TRANSFORMATIONAL TAX REFORM
for Economic Growth and International Competitiveness

The Alliance for Competitive Taxation (ACT) urges Congress to enact an internationally competitive, pro-growth tax reform plan that will drive transformational change in the U.S. economy.

WHAT A GLOBALLY COMPETITIVE TAX SYSTEM LOOKS LIKE

1. Competitive Corporate Tax Rate: 20% or Lower Federal Corporate Tax Rate

Appropriate benchmarks for an internationally competitive corporate tax rate are: (1) the OECD average, and (2) the best in class of the G7 countries. These tax rate benchmarks are trending down; for example, over the last 20 years, the average OECD corporate tax rate has dropped by more than 0.5% per year.

The average corporate rate of the other 34 OECD members, including subnational taxes, is 23.75% in 2017 and, with currently proposed and enacted tax cuts, will fall to 22.9% by 2020.

Including the average U.S. state income tax rate of about 6%, a U.S. federal tax rate of **18%** in 2020 would be required to match the OECD average. A U.S. federal tax rate of **11.7%** would be required to match the UK's 17% tax rate that is scheduled to take effect in 2020.

A competitive corporate tax rate would boost economic growth and high-paying jobs by making the United States a more attractive location for business operations and corporate headquarters of global companies.

2. Competitive International Tax System: A Modern Territorial Tax System

29 of the other 34 OECD countries (including all G7 countries except the United States) have modern territorial tax systems that exempt between 95% and 100% of active foreign business income earned by foreign affiliates of their global companies.

Many OECD countries have anti-base erosion provisions designed to protect their domestic tax bases; however, these rules do <u>not</u> tax active foreign business income of foreign affiliates of their domestic companies.

Imposition of a foreign minimum tax on the active business income of U.S. companies would have unintended and adverse consequences, including: (1) advantaging foreign over U.S. companies; (2) increasing inversions and foreign takeovers of U.S. companies; and (3) increasing taxes paid by U.S. companies to <u>foreign</u> governments (who would have an incentive to tax U.S. companies at the minimum tax rate).

A competitive territorial system is essential to ensuring that U.S. global companies are not subject to a higher tax burden on foreign operations than their foreign competitors. By making the United States an attractive place to locate and expand the headquarters of global companies, a modern territorial tax system would increase U.S. headquarters jobs and generate additional jobs throughout the domestic supply chain of U.S. companies.

Countries that have adopted territorial tax systems have not imposed a transition tax on the unremitted foreign earnings of foreign subsidiaries. An excessive tax on such income has features of retroactive taxation and would reduce the amount of funds available for investment in the United States.

A one-time tax on these foreign earnings no higher than that proposed in H.R. 1 in 2014 (8.75% tax on passively held cash and cash equivalents and 3.5% tax on other reinvested foreign earnings) payable over time would be acceptable.

3. Promoting Innovation: Tax Incentives for Research and Experimentation

Research and experimentation is key to productivity growth yet is underfunded by the private sector absent government incentives. Strong research incentives can enhance U.S. economic growth and retain U.S. jobs and U.S. investment.

Although the research credit was made permanent in 2015, U.S. tax incentives for research rank 32nd from the top out of 41 OECD and other comparison countries according to the OECD.

In addition to credits and super deductions for research expense, other countries increasingly are providing reduced tax rates for income generated from patents and copyrights (so-called "patent boxes").

Since 2001, 17 countries have adopted various types of patent boxes, including three G7 countries (France, Italy, and the United Kingdom) and 14 of 35 OECD member countries. Tax rates on these patent boxes generally range from 5 percent to 15 percent.

4. Tax Base

Income should be defined for tax purposes in a manner that is competitive with other "best in class" OECD countries and should avoid giving rise to permanent differences under generally accepted accounting principles.

Limitations on net interest expense, if any, should follow the international norm of "thin cap" rules that seek to limit disproportionate interest expense, rather than impose an across-the-board disallowance of interest deductions.

If the United States were to impose tougher restrictions on interest deductibility than other competitor countries (1) U.S. companies would have an incentive to locate their debt-financed manufacturing plants outside the United States, and (2) foreign companies (that could deduct interest in their home countries) would have a competitive advantage over domestic companies in acquiring companies and assets located in the United States.

5. Simple and Fair Tax System that Facilitates Efficient Tax Administration

The cost of compliance is a hidden burden of the tax system that is a drag on the domestic economy. According to the 2017 World Bank Doing Business report, for a representative company, the number of hours to comply with corporate income taxes in the United States is 35th highest out of 189 economies. Tax reform should provide clear and simple rules that minimize compliance burdens and tax disputes.

THE LITMUS TEST FOR A GLOBALLY COMPETITIVE TAX SYSTEM

Over time, market forces cause ownership of assets to flow to companies in countries where they can generate the highest after-tax return. Today, the noncompetitive U.S. tax system is driving assets out of U.S. ownership into the hands of foreign companies, through foreign acquisitions of U.S. companies and divisions, inversions, and new start-ups abroad.

The litmus test for U.S. tax reform having achieved global competitiveness is that after reform there should no longer be a tax incentive for businesses to be owned by foreign rather than U.S. companies.

WHY A GLOBALLY COMPETITIVE TAX SYSTEM IS IMPORTANT

The Benefits of a Globally Competitive Tax System

A globally competitive tax system will lead to greater U.S. investment and U.S. headquartering by global companies; higher wages, greater employment opportunities and increased living standards for American workers; and increased ongoing economic growth.

Failure to Enact a Globally Competitive Tax System

If the United States fails to enact a competitive tax system, U.S. companies and U.S. businesses will continue to be more valuable in foreign hands. The tax disadvantage faced by U.S. companies will lead to a decline in their share of global sales due to both outright acquisitions and an inability to compete against their tax-advantaged foreign competitors.

Since 2000, the number of U.S.-headquartered companies in the Forbes 500 list of global companies has declined by over 25 percent, from 202 in 2000 to 147 in 2016. In 2016, foreign acquisitions of U.S. companies were over three times greater than U.S. acquisitions of foreign companies measured by deal value in 2016.

As U.S. companies contract, their U.S. supply chains will contract. A slower growing domestic economy will lead to stagnant or declining wages and fewer jobs for American workers.