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Racing to the bottom

How the Trump-Ryan corporate tax plans will further rig the rules for the rich and boost inequality

Introduction:

In the aftermath of the November 2016 US elections, the incoming Trump administration and leaders in Congress are pursuing a new effort to radically reform the US tax code. President-elect Trump has set high expectations that he will be able to fix a US economy and tax system that, by his own description, is rigged against the poor and middle class and controlled by special interests. Yet an Oxfam analysis of President-elect Trump and House Speaker Ryan's corporate tax proposals suggests that these reforms will only further rig American tax laws in favor of wealthy and powerful special interests and intensify the global race to the bottom on corporate taxation, while doing little to prevent large corporations from shifting their profits into offshore tax havens.[1]

In every country around the world tax revenues pay for schools, hospitals, roads, bridges, first responders, social safety nets and other public services that keep societies running. A well-designed tax system can ensure that those who can afford it most make the largest contribution. Tax policy is widely established as one of the most critical mechanisms governments have for either increasing or reducing economic inequality.[2]

If passed into law, the overall effect of the reforms proposed by Trump and Congressional leaders will be to reduce taxes for the wealthiest Americans and to reward the largest and most profitable companies for avoiding their taxes. The Trump and Ryan plans will primarily benefit profitable multinational corporations and their shareholders, most of whom are already wealthy, while harming poor people and the middle class by slashing revenues needed for infrastructure and public services both in the US and in poor countries. Coupled with their multi-trillion dollar proposals to slash taxes for wealthy individuals, these plans are a blueprint to drive even greater inequality in the US and around the world.

Americans are tired of a rigged tax system that rewards the wealthy and corporate tax cheats. They want US corporations to pay their rightful share of taxes and stop unloading their tax burden onto the backs of domestic companies, small business, and American families.

The Trump and Ryan proposals on corporate tax rates

The current "statutory" federal corporate tax rate is 35%, but large companies use various tax incentives and loopholes to lower their effective tax rate to about half the statutory rate.[3] In the US, the top 1 percent (those making more than $450,000 per year) earns 45 percent of corporate income.[4] That means the cost of corporate taxes applies much more to the wealthy than average Americans.[5] To the extent that corporate income taxes also affect shareholders in the form of reduced stock dividends, the impact is, again, felt primarily by wealthy Americans, since they receive the lion's share of those dividends.[6] That means the primary impact of reducing the corporate tax rate will be to increase incomes for wealthy shareholders.

TRUMP PLAN: President-elect Trump has proposed to lower the statutory corporate tax rate to 15%.

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RYAN PLAN: Rep. Ryan has proposed to lower the statutory corporate tax rate to 20%.

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The average statutory corporate tax rate of rich countries (OECD) is 25%. Even after "closing loopholes" both plans lower US taxes to well below this average – intensifying the race to the bottom by encouraging other countries to lower their rates even further.

Current tax law provides a series of tax incentives to US companies allowing them to reduce their rates substantially below the statutory rate of 35%. The average "effective" rate that US corporations actually pay is about the same, or slightly less than other rich countries, approximately 27.1% in the US compared to 27.7% for other rich countries.[7] For large multinationals it's even lower. The Government Accountability Office has calculated that profitable US corporations with at least $10 million in assets had an average effective tax rate of 17%.[8] Citizens for Tax Justice examined five years of data and found that Fortune 500 companies paid an average federal effective corporate tax rate of just 19.4 percent.[9] The narrative that the US is not competitive and has the highest corporate taxes in the world is – simply put – a lie. Moreover, how can the US "compete" for the lowest corporate rate when tax havens offer a tax rate of zero? That is a foolhardy contest that cannot be won.

Trump and Ryan proposals on taxing US companies for profits earned offshore

Current US tax law mandates that US companies pay taxes in the US regardless of where their profits are earned. This is known as a "Worldwide System". Companies receive a tax credit for any taxes they pay to foreign governments on these profits.

In other words if US Widget Company earns profits by making widgets in Cambodia and pays a 20% tax rate on these profits to Cambodia, it must pay a 15% tax to the US, which is the difference between the US tax rate (35%) and the Cambodian tax rate (20%).

Many companies use various tricks and arrangements to artificially shift their profits into tax havens to lower the rate they pay to foreign governments. On average US companies pay just 6% tax on offshore profits which means they would owe a rate of about 29% to the US.[10]

Currently, the law allows companies to indefinitely defer paying US taxes on these profits by deeming them "permanently reinvested abroad". This is known as the "Deferral Loophole". US companies currently have $2.4 trillion stashed offshore as a result of this loophole.[11] The largest 50 companies alone account for more than half of this amount.[12]

TRUMP PLAN: President-elect Trump has released two different proposals on offshore taxes. The first proposal released by his campaign would have ended the Deferral Loophole, which would prevent US companies from indefinitely stashing profits offshore. The plan relied on closing that loophole to finance a lower overall corporate rate of 15% on all profits. Ending the Deferral Loophole would also have reduced the incentive of companies to shift profits into tax havens.

Unfortunately President-elect Trump's more recent plan does not end the Deferral Loophole and says nothing about changing the worldwide system. Ultimately, this would protect corporations' ability to stash money in tax havens and do nothing to ensure profits are brought back on shore.

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RYAN PLAN: Rep. Ryan has proposed ending the "Worldwide" system of taxation altogether, which means that instead of owing an average 29% tax rate on profits earned abroad, multinationals would owe $0 in taxes to the US government for these profits.

This shift would not only deprive the US treasury of billions of dollars, it would also exacerbate tax competition among other countries. Under the current "worldwide" system, neighboring developing countries like Mozambique and Tanzania do not have to compete on tax rates to attract US investors, because US investors technically owe a 35% rate anyway.

One advantage of the worldwide system is that it removes tax rates as a factor for US investors, since they'll pay the US rate regardless of the national rate. US investors can make their decisions based on the merits of the investment rather than tax rates. Under a territorial system, US investors will have a stronger incentive to shop around for the lowest tax rates or, even worse, pressure countries to reduce their rates. For poor countries, which desperately need revenues to provide basic services, this creates a destructive dynamic. Poor countries raise a disproportionate share of their revenue from corporate tax.[13] This policy change would undermine poor country governments' ability to raise revenues to pay for schools, hospitals, roads, vaccines and any other basic needs that help drive equitable growth and reduce poverty.

Giving away tax incentives is a major issue for developing countries. It deprives them of billions of dollars, $138 billion a year according to Action Aid estimates.[14] In some countries, the revenues foregone in tax incentives are greater than the entire budgets for healthcare or education. Governments of poor countries are cash-strapped and desperate to attract foreign investment. They sometimes feel powerless when executives of multinational corporations demand tax incentives and threaten to invest in another country instead.

The same dynamic also puts pressure on developed countries like the US to provide more foreign aid to poor countries to make up for corporate tax revenue fleeing to tax havens. Breaking this cycle will require ensuring developing countries can stop the drain on their budgets and raise the revenues they need domestically.

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Trump and Ryan proposals on a tax holiday to pay for infrastructure

Many business leaders have called for the US government to provide a one-time tax break, known as a "Repatriation Holiday" to encourage companies to bring the offshore profits they have already earned back to the US. This tax break would retroactively lower the taxes already owed on those profits. Some in Congress have called for using this one-time revenue to pay for a large US infrastructure investment.

A repatriation holiday was attempted in 2004 under the Bush administration and was a massive failure. A US Senate investigation of this policy found that the 15 companies that benefited the most from that repatriation tax holiday cut more than 20,000 net jobs and decreased the pace of their research spending, cost the US Treasury $3.3 billion in estimated lost revenues over 10 years and led to US companies directing more funds offshore.[15]

Repatriation holidays reward companies for avoiding their taxes and ultimately cost the US Treasury substantially. It also incentivizes companies to move their profits to tax havens and avoid paying taxes where profits are actually earned with the expectation that they will eventually benefit from a one-time tax cut. Moreover much of "offshore" income is already invested in the United States but is simply untaxed.[16] The primary effect of tax holidays is to allow companies to pay more out in dividends to wealthy shareholders without having to pay taxes on the profits.

Corporate executives are already signaling this approach and saying that the windfalls from tax-holiday proposals are likely to be spent to benefit investors rather than jobseekers.[17] Any broader benefits would need to trickle-down.

TRUMP PLAN: President-elect Trump proposes a one-time tax on offshore corporate profits of 10%, which is substantially lower than the 35% statutory rate and the average 29% rate estimated to be owed by large corporations.

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RYAN PLAN: Rep. Ryan proposes a one-time tax on offshore corporate profits of 8.75% on cash and 3.5% on other earnings, payable over an 8 year period. That is substantially lower than the 35% statutory rate and the average 29% rate estimated to be owed by large corporations.

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Trump and Ryan proposals to fight tax haven abuse

Mandating public reporting of profits, taxes, assets and employees on a country-by-country basis is a critical step to shed transparency on offshore tax dodging. It would enable countries to crack down on tax dodging that is hidden by corporate secrecy and discourage companies from artificially shifting their profits. In 2016, the US put rules in place requiring large multinationals to begin reporting that data to the IRS, but not to the public, which is a crucial next step to ensure developing countries can access the data and fight tax avoidance or evasion. Mandating transparency of the real owners of shell corporations is another step that would help fight tax evasion and other financial crimes.

Other steps including consolidating the worldwide system by ending the Deferral Loophole and preventing inversions[18] would reduce tax havens abuse by US corporations, for both their domestic and foreign profits. Steps to punish tax havens and to prevent specific activities like abusive "Transfer Mispricing" practices[19] and "Earnings Stripping" [20] are also critical to cracking down on tax dodging.

TRUMP PLAN: No proposals to end tax havens abuse.

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RYAN PLAN: No proposals to end tax haven abuse.

Speaker Ryan argues that shifting away from a "Worldwide" tax system would help stop tax dodging. But that claim ignores the new incentive corporations would have to mischaracterize US profits as non-US profits to take advantage of the zero tax rate that the US would apply to foreign income. Multinationals can use a variety of well-worn tricks like "Earnings Stripping" and abusive "Transfer Mispricing" to ensure that profits earned in the US end up in tax havens.

Moreover US companies will still owe taxes to the foreign countries where they operate and the territorial system will do nothing to end the incentive to shift foreign profits into tax havens to avoid those taxes. Many poor countries will continue to lose out as a result.

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Racing to the bottom

While much of the campaign rhetoric from all of the presidential candidates focused on cracking down on corporate practices that line the pockets of executives at the expense of working people, the plans proposed by President-elect Trump and Speaker of the House Ryan will have the opposite effect, further rigging American tax laws in favor of powerful

special interests, intensifying the global race to the bottom on taxation, and doing nothing to prevent corporations from shifting their profits into offshore tax havens.

If the resounding message of the 2016 election is that Americans are demanding real change in Washington, which fights inequality and addresses economic anxiety, these tax plans are sure to disappoint.

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[2] http://www.taxpolicycenter.org/sites/default/files/alfresco/publication-pdfs/413067-Taxes-and-Inequality.PDF
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[4] https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/WP-104.pdf
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[8] GAO report above
[9] Robert S. McIntyre, Matthew Gardner, Richard Phillips, The Sorry State of Corporate Taxes, Citizens for Tax Justice, Institute on Taxation and Economic Policy (February 2014) http://www.ctj.org/corporatetaxdodgers/sorrystateofcorptaxes.pdf
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[16] https://www.americanprogress.org/issues/economy/reports/2014/01/09/81681/offshore-corporate-profits-the-only-thing-trapped-is-tax-revenue/
[17] https://www.bloomberg.com/news/articles/2016-11-21/trump-s-offshore-cash-plan-will-benefit-investors-not-jobseekers
[18] Inversions—when a US company renounces its US citizenship by buying a foreign subsidiary in a low-tax jurisdiction, where it reincorporates. In some cases, nothing changes about the actual business—the new inverted company remains headquartered in the US and still conducts business from the US, enjoying all the advantages of the US market, but no longer pays its rightful share of US taxes.
[19] Transfer Mispricing- a widespread technique in which corporations manipulate the price of internal company transfers of goods and service between subsidiaries to dodge taxes.
[20] Earnings stripping- A subsidiary in a high tax country can borrow from a subsidiary in a low tax country enabling the parent company to essentially pay artificially high interest rates to itself. For the global company as whole, it's a wash – profits on one side match losses on the other – and no real business activity has occurred, except that the company's global tax bill is lower.