WebMemo

Published by The Heritage Foundation

No. 2426
May 5, 2009

Obama International Tax Plan Would Weaken Global Competitiveness

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President Obama and Treasury Secretary Geithner unveiled a tax reform plan yesterday that, if enacted, would seriously damage the international competitiveness of U.S. businesses. The plan would:

- Limit the ability of American businesses to defer U.S. tax on their foreign income and
- Reduce the credit for foreign taxes paid.

Both provisions would substantially raise taxes on U.S. businesses operating globally. Although intended to keep more jobs in the U.S., these proposals would cost Americans jobs and wages.

Failing to Understand International Business. The President's proposals demonstrate a fundamental misunderstanding of tax policy principles and of the incentives international companies face and the market forces that drive the global economy.

In an increasingly global marketplace, U.S. businesses compete against companies from around the world in U.S. and foreign markets. They compete through quality, service, and price—all of which depend on the companies' ability to operate as efficiently as possible. Rather than exporting their products from the United States, American businesses often choose to operate in foreign countries to gain local market exposure and tap into local market expertise and existing sales channels. In other instances, companies pursue cost efficiencies. Sometimes this can best be accomplished from the United States; often it requires major investments abroad that also synergistically make U.S. operations more competitive.

U.S. businesses operate internationally to maximize their competitiveness against rival firms. And in so doing, they make their U.S. operations and workers more competitive, thus supporting domestic jobs and wages, while building profitability for their shareholders. For every worker employed by a U.S. subsidiary in a foreign country, 2.3 Americans are employed in the U.S.[1] And a 10 percent increase in foreign investment by businesses has been associated with a 2.6 percent increase in investment in the businesses' home countries.[2]

Misunderstanding Tax Principles. Income earned by U.S. companies' foreign operations is fully taxed in the country where it is first earned. For example, income earned in Germany is taxed in Germany. U.S. tax is then imposed in addition to the foreign tax. In most instances the U.S. tax is not due until the money is sent back to the U.S. parent company. This process is called "deferral," as the tax payment is deferred until the income comes home, usually in the form of a dividend received for owning a portion of the foreign subsidiary.

For decades, proposals to eliminate deferral have cropped up and been defeated. Invariably, Congress comes to recognize the harm these proposals would

This paper, in its entirety, can be found at:
www.heritage.org/Research/Taxes/wm2426.cfm

Produced by the Thomas A. Roe Institute
for Economic Policy Studies

Published by The Heritage Foundation
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do to the American economy. The current economic weakness and the increasing globalization of business strongly affirm the importance of Congress once again turning aside this misguided proposal.

Under U.S. law, both the U.S. government and the government where income is earned impose tax. To reduce double taxation, the U.S. allows a tax credit equal to the amount of foreign tax paid. Current U.S. law already limits the applicability of the foreign tax credit in numerous ways, all of which result in double taxation, distorting economic decision making and leaving U.S. companies at an even greater competitive disadvantage.

The foreign tax credit and deferral are two critical features that prevent the U.S. corporate income tax from crippling the international competitiveness of U.S. companies. The President has proposed to cut back on deferral and to limit the applicability of the foreign tax credit. This would significantly increase taxes paid by U.S. businesses, subjecting more U.S. foreign income to double taxation and severely undermining their ability to compete abroad and to grow at home.

Sound Tax Policy Supports the Economy. Sound tax policy would move in the opposite direction of that proposed by President Obama. Income should be taxed in the country where it is earned, and only by that country. This would be an economically neutral policy that avoids distorting economic decision making.

International companies operate on an integrated, global basis to be as competitive as possible. Neutral tax policy allows companies to pursue their competitiveness strategies without artificial incentives or disincentives from tax policy. Consequently, the companies are stronger, more flexible, and better able to expand at home and abroad. Increasingly, governments around the world understand this and have moved toward adopting a more neutral policy to advance the international competitiveness of their companies and the jobs and wages of their domestic workers.

Protectionism by Another Name. The President's international tax plan is fundamentally protectionist. The theory behind protectionism is to raise tariffs and quotas to protect domestic producers against foreign goods. Behind the tariff wall, domestic producers can then charge higher prices, sustaining their employment levels. This subsidizes the wages and jobs at the protected industries at the expense of everyone else.

The notion behind President Obama's proposals is to raise taxes on U.S. companies to discourage them from operating abroad, thereby encouraging them to invest at home to meet the demands of the domestic and foreign markets. Once again, this policy subsidizes the wages and jobs of a few at the expense of the many as well as the long-term strength of the economy. Ironically, the Treasury release on this policy refers to "leveling the playing field."[3] This policy does no such thing. Instead, it builds a wall behind which a few can hide from normal market forces. Artificially restricting the movement of capital is as harmful and self-defeating as restricting the trade of goods.

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1. Matthew J. Slaughter, "How U.S. Multinational Companies Strengthen the U.S. Economy," Business Roundtable and United States Council Foundation, Spring 2009, at *http://www.uscib.org/docs/foundation_multinationals.pdf* (May 4, 2009).
2. Mihir Desai, C. Fritz Foley, and James R. Hines, Jr., "Domestic Effects of Foreign Activities of Multinationals," *American Economic Journal: Economic Policy*, Vol. 1, No. 1 (February 2009), pp 181–203.
3. Press Release, "Leveling the Playing Field: Curbing Tax Havens and Removing Tax Incentives for Shifting Jobs Overseas," U.S. Department of Treasury, May 4, 2009, at *http://www.ustreas.gov/press/releases/tg119.htm* (May 5, 2009).

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