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Think-tanks seek US corporate tax overhaul

By James Politi in Washington

The US should overhaul its corporate tax system to ignore all international transactions for tax purposes, two independent Washington think-tanks **with close ties to the Obama administration will propose this week.**

In a report obtained by the Financial Times that could catalyse the debate over corporate tax reform, the **Hamilton Project and Center for American Progress (Cap) will argue US companies should no longer be taxed on foreign earnings.** At the same time, however, they would no longer be able to take tax deductions on the costs of doing business overseas and interest payments on money borrowed from banks located outside the US. Capital investments in the US could be immediately written off for tax purposes instead of being subject to long depreciation schedules.

The proposal, which is being examined by White House officials, seeks to marry two seemingly conflicting aims of corporate tax reform: to encourage investment in the US and discourage “offshoring”, while bolstering the competitiveness of US companies with large international operations.

“I think people are locked into thinking about this trade-off as if there are only two alternatives. It doesn’t have to be that way,” says Alan Auerbach, an economics professor at the University of California at Berkeley and author of the report, which will be released on Friday at a joint event hosted by Cap and Hamilton, which is affiliated with the Brookings Institution.

The US corporate tax system is widely believed to be in need of reform, given its headline rate of 35 per cent – one of the highest in the developed world – and a web of loopholes and tax breaks that are judged to be extremely inefficient.

The potential for an overhaul has been rising in recent months, with Barack Obama, US president, suggesting last month he was prepared to consider lowering rates and getting rid of special tax treatments as long as this did not add to the budget deficit.

Meanwhile, the national commission on fiscal responsibility, which met again on Monday for a final round of talks before its report due on Wednesday, has presented options for corporate tax reform, including a return to a territorial system of taxation.

The Hamilton-Cap proposal, which has elements of tax reform ideas considered in 2005 under president George W. Bush, could heavily influence the debate, since it appears to

achieve many of the policy objectives Republicans and Democrats are striving for: increased competitiveness, encouraging investment in the US, and simplification.

Nevertheless, it is expected to face significant hurdles. Critics could point to it as introducing a modified form of consumption or value added tax to the US, since taxes would be collected based on where a company's sales occur.

Large importers of goods manufactured overseas – such as retailer Walmart – might view this as a big tax increase for them, while it would benefit US exporters such as Caterpillar, which would no longer have to pay levies on products sold internationally. There might also be questions surrounding the proposal's compliance with global trade rules, since it might be judged by opponents and international competitors to be a form of export subsidy. However, if it leads to a strengthening of the dollar, the adverse impact on US importers and benefits to exporters might be mitigated.

The proposal also seeks to tackle another thorny issue in the US corporate tax structure: the ability of companies to deduct interest on debt, which critics say encourages leverage and borrowing at the expense of equity investments.

Under the plan, debt borrowed internationally would no longer be deductible, while tax breaks on money borrowed from banks located in the US would also be curbed. The proposal has not been analysed to measure its impact on the budget deficit.

The plan could also be accompanied by a lowering of rates and the elimination of some other corporate tax loopholes, but that is not its focus.

This could be opposed by businesses that rely heavily on borrowing, such as private equity-owned groups or traditional utilities.