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

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WRITTEN TESTIMONY | BY DAVID M. MORSE, TAX POLICY DIRECTOR

As the Senate Committee on Finance conducts a review of U.S. international tax policy about American employment and investment, the Coalition for a Prosperous America (CPA) would like to offer its views as a nonprofit, nonpartisan organization representing the interests of 4.1 million households, including manufacturing, agricultural, and labor members.

Key Points

American domestic companies can no longer accept the tax status quo in light of the pressing need for American production for jobs and strategic industrial security:

1. Multinational corporate profit shifting affects domestic American companies by rewarding the companies who move profits and jobs overseas.
2. The Tax Cut and Jobs Act did reduce inversions and resolved the byzantine tax deferral system. However, profit shifting did not end despite the Global Intangible Low-Taxed Income (GILTI) provision. The Border Erosion Anti-Abuse Tax (BEAT) and the Foreign-Derived Intangible Income (FDII) especially failed to meet expectations.
3. The international tax provisions of the Tax Cuts and Jobs Act (TCJA) are complicated. The intermediate results have not inspired confidence that they will ultimately address the resulting "tax disparity" between domestic companies and their multinational competitors. The "Tax Morale" of American businesses requires a more straightforward and fair tax system.
4. Equal to the need for simplicity, efforts to reward the reshoring of jobs remain of paramount importance. The United States no longer rewards American production and has incentivized offshoring. Incentives are half of the solution to this problem.
5. American domestic businesses need penalties for offshoring of jobs to reverse the decades-long trend of American job flight. Loyal domestic production will not benefit from additional incentives, but they need protection from the offshoring competition that our tax system helped create.

1. Overview

This testimony incorporates CPA's economic analysis of the S&P 500 corporate tax reporting under the TCJA and the benefits of a Sales Factor Apportionment solution.
The TCJA did reduce the headline rate of corporate tax from 35 percent to 21 percent. Many businesses appreciated this short-term goal to bring the United States closer to the average global corporate tax rates. In the long-term, Congress needs to address the "Race to the Bottom" tax system. Preserving our confused system of international taxation retains the tax avoidance strategies that reward the largest multinational corporations.

Currently, the international tax system has three problems:

- It distinguishes sharply between U.S. and foreign headquartered companies. The differences create imbalances between tax rules that apply to U.S. companies compared with foreign headquartered competitors. The residency distinction generates realistic fears of advantageous tax regimes permitting foreign buyouts and inversions.
- Meanwhile, the current tax system is unrealistic because it treats every subsidiary of a company independently and separately, but multinationals don't behave as if every subsidiary was separate. Attempts to prove the company did not behave properly are complex and costly.
- Third, the tax system still relies on a Physical Presence test, an outdated early 20th-century concept. Especially during the pandemic, the country learned how little commerce relies on a physical presence.

Destination-Based Sales Factor Apportionment solves the three problems. The multinational parent and its subsidiaries are treated as a group. Then, the group's attributed total net profits are based on the percentage of sales they make to the United States. The American vs. Foreign headquarter distinction is eliminated. Internal transactions are ignored, so the sales that matter are sales outside the corporation group. Digital and other similar concerns no longer apply as the physical presence test is replaced with an economic test.

The sales-based formula does not include capital or labor taxation to avoid the flight of inputs outside the United States. Tax rests solely on participation in the large U.S. market. Some outdated rules, such as Transfer Pricing and the Arm's Length Principle, would give way to a simpler and fairer tax system. But Congress could embrace this proper territorial tax, allowing all multinationals to pay U.S. taxes as American domestic companies do.

2. Current Tax Disparity reduces U.S. industry competitiveness

The TCJA attempted to improve the situation by limiting U.S. taxation to profits linked to U.S. activities while adding several innovations to reduce the incentive to shift profit out of the country to low-tax or zero-tax jurisdictions. The United States moved from worldwide taxation to quasi-territorial taxation, and the effort was commendable.

However, Congress must ameliorate the retained complexity in the tax code while denying the tax avoidance strategies to multinationals. The American government must allow U.S. domestic

corporations to compete fairly. Currently, American multinational and domestic corporations fear their tax planning is not aggressive enough to reduce the tax rate versus their competition.

When a domestic business faces a competitor in the American marketplace, they expect to compete on quality, the scale of production, service, etc. These inputs all have a price. But the ability to hire numerous expert tax professionals to implement tax strategies involving foreign tax havens is not a fair input. Congress needs to end the creation of this "tax disparity" between domestic companies and Multinational Enterprises.

3. **GILTI, BEAT, and FDII.**

GILTI receives a significant amount of attention, primarily because it affects American headquartered corporations. But all three of the Tax Cut and Jobs Act's international provisions are worthy of attention. Domestic companies need working international tax provisions to reduce the tax disparity.

Its exemptions hampered GILTI's effectiveness. Designed as a global minimum tax, companies can avoid GILTI liability on their tax haven operations using tax credits from higher-tax countries. GILTI liability permitted the blending of tax haven reporting with higher tax jurisdiction reporting. These efforts negated the effectiveness of combatting tax haven usage. Additionally, GILTI was abnormally generous on what it considered deemed routine profit returns. A 10 percent return on investment is an abnormally stellar year for most domestic companies. A reduced Qualified Business Asset Investment calculation could have kept in line with domestic rates of return. However, the incentive to increase overseas assets would have remained.

The BEAT was too limited in scope to achieve the promised return, with too many detrimental effects to consider keeping. The BEAT promised to protect from foreign multinational corporations' profit shifting. But the exemptions were so vast that it was never going to raise the amount of money projected in 2017. With a small inversion exception, the BEAT does not apply to payments for the cost of goods sold. Accounting advice routinely recommended increasing the cost of goods sold on financial statements to avoid the BEAT tax included. This provision's response provided the clearest line of demarcation why the tax system could not be fixed within the currently accepted confines known as Transfer Pricing and the Arm's Length Principle. Congress should not be implying that simple reallocation of profits to different categories in a foreign subsidiary is a permissible use of the U.S. tax system to profit shift sales from American customers.

While marketed as a benefit to all domestic companies, FDII remains most beneficial to multinational companies for officially locating their I.P. in the United States. Finding the FDII requires splitting regular income from excess income over a fixed return on specific assets. This division creates two pots of money taxed at different rates, and it is better to have the money in the unique FDII pot. But the FDII pot is only received above a 10 percent return on a corporation's domestic tangible assets. Most domestic companies don't achieve many profits in this special FDII pot effortlessly. So either we encourage domestic companies to reduce tangible investments in the United States, or we accept the FDII is mainly a subsidy for multinationals to land their I.P. here with no ties to increased R&D. CPA supports neither concept.

Congress designed these components to work in concert with the low 21 percent corporate tax rate, and the low corporate tax rate was the most effective component to reduce inversions. However, the low tax rate's benefits may not be sustainable because another country can offer a better corporate tax rate. While this may be a desirable option in some circles, the tax rate is a less immediate concern to domestic companies than the tax disparity.

4. Tax Complexity

Despite disagreements regarding the international tax provision, almost all parties accept that they are complicated. New proposals regarding these provisions rarely consider the detriment of retaining this complexity. The Department of the Treasury and the Internal Revenue Service have taken years to write the resulting administrative code to implement these aspects of TCJA. Their task was recognized as 'Herculean.'

While these efforts are appreciated, the resulting complexity remains one of the major stumbling blocks for the law's broad acceptance by American business professionals. Most don't understand it. The largest multinational enterprises have experts that allow them to parse through the application. But smaller corporations cannot afford these employees. Moreover, the last few years reporting of Corporate tax data did not inspire confidence that complexity is the solution to ending companies' profit shifting.

Tax Morale is the measurement of taxpayer perceptions and attitudes towards paying and evading taxes. Without simplification of the tax code, American domestic businesses will be dubious of efforts to reduce tax avoidance through profit shifting. Simplicity and transparency without sacrificing effectiveness would be incredibly beneficial for American tax morale.

The U.S. has vital interests in strategic industries like chip manufacturing. Micron, the largest American chip manufacturing company, is a shining example of a company that the U.S. should incentivize to expand and grow in the United States. But according to Micron's recent 2020 annual 10k provided to the U.S. Securities and Exchange Commission, they reported operating "in a number of jurisdictions outside the United States, including Singapore, where we have tax incentive arrangements. These incentives expire, in whole or in part, at various dates through 2034 and are conditional, in part, upon meeting certain business operations and employment thresholds."

Micron is in an incredibly competitive field, and they need every advantage they can get. By failing to address the international tax system and the tax disparity, Congress has incentivized a strategic company to offshore production that could be conducted in the United States. But until Micron's foreign competitors are expected to pay similar tax rates on profits made selling to U.S. customers, Micron will worry about being at a disadvantage. Domestic corporations need to know American multinationals will pay an equivalent effective tax rate and American multinationals need to know foreign multinationals will similarly pay such a rate. As stated previously, a more straightforward tax system, such as Sales Factor Apportionment, could achieve these goals. But the damage has already been done, and the U.S. has immediate needs to regain lost production.

5. Reshoring Tax Incentives

In previous testimony before this committee, many multinational corporations' representatives embraced tax incentives to reshore manufacturing and good-paying jobs to the United States. In this regard, CPA wholeheartedly agrees. The United States must have a vibrant and robust manufacturing industry.
Congress should consider tailored tax incentives to ensure products are made in America and not just in name. These tax incentives should be tied to U.S. inputs, production, and jobs created. At every juncture of production, the United States has lost a step over the years of neglect. Many production inputs are now imported, manufacturing facilities lie dormant or neglected, and the middle class's quality jobs are just not available. All tax incentives must be viewed through this lens first. U.S. manufacturing deserves to be able to compete fairly again.

6. Offshoring Tax Penalties

Many loyal American owners stayed in the United States and struggled to compete but refused to give up. Some of the more successful ones will be able to take advantage of incentives. But all American manufacturers need to be protected from offshoring efforts. Incentives are only half of the immediate solution. Currently, the U.S. tax code can reward offshoring. This loophole should end. But additionally, a penalty should be assessed for moving jobs offshore for a tax benefit.

The United States has to invest in a better tax code for American companies, but this investment must partner with American companies' commitment to the country. The Biden campaign proposed a surcharge tax penalty for offshoring. CPA believes that such a penalty would protect American jobs.

7. Conclusion

Destination-Based Sales Factor Apportionment solves many of the issues raised in these discussions and provides a 21st-century framework for a 21st-century economy. It could be implemented in part to replace the BEAT for foreign multinationals or as a whole. But it is essential to recognize that the system is not working, and American domestic companies need short and long-term solutions to allow the country to build up manufacturing and jobs.

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