INTERNATIONAL
TAX REVIEW

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What the US presidential hopefuls are saying on tax reform

27 April 2016

Amelia Schwanke

Election day – November 8 – may still be some way off, but the buzz around the battle for the presidency is already at peak levels, largely driven by the polarising Donald Trump and his drive for the Republican presidential nomination. But while his hairdo continues to dominate the front pages, how would a Trump-inspired tax reform be received on the business pages? Amelia Schwanke analyses where each of the front-runners for the White House stand on corporate tax.

Corporate tax reform has been a hot topic internationally in light of global change from the OECD's BEPS Project and pressures from the media and tax campaigners on tax transparency.

"Change is in the air," declared Elizabeth Warren, US Senator for

Massachusetts, in a November 18 speech on corporate tax reform. This sentiment reflects the fact that there is agreement – from both sides of the aisle – on the need for a tax code rewrite. This does not mean legislative action is forthcoming, however, with Congressional gridlock stymying meaningful progress. It is clear that the new president will need to provide fresh impetus for corporate tax reform; but which of the White House hopefuls has the 'best' reform plan for businesses?

Eric Toder, institute fellow and co-director of the Urban-Brookings Tax Policy Centre, which provides analysis of tax policy and tax policy proposals, points out that the tax reform proposals of each of the leading candidates – regardless of political affiliation – are "radical".

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Taking a broad overview, and focusing on general outcomes rather than specific proposals, a victory for the Republicans would probably provide the best building blocks in terms of laying the foundations for a tax code overhaul, based primarily on the way the political cards would fall post-election as well as the Republican desire to make US businesses more competitive, internationally.

"Given that control of Congress will likely remain with the Republicans after the November elections, a Republican in the White House would improve the chances for substantive tax reform considerably," says Douglas Stransky, international tax partner at Sullivan & Worcester in Boston.

"Not to take sides; but the Democrats' focus has been on tax policies that would soak the rich, not make the country more competitive," he adds.

As things stand, Hillary Clinton, former secretary of state is leading the race for the Democratic nomination, with Bernie Sanders not too far behind.

On the Republican side, Ted Cruz has the most revolutionary proposals, governor of Ohio John Kasich is largely in line with the other candidates' thoughts on the need for reform, and businessman Donald Trump is pro-business, while Marco Rubio has now suspended his campaign. Rubio could yet revive his bid for the White House, but is keeping his cards close to his chest, potentially with a view to making a bid for the vice-presidency. He

may also have an eye on gaining allies for a future presidential ticket.

Generally speaking, the two sides can be categorised according to long-held party principles. "Of those leading candidates ... the Democrats are typically not aggressive in the corporate reform area; they talk about keeping jobs in the United States but then they want to penalise people who are here," says Peter Glicklich, partner at Davies Ward Phillips & Vineberg in New York.

"And the Republicans take a point of view that you should facilitate corporate activity, reduce taxation to make America more competitive and deal with trade and job exports in a more direct way than the Democrats would; I think the Democrats would avoid the issue," he adds.

The US tax code: what's not to love?

Eric Toder, co-director of the Urban Institute-Brookings Institution Tax Policy Center and former deputy assistant secretary of the Treasury for tax analysis, identifies specific failings of the existing US tax code.

The corporate income tax has numerous problems:

- It encourages corporations to use debt instead of equity financing, distorting the allocation of capital and increasing the risks of bankruptcy.
- It favours businesses taxed as flow-through enterprises over taxable corporations. The result is too little investment in the corporate sector relative to sectors like real estate, where flow-through enterprises dominate.
- It contains numerous targeted tax preferences. Some of them, like the research credit, may be justified as a way to encourage activities with broader social benefits. But in general, tax preferences lead to resource misallocation, undermining productivity.
- The high US tax rate favours foreign investment over domestic, and encourages multinational corporations to shift profits to other jurisdictions. Although various tax preferences make the average effective rate on corporate investments lower than the statutory rate, the US still has a high effective rate compared with the OECD average.
- The US tax on repatriated income encourages US multinationals to keep their funds overseas instead of paying dividends to US shareholders – and, some argue, places US multinationals at a disadvantage compared with foreign-based ones. Other countries, notably Britain and Japan, have shifted to territorial systems that exempt profits repatriated by their own multinational corporations.
- The combination of deferral and rules that determine how income and expenses are allocated among countries has enabled many profitable US multinationals to avoid a lot of tax liability. These opportunities are especially large for US companies with intangible income – royalties on patents, for example – that are able to shift reported income to low-tax countries like Ireland or to tax havens like the Cayman Islands or Bermuda. Over the past decade, the reported foreign profits of US multinationals have grown much faster than other measures of their foreign activity (like employment and sales), suggesting that much of this growth comes from aggressive tax planning. Thus, the tax distorts investment choices, discourages investment in the US and damages the competitiveness of US multinationals while at the same time allowing some large and profitable US multinationals to pay very little tax on their worldwide income. No wonder most everyone favours reform, at least in the abstract.

The information provided in this boxout is based on a longer article put together by Toder and Alan Viard from the America Enterprise Institute for The Milken Institute Review, Q1 2014, used with the author's permission.

The US tax landscape

The US has the highest corporation tax rate in the industrialised world. It was set in the early 1960s at 35%, although effective tax rates vary due to state and local taxes, deductions, exemptions and credits along with loopholes.

The last time the tax code received a rewrite was in 1986, when the US had a Republican president (Ronald Reagan), a Democratic House (with Tip O'Neill as Speaker) and a Republican Senate.

But progress has been painstakingly slow.

"If we listen to the rhetoric on Capitol Hill, we'd believe tax reform is right around the corner," Remy Farag, senior international tax analyst at Thomson Reuters told *ITR* in 2013. The statement has retained relevance ever since.

Aside from the fact that globalisation and digitalisation have drastically changed the way that businesses operate since then, rendering the code outdated, Warren says another issue is that the tax code is not raising sufficient revenue.

"So what's the problem with our corporate tax code? It's not that taxes are far too high for giant corporations, as the lobbyists claim. No, the problem is that the revenue generated from corporate taxes is far too low," says Warren.

"This trend line is unmistakable. Over the past 60 years corporations contributed a smaller and smaller share of costs of running government. Back in the 1950s, corporations contributed about $3 out of every $10 in federal revenue. Today corporations contribute just $1 out of every $10," she adds.

US income from capital gains and dividends are taxed at lower rates than other income, with a top rate of 23.8% (20% plus a 3.8% tax to fund the Affordable Care Act), which is the sixth highest rate in the OECD.

Glicklich says that "there are two or three categories of issues that are talked about in terms of facilitating corporate activity".

"One is the absolute tax rate, the other is repatriation of offshore earnings and the third is kind of a coordination of taxes on shareholders and corporations."

Advancing the tax code

Brad del Matto, global head of tax at Nintex, a computer software company based in Washington, says there are two principal reasons that the US tax code needs reforming, but that the complexity of corporate taxation makes this difficult to relay to the public.

"The broad impression with the public is that corporations are allowing strictly for a lower tax rate and I don't think the public understands the implications in terms of worldwide competitiveness," says del Matto. "I think the media – including the business media such as the *Wall Street Journal* – they might mention the territorial tax system that the UK and pretty much everyone else uses except for Japan and the US. But I think it's not very well understood here. I think that's where reform is going to go but it's going to take a lot more understanding by the people in government and also by the public so it becomes more acceptable."

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Elizabeth Warren, US Senator for Massachusetts

He also points out that the lack of a US federal VAT further complicates the issue of moving to a territorial system, because a nationwide indirect tax is typically a large proportion of government revenues in countries around the world.

"The second thing is that in most of the territorial countries, including for example the UK, they rely much more heavily on VAT revenue to support the government. In the US we don't have that, we rely much more heavily on corporate taxes more than other countries do," says del Matto. "Part of the equation is we'll have to figure out how to replace some of the loss, if they're to implement tax reform that lowers the corporate revenue.

The interplay between federal and state and local taxes further complicates the issue, with states levying sales taxes at varying rates throughout the country.

"It's complicated here because we have sales tax in almost every state and I don't know how we could have a system that exists like we do today where the local governments collect tax and then we have a federal tax on top of that; it would have to be much more comprehensive like we only have a GST or VAT and then the revenues are distributed to the local government – but because the states have the right to impose sales tax, I think getting all 50 states to agree to something is pretty much impossible."

Multinationals moving away from the US

One of the major symptoms of an inefficient tax code is the movement overseas of US-based multinationals, and US-headquartered companies are increasingly 'voting with their feet' by relocating abroad, driven away by provisions built for a far less

globalised – and far less digital – business environment.

This has prompted bipartisan support for reform, in principle, though meaningful action has been less forthcoming.

"Nobody is defending the *status quo*," said Peter Roskam, Republican congressman from Illinois, at a Congressional hearing in April. "There's no voice here on the dais or among the witnesses. Nobody is saying 'Oh, it's great. Just leave it alone.'... Everybody is communicating a sense of urgency about this."

Raymond Wiacek, partner at Jones Day in Washington, DC, says the cure must lie with comprehensive reform that produces a more competitive system.

"We better figure out for our communities and our country what's happening and why we're losing. And one of the reasons we're losing is that we have a non-competitive tax system," says Wiacek.

"Since January, three major American companies have decided to move their headquarters, and many American jobs, overseas. To put this in perspective, in the two decades leading up to 2004, we averaged two 'inversions' of substantial American businesses per year," says Kevin Brady, chairman of the House Ways and Means Committee. "In the decade through 2014, we averaged four per year. In 2015, there were six more. And if the pace so far this year continues, the three in January might become 30 by the end of the year."

"Each of these factors is making it harder for our businesses, and the hard-working Americans they employ, to compete successfully. The end result is driving American job creators to take their jobs and their investments to other countries," he adds.

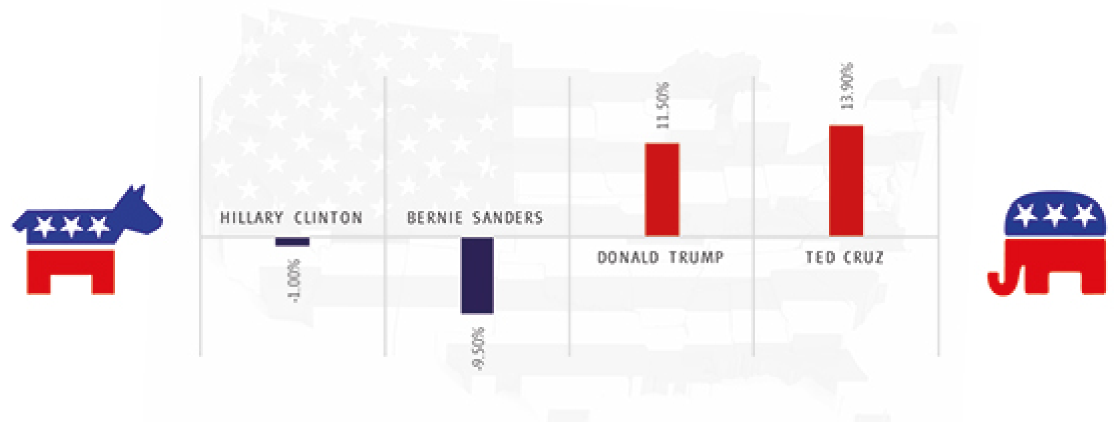
Complexity-related challenges aside, del Matto agrees with Roskam that the *status quo* cannot continue. The tax system in the US has become outdated, uncompetitive and is causing the US authorities to aggressively chase tax dollars from well-known multinationals rather than focus on improving the system to attract greater levels of investment. Until such improvements can be made, del Matto says the 'battle' is set to continue.

"Part of the problem we have today with the existing system is that it's antiquated and the government is always trying to chase the big multinationals – the really successful ones like Apple, Microsoft for having money offshore or for other things. It's going to be a continuing battle until we do some corporate tax reform," he says.

"In government, they're really working against themselves to some extent, [because] the law, as you know, was created a long time ago and getting Congress to do tax reform seems almost impossible," says del Matto. "So the government is left with trying to change regulations and that's not a very effective way to go. Until we have a change like adopting a territorial system we are going to continue to see companies that will try to do things like invert and the government's only tool that they will have will be to change the regulations rather than changing the underlying law, to the extent that they can change the regulations. It truly questions how much power they really have to do that and we're

already seeing a lot of those battles."

Estimated 10-year GDP growth from the candidates' tax plans



*According to estimated figures by the *Tax Foundation*

A breakdown of the US presidential candidates' tax proposals

Hillary Clinton

Clinton proposes a series of tax changes that would increase taxes on high-income taxpayers, modify international taxation for corporations, repeal fossil fuel tax incentives, and increase estate gift taxes.

Toder believes that Clinton is basically proposing a continuation of the '*status quo*'. It is unlikely that she will depart too markedly from the current – albeit vague – direction of tax policy; the majority of her tax policies are largely in line with those put forward by the Obama Administration.

According to the Tax Policy Center, Clinton's proposals would increase revenue by $1.1 trillion over the next decade.

"From what we can tell, Clinton doesn't focus much on corporate tax reform; she tends to back what Obama has suggested and he's suggested a reduction in rate over time, if it was accompanied by other tax reform proposals and a fairly high tax – a minimum tax – on corporations' worldwide income," says Glicklich.

"The Obama administration kind of becomes Clinton *de facto*; he wants to have a fairly high tax on the second

> **"America needs a new 21st Century tax code that is built for growth – the growth of families' pay checks, the growth of local businesses, and the growth of our economy ... To deliver the simpler, fairer and flatter tax system**

category of repatriation of earnings, it's more than 15% as I recall."

Americans deserve, members of our Committee will think fresh and bold"

Kevin Brady, chairman of the House, Ways and Means Committee

Like Obama's proposals, Clinton's anti-inversion proposals and taxation of carried interest as ordinary income are intended to deter tax avoidance.

Her other proposals include implementing a 4% surtax on income above $5 million, raising rates on medium-term capital gains to 24% and on long-term capital gains to 39.6%, and implementing an 'exit tax' on un-repatriated earnings of US firms going through inversions, which would hold corporations hostage if they should choose to relocate abroad.

She has also alluded to a tax on high frequency trading, though the rate has not been specified and, consequently, the proposal has not been modelled. Such financial transaction taxes are popular among the general public, but the concern from the financial sector would be that future legislators may be tempted to hike the rate as a revenue-generator, meaning that even a low-rate trading tax could fall victim to 'mission creep' in years to come.

Even setting aside the potential financial transactions tax, Stransky fears the Clinton plan would not go far enough to place US businesses in a strong position alongside their international competitors.

"Since most of the businesses in this country are small businesses, Hillary Clinton's tax plan imposes additional taxes on those businesses (through their owners) that will continue to result in slow economic growth and continue to make American companies less competitive with their international counterparts," says Stransky.

Bernie Sanders

Sanders is proposing very large tax increases, including significant increases in federal income, payroll, businesses, estate taxes, as well as the creation of two large excise taxes – on financial transactions and carbon.

"Certainly from the narrow point of view of corporate taxpayers I think that Sanders' proposals are the least attractive," says Toder. "Sanders is proposing a very big shift in the way we do business in the United States, including a very big expansion of federal responsibility."

Sanders proposes to end the deferral of US tax on earnings of controlled foreign subsidiaries, impose a per-country limitation on the foreign tax credit, and modify

Which candidate has the most attractive tax plan? You decide.

rules about corporate inversions and foreign corporations operating domestically.

The Tax Policy Center estimates that his proposals would increase federal revenue by $15.3 trillion over the next decade.

It is expected that all income groups would pay some additional tax under Sanders, but most revenue generated from his proposals would come from high-income households.

"Bernie Sanders's proposal is even worse as he proposes to raise taxes for individuals across the board at rates up to 52%," says Stransky, "But then, Mr. Sanders has made no secret of his desire to take more income from people for his government programs."

Sanders proposes to tax capital gains and dividends at ordinary income rates for households with incomes over $250,000.

"He's probably the one real grown up in the room in terms of responsibility to society and the world would probably be a better place if we had Sanders elected," says Glicklich. "Unfortunately, his chances are fairly low although he's stronger than a lot of people expected at this point in the Democratic race."

Ted Cruz

Ted Cruz would revoke the corporate income tax and replace it with a 16% 'business transfer tax' applying to all capital income and labour payments, eliminate payroll taxes for estate and gift taxes, and break down the seven individual income tax rates to a single 10% rate.

"Cruz has the most revolutionary proposals here in the sense that he would eliminate the corporate tax all together and replace it with a 16% value added tax (VAT)," says Glicklich.

Cruz proposes to lower the rate on capital gains and dividends income to 10%, as well as taxing repatriation of foreign income at a 10% rate, and implementing a pass-through business income tax at 10%.

Cruz's proposals are estimated to reduce federal revenue by $8.6 trillion over the first decade, according to the Tax Policy Center.

"When they scored Cruz's proposals it was quite expensive but not as expensive as some of the Rubio and Trump proposals on the Republican side," says Glicklich. "He's set a rate on business

transactions taxes but what he probably doesn't take into account is the taxes that people are currently paying at the state and local level on sales taxes, so they can talk about the federal tax and the federal rate but the Cruz proposal is untested on the details and throwing out the baby of the corporate tax with the water of the value added tax just because it hasn't been done before is kind of aggressive."

Cruz is in favour of implementing a territorial tax system to encourage companies to bring their overseas profits back onshore to be taxed domestically, which is popular among the Republicans as it would help to bypass the mess of tax law in the international tax area.

John Kasich

Kasich proposes to lower corporation tax to 25%, which "will restore global competitiveness to America's business to create new jobs", says Kasich in his Action Plan.

"The issue in the US is how do they remain competitive compared to other countries and therefore stop the symptom of the problem, which is inversions. So what Congress has done generally is attack inversions directly and the Treasury Department has been very aggressive in trying to expand the reach of the statute [in ways] that were probably never anticipated by Congress," says Glicklich.

Kasich is also in favour of a territorial tax system, although Glicklich warns that, "territoriality may make you more competitive with other systems but it won't address the issue of job exportation and it's hard to address the issue of job exportation unless you reduce the rate".

"I think that because the rubric of US competiveness is kind of the flip-side of BEPS. So you can address BEPS by closing loopholes, imposing higher taxes in rural jurisdictions or reduce the rate so that they're more worldwide competitive so you don't have people trying to avoid doing business in that jurisdiction merely because the rate is so high and base eroding through earning stripping and other kinds of deductions – it takes a lot of pressure off if the rate was lower," says Glicklich. Among Kasich's other proposals, he would lower the rate on long-term capital gains to 15%, fully expense investment costs and implement repatriation of foreign differed earnings with no tax.

The estimated impact of Kasich's proposals on federal revenue has not been disclosed.

Donald Trump

Trump is proposing to slash the corporate tax rate to 15% for all companies as well as to tax pass-through businesses at the rate of 15%, commensurate with 'traditional' corporations.

In addition, Trump proposes to remove the net investment income surtax and end the deferral of foreign income at a 10% rate.

"Generally, if one was going to propose to end deferral, I would prefer to have a territorial system of taxation where a US corporation is not taxed on its foreign profits," says Stransky.

"Thus, when such profits are repatriated to the US, they would be exempt from US tax–like most of the world."

"Under Trump's plan, however, he ends deferral and continues to tax foreign profits, but because he lowers the US corporate rate to 15% and provides for a foreign tax credit, the effect will be that there is no US taxation on foreign profits since most countries have a corporate income tax of at least 15% or higher," he adds.

Trump's one-time tax on foreign profits would be beneficial to the US economy as long as it is accompanied by the lower tax rate he proposes.

However, unless Trump's plan is accompanied by very large spending cuts it could increase the national debt by nearly 80% of GDP by 2036, and over the next decade the Tax Policy Center estimates that it would reduce federal revenues by $9.5 trillion.

Marco Rubio

Rubio formally suspended his campaign on March 15 but, while he may be out of the race, some of his proposals may stick around in his tax plan.

Rubio proposed a modified version of the 'X-tax' – which is a tax reform plan developed by the late economist David Bradford – that would move the US tax system to a consumption-based tax that is in line with a territorial tax system.

He proposed to lower the rate on capital gains and dividends to 0%, to cut the corporate tax rate to 25% and to tax pass-through business income at 25%.

On November 3 2015, Rubio responded to a report from the Tax Foundation that found his tax plan would "decrease government revenues by $6 trillion over 10 years".

"The argument about the debt... cannot simply [be] solved... through a tax plan alone," Rubio explained. "It has to be a combination of things. You have to have the spending discipline on the mandatory spending programs and you need to sustain significant economic growth."

A strengthened US

Each of the candidates has focused on tax reform that would stimulate economic growth and simplify the existing system, while 'fairness' is another issue that creeps into the respective plans in one form or another.

"In this environment, how we advance international tax reform will depend on how targeted and tailored it is," says Brady.

"America needs a new 21st Century tax code that is built for growth – the growth of families' pay checks, the growth of local businesses, and the growth of our economy ... To deliver the simpler, fairer and flatter tax system Americans deserve, members of our Committee will think fresh and bold. We will examine the whole range of tax ideas – consumption tax, reformed income tax, and any other approach that will be pro-growth. There is no perfect way to tax, but there are proven ways to grow investment – and that's what we will focus on," he adds.

Toder perhaps says it best in the closing remarks of his paper titled 'Corporate Income Tax Reform: Dreaming On', which state: "the current system is broken, and simple patches will not go very far to improve efficiency, reduce inequities or even yield a political consensus, [which] is why it's time to think about big solutions to a big problem".

There is a long way to go before the identity of the next US president is revealed, but with the increased 'mainstreamification' of corporate tax issues, the candidates' stance on taxation is likely to be more important in influencing the outcome than ever before.

The candidates' key tax ideas

*According to analysis carried out by the *Tax Foundation*

Democrats

Hillary Clinton

Proposes a 4% surtax on income over $5 million

Bernie Sanders

Proposes to tax capital gains and dividends at ordinary income rates for households with incomes

over $250,000

Proposes to end the deferral of tax on foreign income

Proposes several limits on the foreign tax credit

Proposes to revise rules about corporate inversions and foreign corporations operating domestically

Proposes to raise rates on medium-term capital gains to between 24% and 39.6%

Proposes an 'exit tax' on un-repatriated earnings of US firms going through inversions

Republicans

Ted Cruz

Proposes to lower the rate on capital gains and dividends income to 10%

Proposes to replace corporate income tax with a 16% business transfer tax

Proposes full expensing of investment costs

Proposes a territorial tax

John Kasich

Proposes to lower the rate on long-term capital gains to 15%

Proposes to lower corporate tax to 25%

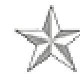
Proposes full expensing of investment costs

Proposes a territorial tax system

Donald Trump

Proposes to end the net investment income surtax

Proposes to lower corporate tax to 15%



Proposes to end the deferral of foreign corporate income

Proposes to enact a 10% rate on repatriation of foreign income

system,

Proposes repatriation of foreign income at a 10% rate

Proposes to tax pass-through business income at 10%

Proposes repatriation of foreign deferred earnings with no tax

Proposes to tax pass-through business income at 15%