List, 1999-2000; International 500 List, 2001-2003; Global 200 List, 2014-2017.

Figure 7

U.S. Cross-Border Mergers and Acquisitions, 2005-2016



Source: Thomson Reuters SDC M&A Data, various years and PwC calculations.
Note: Deals limited to those in which at least 20% of the shares of the target were acquired. Includes asset sales and divestitures.