Business Roundtable

Globally Engaged American Companies Face High Effective Tax Rates

In 2012, U.S. companies faced the highest *statutory tax rate* among the 34 members of the Organization for Economic Cooperation and Development (OECD). The U.S. rate was 39.1 percent, including federal and state income taxes, according to the OECD, nearly 14 percentage points higher than the OECD average (excluding the U.S.) of 25.0 percent.[1]

Effective tax rates are another measure of tax burden based on financial accounting principles. It is sometimes alleged that despite the high statutory tax rate faced by U.S. companies, they pay low effective tax rates. In fact, effective tax rates for globally engaged American companies are also among the highest in the world.

High U.S. Effective Corporate Tax Rates

A recent comprehensive cross-country study of financial statement information by accounting researchers Kevin Markle and Douglas Shackelford found that U.S. corporations have above average effective tax rates, higher than all other trading partners except Japan during the study period.[2] For example, globally engaged American companies were shown to have effective tax rates of 30 percent between 2005 and 2009, compared to 39 percent for Japan, 29 percent for Germany, 28 Percent for France and South Africa, and 26 percent for Australia, Canada, and the United Kingdom. Japanese companies operating globally will also likely benefit from lower effective tax rates beginning in 2009 with Japan's adoption of a territorial tax system and from a reduction in its statutory corporate income tax rate by 5 percentage points over several years, beginning in 2012.

Are U.S. Corporate Taxes 2.3 Percent of Income?

A 2009 White House press release stated that U.S. companies operating globally faced only a 2.3 percent tax rate in 2004.[3] This calculation has been widely mistaken as evidence that U.S. companies face very low taxes on their foreign income and are improperly avoiding U.S. and foreign tax liability. To the contrary, globally engaged American companies pay substantial taxes on their foreign earnings.

The White House calculation took into account only a small portion of taxes paid by globally engaged American companies and made other unstated assumptions that minimized the true tax burden faced by these companies. Specifically, the White House calculation omitted foreign taxes paid on foreign earnings and the tax rate calculation was based on U.S. taxes paid on *gross* foreign earnings (i.e., earnings before deductions for expenses incurred in producing income) rather than on *net* earnings or taxable income.

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[1] OECD tax database Table II.1 http://www.oecd.org/ctp/taxdatabase

[2] Kevin Markle and Douglas Shackelford, "Cross-Country Comparisons of Corporate Income Taxes" National Bureau of Economic Research, Working Paper #16839, February 2011.

[3] White House Press Release, "Leveling the Playing Field: Curbing Tax Havens and Removing Tax Incentives For Shifting Jobs Overseas," May 4, 2009.

A proper calculation of the total tax burden on foreign earnings faced by globally engaged American companies must take into account both foreign taxes and U.S. taxes paid on foreign earnings.

The United States taxes the worldwide business earnings of U.S. companies when those earnings are remitted to the United States. Additionally, on income that is subject to current U.S. tax, the United States provides a foreign tax credit intended to eliminate double taxation of income. Therefore, U.S. tax on remitted foreign income is always the additional amount of tax owed to the United States after subtracting credits for foreign taxes already paid on that income.

Globally engaged American companies paid foreign taxes equal to 22.5 percent of their net foreign earnings in 2008.[4] Including the additional U.S. income tax paid on foreign earnings subject to current U.S. taxation raises the total U.S. and foreign effective tax rate on these earnings to 25.3 percent of income. These current cash taxes paid on foreign earnings differ from financial statement effective tax rates due to timing differences and they additionally differ from statutory rates due to tax incentives that may be offered in the foreign locations.

The total U.S. and foreign current cash taxes differ from the 35 percent statutory rate because, as noted above, U.S. income tax is not owed on foreign earnings that are not currently repatriated to the United States. This has been a fundamental principle of international taxation incorporated into U.S. tax law for nearly 100 years. Most OECD countries (28 of 34) employ territorial tax systems that exempt the foreign earnings of their companies from taxation at home. The five other countries that tax the worldwide income of their companies (Chile, Ireland, Israel, Korea, and Mexico) also do not tax the foreign earnings of their companies until they are repatriated. U.S. tax of 35 percent, less the credit for foreign taxes, is assessed on foreign earnings at the time they are repatriated to the United States.

Other Measures of Corporate Tax Burden

Some claim U.S. corporations face low rates of tax by comparing corporate income tax payments to GDP in the United States and other OECD countries. However, to make an apples-to-apples comparison, several adjustments are necessary to account for the different ways in which businesses operate across countries. Properly measured, there is no evidence that U.S. corporations face low rates of tax relative to other OECD countries.

Simple cross-country comparisons of corporate income tax revenue relative to GDP are premised on the assumption that both business income to GDP and the corporate share of business income are similar across countries. But, in fact, the United States has a substantially larger share of unincorporated businesses, especially larger businesses, than other OECD countries.[5]

In total, more than half of all business income in the United States is earned by business entities not subject to corporate tax (typically partnerships and sole proprietorships) and therefore is taxed under the individual income tax system.[6] If the corporate share of business income in the United States were more similar to the OECD average, U.S. corporate tax payments as a percentage of GDP would have been among the OECD's highest.[7]

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[4] This calculation is based on data on Controlled Foreign Corporations ("CFCs") and foreign tax credit information published by the Internal Revenue Service's Statistics of Income Division.
[5] U.S. Treasury Conference on Business Taxation and Global Competitiveness, "Background Paper," July 23, 2007, p. 16-18.
[6] Report of the President's Advisory Board on Federal Tax Reform, November 2005, p. 99.
[7] Peter Merrill, "The Corporate Tax Conundrum," *Tax Notes*, October 8, 2007, 174-176.

As a result, while some adjustments must be made to properly compare tax collections as a share of GDP, this evidence again supports the finding that U.S. companies face relatively high rates of tax compared to companies based in other OECD countries.

Conclusion

U.S. companies operating globally face both a high U.S. statutory tax rate and remain subject to tax on their foreign earnings when repatriated to the United States. These factors contribute to globally engaged U.S. companies bearing effective tax rates that are among the highest in the world.

Let's maintain the foundation for sustained economic growth.
Business tax policy must promote U.S. international competitiveness.

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