

**Statement
of
Tax Executives Institute
on
Guideposts for Tax Reform**

October 15, 2009

As the preeminent association of in-house tax professionals worldwide, Tax Executives Institute appreciates the opportunity to comment on key principles that should frame the debate on tax reform. TEI's 7,000 members represent more than 3,000 companies in the United States, Canada, Europe, and Asia. Our members deal with the tax laws – in the United States and throughout the world – on a day-to-day basis, and we are proud of our record of working with Congress, the Treasury Department and Internal Revenue Service, and their counterparts around the globe to improve both tax policy and tax administration.

Background

The tax world has changed dramatically since Congress last enacted major tax reform in 1986. Since then, the Internal Revenue Code – like the world around us – has grown in size and complexity, a consequence of both the ever-changing, increasingly global economy and the patchwork approach that has been taken in developing statutory law, regulations, rulings, and case law. Another reason for the complexity, however, is Congress's use of the Internal Revenue Code to advance economic and social policies, separate from raising the revenues necessary to fund governmental operations.

While the policies undergirding the tax code are often laudable (especially in terms of fostering economic growth), they impose added complexity and administrative cost to the tax system and its participants, including the IRS and its counterparts in the states. They also have had the effect of increasing tax rates, thereby diminishing the overall competitiveness of the U.S. tax system and hence, U.S.- based businesses.

Tax Executives Institute believes the time is ripe for an open and comprehensive examination of the U.S. tax code and, in particular, of how the United States taxes corporations and other business enterprises. A roiling economy, unrelenting globalization, and staggering budgetary challenges have spawned a plethora of legislative proposals to revise and reform the Code. As a broad-based association of businesses headquartered both in the United States and abroad, TEI is committed to improving both the structure and administration of the tax system, and recommends that the following guideposts frame this critical examination.

1. U.S. Business Does Not Operate in a Closed System.

TEI submits that it is imperative that the United States avoid what has been referred to as "U.S. exceptionalism," where U.S. tax policy is seemingly set in a vacuum, without full regard to the tax systems in other countries. For example, most of the U.S.'s major trading partner's exempt foreign source income from business operations from domestic taxation, *i.e.*,

they employ a so-called territorial system. Thus, the United States is nearly alone in subjecting resident corporations to tax on worldwide income, though the incidence of double taxation is ameliorated by the foreign tax credit and a network of bilateral income tax treaties.

Specifically, Subpart F of the Code, which sets the rules for taxing foreign base company income (and which has been expanded several times since its enactment in 1962), impedes U.S. competitiveness by limiting the deferral of U.S. tax on unrepatriated income earned abroad. In contrast, foreign-owned companies are generally not taxed in their home countries on foreign operating income. Although the foreign tax credit limits the double taxation of actual distributions and Subpart F inclusions, the relief is imperfect and incomplete. The current system also fosters an economically-inefficient “lockout” effect, effectively discouraging U.S. multinationals from repatriating earnings in order to deploy them domestically.

Business decision-making requires a protean analysis of complex, varied, and ever-changing factors, including political stability, labor costs, legal structure, proximity of products to market, and the tax environment. As the tax reform debate proceeds, the overarching goal must be the creation of a tax environment conducive to U.S. companies’ competing around the world while retaining research, manufacturing, and headquartered jobs at home. Thus, tax reform proposals must be analyzed in the context of the rules in other countries to ensure that our system does not have the perverse effect of dampening the United States’ ability to compete.

2. The U.S. Corporate Tax Rate Must Be Competitive.

For U.S. businesses to compete effectively in a global marketplace, the price of operating in the United States cannot be disproportionately higher than it would be abroad. A critical aspect of tax competition is the corporate tax rate. In 1986, Congress recognized this and acted to reduce the top corporate tax rate from 46% to a then global-leading 34%. (The corporate tax rate remained stable for a period of years; it was raised to 35% in 1993.) Since then, while we have stood in place, our trading partners around the world followed the initial U.S. lead in 1986 and made rate reductions the rule of the day. As a result, the average statutory corporate tax rate of all OECD nations now is 26.5%. Thus, today the combined federal and state corporate tax rate in the United States is 39.1%, with only Japan’s 39.5% combined rate being higher among industrialized countries.

Stated briefly, at least 25 countries have reduced their corporate income tax rates since 2001, motivated in large measure by a commitment to attract international business. For example, Ireland, which cut its corporate tax rate from 50% in 1986 to 12.5% today, has seen a period of remarkable growth. When Ireland joined the European Union in 1973, its GDP was 60% of the average European GDP; by 2006, it was 110%. Other examples include Germany, which has reduced its rate from 60% to 30%; the Netherlands, which has reduced its rate 5 times in the last 20 years, most recently to 25.5%; and China which, in 2008 reduced its rate from 33% to 25%. In fact, from 1986 to 2008, the average top statutory corporate tax rate for the 27 countries of the European Union dropped about 20 percentage points (from 43.2% to 23.5%).

Importantly, lower rates do not necessarily mean lower revenue. Indeed, economist Martin Sullivan of the independent publication *Tax Notes* has confirmed that despite significant

reductions in the tax rate in European countries, corporate tax revenue as a percentage of GDP is rising. This is not only because of changes in the tax base in the affected countries, but also because lower rates (and lower taxes) have triggered significant economic activity and job growth. The dynamic effect of tax cuts may not always be easy to measure, but it proves too much to say that the sharp increase in tax revenues in other countries has no causal link to recent tax rate reductions.

U.S. businesses and potential inbound investors want to build technology centers, manufacturing plants, testing facilities, etc., here. A competitive tax system will facilitate this. As part of fundamental tax reform, Congress should act to both level and stabilize the “rate” playing field and thereby make the U.S. tax system – and U.S. business – more competitive.

3. The Tax System Should Generally Not Pick “Winners” and “Losers.”

The amount of revenue raised by a tax system is the product of its tax rate and the tax base. While some incentives such as those for research and education have widespread support, a growing consensus favors lower rates and a broader tax base to reduce complexity, ease tax administration, and minimize the government’s role in picking “winners” and “losers.”

TEI recognizes the challenge of balancing the need to fund the government and the goal of encouraging (or discouraging) certain behavior. For example, the United States has long placed a premium on education and, as a result, Congress has enacted numerous incentives to advance that goal. Similarly, the strategic importance of having research conducted in the United States prompted the 1981 enactment of the research tax credit, which has helped retain and enhance U.S. research activities. More generally, TEI believes the Nation’s tax policy should not only be designed to raise revenue fairly and efficiently, but should do so in a manner that improves the lives and living standards of U.S. citizens and residents. We also believe that these objectives can complement each other through the prudent streamlining of the current patchwork of tax incentives and inducements.

Tax reform will unavoidably produce “winners” and “losers,” as provisions are changed. This inevitability, however, especially on a transition basis, cannot and should not be permitted to stanch the debate. Rather, we suggest that appropriate transition provisions can temper any dislocation that occurs when tax reform is enacted.

4. The Tax System Must Be Simpler.

It is not easy to achieve and maintain an effective balance in the tax system among the goals of fairness, efficiency, effectiveness, and simplicity. At one extreme, perfect fairness (or horizontal equity), *i.e.*, treating similarly situated taxpayers exactly in the same way could require very complex tax rules. At the other end, simplicity (or a lower level of complexity) will effect no small measure of “rough justice.”

TEI acknowledges that the tax rules must, of necessity, be marked by some level of complexity. They need not, however, be consumed by it. Simple is good, not only on its own account, but because complexity represents a daunting, hidden tax on American business. The

Tax Foundation estimated that in 2005 taxpayers incurred total costs in excess of \$265 billion to comply with federal income tax laws, with business's share being a staggering 55%.

A simpler tax system will also be easier for the IRS, which currently spends considerable resources addressing so-called loopholes, often creating unintended (and often costly) consequences. Stated simply, the more complex the Code, the greater the likelihood for interpretative issues and questions that make it difficult if not impossible to be tax compliant. Complexity also spawns ambiguity and opportunities for tax controversy predicated on intended and unintended consequences. Simplifying the Code will also eliminate the need for Band-Aid-like compliance measures that can impede routine, day-to-day business transactions and force law-abiding businesses to absorb the heavy proxy tax of additional recordkeeping.

Finally, a primary cause of uncertainty and complexity is the frequent alteration of the tax laws. Thus, to be effective, both in the short and long term, the tax law must not be subject to continuous changes. While changes are sometimes necessary to deal with changed conditions (or with unintended consequences of legislation), change in itself exacts a toll, with the administrative burdens exceeding the benefits.

5. The Tax Laws Should Make the United States an Attractive Place for Business Regardless of Whether the Taxpayer is U.S. or Foreign-Owned.

A paramount objective of U.S. tax policy should be to support job creation in the United States. To this end, it should make no difference whether the employer is a private or publicly held U.S. corporation or a subsidiary of a corporation headquartered overseas. Employees working in the United States for a foreign-based company will enable spending, consumption, and investment and thereby contribute to overall economic growth. Hence, our tax system should encourage, not punish, foreign companies for investing in the United States. Similarly, our tax laws should not put U.S. companies at a competitive disadvantage with their foreign-based competitors. Encouraging in-bound investment and not hindering U.S.-based companies with unfair tax laws are both worthy and consistent objectives.

6. A Comprehensive Solution Is Necessary.

Given the integrated, interlocking nature of our current tax code, any review of potential changes to the current corporate tax system (especially those relating to foreign income) should be made within the context of comprehensive tax reform. Thus, TEI cautions against congressional action on an isolated basis, such as the international tax proposals in the Obama Administration's fiscal year 2010 budget or the tax provisions in pending House and Senate health care bills. Rather, the important issues addressed in those proposals should be considered as part of the overall debate on tax reform (including the core issue of rates).

For example, changes to the foreign tax credit, the deductibility of expenses relating to foreign source income, the so-called check-the-box rules, the limitation of treaty benefits, and codification of economic substance could all have a profound effect on our economy and the administration of our tax laws. Congress should resist the temptation to "cherry pick" certain provisions for use as revenue offsets to fund policy decisions relating, for example, to transportation funding or even the virtually annual tax "extenders" legislation.

7. Tax Compliance and Enforcement Processes Are Necessary to Ensure Compliance and Should Be Strengthened.

The U.S. federal tax system is predicated on self-assessment, and any effective reform effort should enhance both voluntary compliance and the IRS's ability to ensure compliance through its enforcement programs. TEI has long supported adequate funding of the IRS, as well as the enactment of meaningful, balanced information reporting, disclosure, and enforcement rules. By doing so, non-compliance is deterred and compliant taxpayers are not disadvantaged by their adherence to the rules. Congress must remain mindful, however, that the imposition of new reporting requirements and the "outsourcing" of compliance efforts to employers and other third-party payers - while appropriate in some circumstances - exact their own price in terms of efficiency and competitiveness. Thus, while TEI supports the goals underlying the compliance provisions in the Administration's fiscal year 2010 revenue proposals, we urge caution in crafting the provisions.

8. The Budget Deficit Must be Addressed.

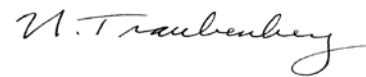
TEI fully recognizes the pressing need for the United States to address its burgeoning budget deficit. This must be done, however, not only through tax law reform (including tax rate reductions, possible base broadening, and even consideration of alternative revenue sources), but also through balanced changes to entitlement programs, spending cuts, and other actions. Failure to do so will impair the long-term health of our economy and the country. Regrettably, there is no quick fix to the country's budget problems, and rushed efforts to achieve one could be counterproductive in terms of job creation, competitiveness, or Americans' quality of life.

Conclusion

Tax Executives Institute appreciates the opportunity to provide these comments to assist in framing the consideration of tax reform. TEI stands ready to be an active participant in this critical debate and, as appropriate, comment on aspects of the discourse that are of particular interest and relevance to our membership.

Respectfully submitted,

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