



Business Roundtable

Worldwide American Companies Face High Effective Tax Rates

U.S. companies face the second highest *statutory tax rate* among the 30 members of the Organization for Economic Cooperation and Development (OECD). The U.S. rate was 39.1 percent in 2009, including federal and state income taxes, according to the OECD.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 worldwide 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 and Germany during the study period.² For example, worldwide American companies were shown to have effective tax rates of 30 percent between 2003 and 2007, compared to 39 percent for Japan, 33 percent for Germany, 28 percent for France and the United Kingdom, 26 percent for Canada, and 18 percent for China. More recent data, not yet tabulated, would likely show U.S. companies bearing higher effective tax rates than German companies since Germany reduced its corporate tax rate in 2008 to 30 percent from 39 percent. Japanese companies operating worldwide will also likely benefit from lower effective tax rates beginning in 2009 with Japan's adoption of a territorial tax system.

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

A recent White House press release stated that U.S. companies operating worldwide 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, worldwide American companies pay substantial current taxes on their foreign earnings.

¹ OECD tax database Table II.1 <http://www.oecd.org/ctp/taxdatabase>

² Kevin Markle and Douglas Shackelford, "Do Multinationals or Domestic Firms Face Higher Effective Tax Rates?" National Bureau of Economic Research, June, 2009. These tax rates are "book" tax rates reported for financial statement purposes.

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

The White House calculation took into account only a small portion of taxes paid by worldwide 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.

A proper calculation of the total tax burden on foreign earnings faced by worldwide 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.

Worldwide American companies paid current foreign taxes equal to 21.3 percent of their net foreign earnings in 2004.⁴ Including the additional U.S. income tax paid on foreign earnings subject to current U.S. taxation raises the total U.S. and foreign tax rate on these earnings to 25.1 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 tax 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 (25 of 30) employ territorial tax systems that exempt the foreign earnings of their companies from taxation at home. The four other countries that tax the worldwide income of their companies (Ireland, Mexico, Poland, and South Korea) 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.

⁴ This calculation is based on data reported in Lee Mahony and Randy Miller, "Controlled Foreign Corporations, 2004," *Statistics of Income Bulletin*, Summer 2008, Internal Revenue Service, and foreign tax credit information published by the Internal Revenue Service, *Statistics of Income Division*, for 2004.

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

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

Worldwide American companies 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 U.S. companies operating worldwide bearing effective tax rates that are among the highest in the world.

A massive increase in taxes will disadvantage American companies and make U.S. workers less secure.

⁵ U.S. Treasury Conference on Business Taxation and Global Competitiveness, "Background Paper," July 23, 2007, pp. 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, pp. 174-176.