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Contact:
Anne Singer
(202) 299-1066 x 27

# What the President's Council on Jobs and Competitiveness Got Wrong about Corporate Taxes

President Obama's jobs council has released a report[1] full of recommendations, including somewhat misguided points on the federal corporate income tax. The report rightly points out that the corporate income tax is full of loopholes that should be closed, but fails to call for a reform that actually raises revenue to support under-funded public services and investments. The report also perpetuates some misunderstandings about the effects of the U.S. corporate income tax on our economy and on working people.

## What the Council Got Right: There Are Too Many Corporate Tax Loopholes

The report does make valuable points. For example, it explains that

> …the business tax system—which often applies to non-corporate businesses as well as corporate businesses—has numerous provisions for special deductions, credits, and other tax expenditures that benefit certain activities. These provisions reduce the effective tax rate below the statutory rate. In addition, these provisions also result in very different marginal tax rates applying to seemingly similar types of business activities.

The report also explains that "because certain assets and investments are tax-favored, tax considerations can drive overinvestment in those assets at the expense of more economically productive investments." In other words, companies and investors are making decisions to get special tax breaks instead of just providing whatever goods or services people actually want.

## Missing the Most Important Point: Corporations Need to Pay More in Taxes

Unfortunately, the report proposes, at least implicitly, the wrong solution, when it says, "Reducing the corporate tax rate and broadening the base would reduce these distortions and create a more level playing field among alternative investments."

Reducing the statutory corporate income tax rate *slightly* might be acceptable, but *only if* Congress also closes so many loopholes that corporations altogether pay a lot more in taxes than they do today. In other words, corporate tax reform should be *revenue-positive*.

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[1] President's Council on Jobs and Competitiveness, "Roadmap to Renewal," January 2012. http://www.jobs-council.com/recommendations/summary-of-road-map-to-renewal-report/

Presumably, the council is following the lead of President Obama and many Congressional leaders and calling for a corporate tax reform that is *revenue-neutral*. In other words, President Obama would close corporate tax loopholes, but he would use *all* of the resulting revenue savings to offset a reduction in the corporate income tax rate.

In May, 250 organizations, including groups in every state, sent a letter urging Congress to enact a *revenue-positive* reform of the corporate income tax.[2] The letter explains,

> Some lawmakers have proposed to eliminate corporate tax subsidies and use all of the resulting revenue savings to pay for a reduction in the corporate income tax rate. In contrast, we strongly believe most, if not all, of the revenue saved from eliminating corporate tax subsidies should go towards deficit reduction and towards creating the healthy, educated workforce and sound infrastructure that will make our nation more competitive.

CTJ also published a one-page fact sheet and a detailed report explaining why Congress should enact a revenue-positive corporate tax reform.[3]

### The Myth of America's "Uncompetitive" Corporate Tax

The report makes much of the fact that the U.S. has one of the highest *statutory* corporate income tax rates, even though it later admits that the *effective* corporate tax rate (what corporations actually pay as a percentage of their income after accounting for all the tax loopholes) is much lower.

The report declares that the U.S. must reduce its corporate income tax rate so that U.S. and foreign corporations will want to invest in America.

> The increased mobility of capital and the rise of multinational companies suggest that the appropriate corporate income tax rate is likely to be lower today than in the past. This is broadly consistent with the downward trend in corporate tax rates around the world during the last three decades.

If this is true, how exactly would the council explain the finding in CTJ's major study on corporate taxes that most profitable U.S. multinational corporations are actually taxed at higher rates by foreign governments than by the U.S.?

A section of the CTJ study, starting on page 10, focuses on most of the Fortune 500 corporations that were profitable for each of the last three years and received at least 10 percent of their profits from overseas.[4] Of these 134 corporations, 87 of them paid a lower effective tax rate in the U.S. than in the other countries where they had profits, while just 47 paid a higher effective tax rate in the U.S.

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[2] Letter to Congress, May 18, 2011. http://www.ctj.org/pdf/corptaxletter.pdf

[3] Citizens for Tax Justice, "Fact Sheet: Why Congress Can and Should Raise Revenue through Corporate Tax Reform," November 3, 2012. http://ctj.org/pdf/corporatefactsheet.pdf; Citizens for Tax Justice, "Revenue-Positive Reform of the Corporate Income Tax," January 25, 2011. http://www.ctj.org/pdf/corporatetaxreform.pdf

[4] Citizens for Tax Justice and the Institute on Taxation and Economic Policy, "Corporate Taxpayers & Corporate Tax Dodgers, 2008-2010," November 3, 2011. http://ctj.org/corporatetaxdodgers

### Who Ultimately Pays Corporate Income Taxes? The Shareholders, Not Workers

The report from the President's jobs council also claims that "workers bear a rising share of the burden of the corporate income tax in the form of reduced employment opportunities and lower wages."

This is certainly wrong. Corporate income taxes, when they are paid, are ultimately borne by corporate shareholders in the form of reduced stock dividends, and by the owners of business assets generally when the price of those assets are affected.

Corporate leaders sometimes claim publicly that corporate taxes are really borne by workers because these taxes drive the companies to move jobs offshore to lower-tax jurisdictions. But corporate leaders would not lobby for Congress to lower these taxes if they did not think their shareholders were the people ultimately paying them.

Several researchers have concluded that the owners of stock and other capital do bear most of the burden of corporate taxes.[5]

### Jobs Council Divided Over "Territorial" System (Exempting Offshore Profits)

The report explores a shift to a "territorial" tax system, but also acknowledges that members of the council were in disagreement over the issue. A "territorial" tax system is a euphemism for exempting offshore profits from taxes, and it would only increase the existing incentives for corporations to shift their profits into tax havens.

This section of the report begins:

> Many members of the Council believe the United States should move to a territorial system of taxing corporate income akin to the practices of the other developed economies. Territoriality would eliminate the so-called "lock-out" effect in the current worldwide system of taxation that discourages repatriation and investment of the foreign earnings of U.S. companies in the United States.

Translation: The corporate CEOs on the President's jobs council want Congress to exempt their companies' offshore profits from U.S. taxes. The "lock-out" effect is actually the result of an existing tax break for corporations that shift investments offshore — a tax break that should be repealed.

This existing tax break is the rule that allows U.S. corporations to "defer" U.S. taxes on their offshore profits until those profits are brought to the U.S. (until they are "repatriated"). Often these profits remain offshore for years and the U.S. corporation may have no plans to repatriate them ever.

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[5] Jennifer C. Gravelle, "Corporate Tax Incidence: Review of General Equilibrium Estimates and Analysis," Congressional Budget Office, May 2010, http://www.cbo.gov/ftpdocs/115xx/doc11519/05-2010-Working_Paper-Corp_Tax_Incidence-Review_of_Gen_Eq_Estimates.pdf; Gravelle, Jane G. and Kent A. Smetters. 2006. "Does the Open Economy Assumption Really Mean That Labor Bears the Burden of a Capital Income Tax." Advances in Economic Analysis & Policy vol. 6:1.

This "deferral" of U.S. taxes on offshore profits provides an incentive for U.S. corporations to shift operations and jobs to a lower tax country, or just use accounting gimmicks to make their U.S. profits appear to be "foreign" profits generated in offshore tax havens.

These incentives for corporations to shift jobs and profits offshore would only increase if their offshore profits were entirely exempt from U.S. taxes, as would be the case under a territorial tax system. The solution to end the "lock-out" effect is to repeal "deferral."

As the report acknowledges, "Some members of the Council, however, disagree with this point of view [that the U.S. should adopt a territorial system], arguing that a territorial system of taxing corporate income would strengthen incentives for companies to move investment and employment to lower-tax jurisdictions."

In October, when there were rumors that the Congressional "Super Committee" might propose a corporate tax reform, several national organizations and labor unions sent a letter to the committee members urging them to reject any proposal for a territorial tax system.[6]

A CTJ fact sheet explains why Congress should repeal deferral rather than adopt a territorial system, and a CTJ report makes the same argument in more detail.[7]

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[6] Letter to Joint Select Committee on Deficit Reduction, October 26, 2011. http://www.tjn-usa.org/storage/documents/corpletterforjsc.pdf

[7] Citizens for Tax Justice, "Fact Sheet: Why Congress Should Reject A 'Territorial' System and a 'Repatriation' Amnesty," October 19, 2011. http://www.ctj.org/pdf/corporateinternationalfactsheet.pdf; Citizens for Tax Justice, "Congress Should End 'Deferral' Rather than Adopt a 'Territorial' Tax System," March 23, 2011. http://www.ctj.org/pdf/internationalcorptax2011.pdf