Tax Policy Should Encourage U.S. Investment and Growth

By William C. Barrett

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Businesses are compelled (and duty-bound in their obligation to shareholders) to reduce costs and maximize profits. A U.S. multinational competing globally is exposed to lower costs and more efficient offshore operating models. When a company evaluates potential offshore sites for its operations, maximizing return on operating costs such as manufacturing, research, and logistics is a key consideration.

Another consideration when selecting an investment location is the possibility of a lower corporate income tax burden. At a minimum, corporate tax is on an equal footing with other costs of doing business when operational investment location is under review. A low tax rate alone, however, will not compensate for the absence of other favorable business investment conditions.

As part of a global analysis of operational cost and efficiency opportunities, corporate tax is a critical piece of the investment location analysis. If the analysis shows that the United States and country X are equally competitive at the operating cost level, but the country X effective tax rate is 10 percent and the U.S. effective tax rate is 35 percent, the 25 percentage point tax rate difference (representing reduced shareholder return on investment) cannot be ignored if the multinational is to remain competitive.

Tax, as a cost variable in deciding investment location, has a direct impact on locating manufacturing and research and a corresponding direct impact on economic growth and employment. A higher tax rate negatively affects share values, which in turn negatively affects retirement accounts and pensions and the ability to fund healthcare reform.

Recent federal tax proposals are designed to increase the tax rate on income earned (and already taxed) in foreign markets. If

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tax policy takes the path of increasing the U.S. multinational cost structure, multinationals will explore cost reduction alternatives to make up for lost profits as a result of the corporate tax increase — one dollar of after-tax operating cost is no different than one dollar of tax cost.

The result of increasing multinational tax rates is predictable: U.S. companies (or their foreign subsidiaries) will become targets of foreign acquirers; more research and manufacturing will be forced to migrate offshore; management and control will migrate offshore; or companies will become marginalized relative to foreign competitors, which may force them out of business. Those potential outcomes illustrate why the corporate tax is really a tax on employees. An employee who loses a job because of the corporate tax suffers a 100 percent tax burden.

Policymakers — both Democrats and Republicans — find themselves at a very important crossroads. The fiscal policy decisions they make now will either move the country in the direction of increasing indigence or create a favorable investment climate by reducing the corporate tax burden, which will encourage retention and growth of U.S. investment and jobs. The more desirable approach would be to design a tax policy that encourages U.S. investment and does not punish multinationals for being successful in foreign markets.

The global effective tax rate on U.S.-based companies must be reduced if the United States is to become competitive again as a preferred investment location. This can be achieved either through a significant reduction in the existing corporate income tax or through a fundamental change of the way U.S. multinationals are taxed. The following are three alternative approaches to the U.S. corporate tax system:

- A 20 percent or lower U.S. corporate tax rate will produce a global effective tax rate in line with the rest of the world. This can be achieved with either worldwide taxation of income earned offshore or a territorial tax (operating income earned offshore is not taxed in the United States) that replaces the current tax system.
- A variation of the territorial tax approach that would truly distinguish the United States as an attractive investment location would be to "border adjust" exports and imports. Under a border-adjusted tax system, income earned on

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exports from the United States would not be taxed, but imported products would be taxed — either through taxation at import or allowing no deduction for imported goods.

- A further evolution of a border-adjusted approach would be to repeal the existing corporate income tax and adopt a business transaction tax or business activity tax (BTT/BAT). Key features of a BTT/BAT would include border adjustment of exports and imports; territorial taxation of foreign income; a deduction for capital and inventory purchases; no deduction for salaries and wages; a 15 percent or lower statutory tax rate; and a credit for employment taxes.

A BTT/BAT would greatly simplify corporate tax administration, increase transparency, and, most importantly, promote a fiscal policy approach that encourages U.S. investment, employment, and growth. A BTT/BAT can be designed to minimize winners-and-losers transition issues through the employment tax credit and a cap on the BTT/BAT (equal to a percentage of financial statement income). The effective tax rate on U.S. earned income would be higher than the BTT/BAT 12 percent to 15 percent statutory tax rate because of the compensation addback and elimination of most tax credits (other than a credit for employment tax). Therefore, a BTT/BAT system can be designed to be tax revenue neutral for the U.S. government.

A BTT/BAT corporate tax system would send the clearest message to multinational companies that the United States is again a viable investment and job creation location. A BTT/BAT is a better (and simpler) corporate tax model in a global economy, and because of the territorial and border-adjustment elements of the model, it would not override other sovereign countries' tax policies.

Fiscal policy should encourage, not discourage, U.S. investment and employment. Investment, productivity, and real wage growth in the United States increase the asset side of the U.S. balance sheet to absorb increasing levels of federal debt. Corporate tax policy that raises the U.S. global tax rate of multinationals will impede growth and innovation — clean energy, high tech, or otherwise. If the United States does not chart a fiscal policy course of action that encourages U.S. investment and productivity, it will run the risk of systemic unemployment and lag behind the rest of the world in resurgent growth. ■

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