COUNCIL on FOREIGN RELATIONS

Renewing America

Progress Report and Scorecard

Standard Deductions

U.S. Corporate Tax Policy

April 2014

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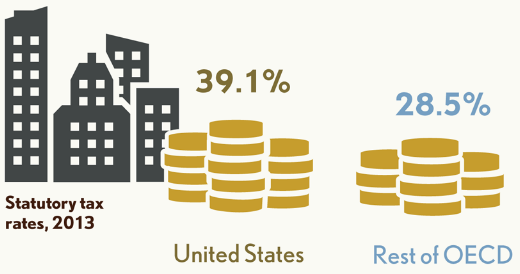
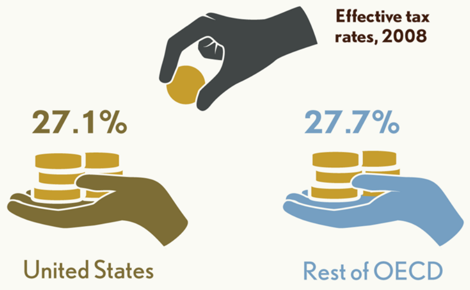
Standard Deductions
U.S. Corporate Tax Policy

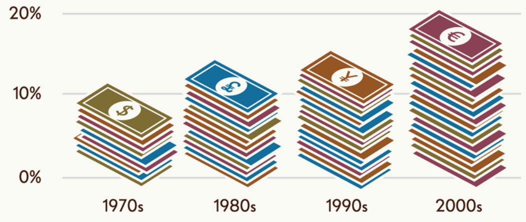
Uneven Rates



The United States has the highest corporate tax rate in the developed world before taking into account tax breaks.

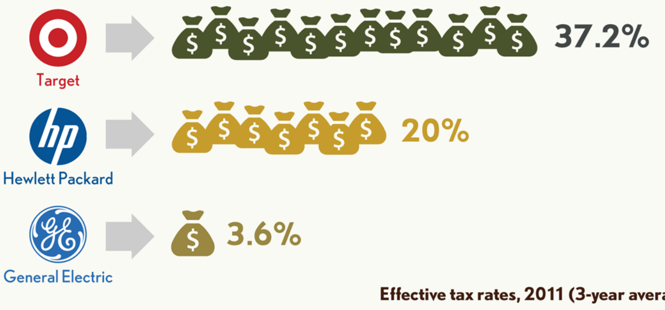


But because U.S. law allows tax breaks, U.S. corporations pay an effective tax rate similar to what their international competitors pay.



Foreign profits as percent of total corporate profits, before taxes

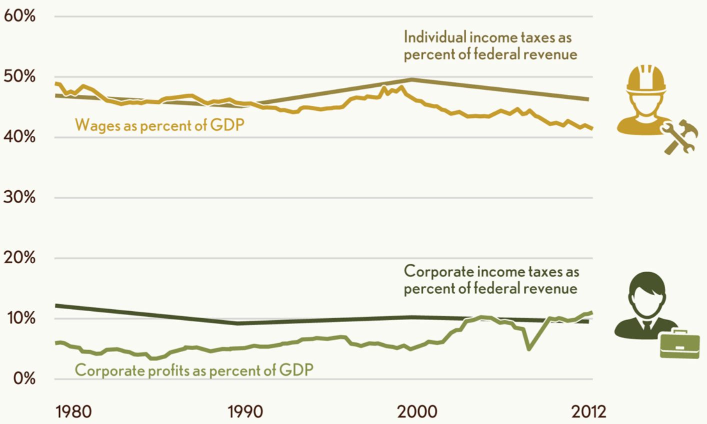
The biggest tax break is for foreign profits, which have been increasing steadily as a share of corporate profits.



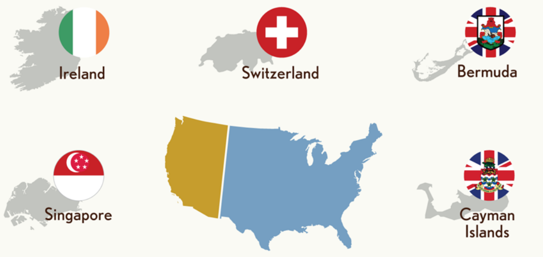
Effective tax rates, 2011 (3-year average)

As a result of these rules, some companies with high foreign profits pay a low tax rate.

Eroding Base



Corporate profits are up and wages are down, yet there has been little change in the relative tax burden between individuals and corporations.

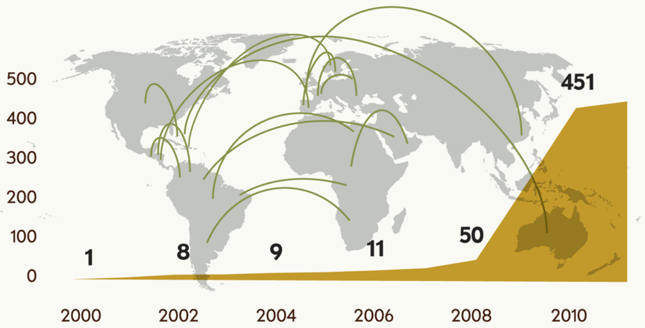


Tax havens make up
1%
of the world economy...

...but hold
24%
of U.S. corporate foreign profits.

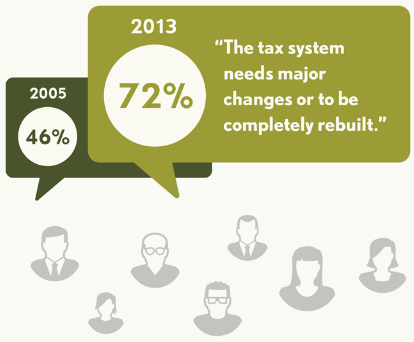
U.S. tax law creates incentives for U.S. firms to record profits in foreign tax havens rather than to reinvest those profits in the U.S. economy.

Future Opportunities



Number of tax information–sharing agreements signed annually

Through tax agreements, the developed world is trying to crack down on tax avoidance.



The public is increasingly in favor of a tax-code overhaul.

Renewing America *Ideas and initiatives for rebuilding American economic strength from the Council on Foreign Relations*

COUNCIL on FOREIGN RELATIONS

SOURCES—statutory tax rates (weighted): OECD; effective tax rates (weighted): Gravelle, "International Corporate Tax Rate Comparisons and Policy Implications"; foreign profits tax rate: Costa and Gravelle, "Taxing Multinational Corporations" and U.S. Bureau of Economic Analysis; tax burden: Federal Reserve Bank of St. Louis and Office of Management and Budget; tax havens: Sullivan, *Corporate Tax Reform*; tax agreements: OECD; public opinion: Pew.

See the full report at
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INTRODUCTION

The way the United States taxes its corporations is outdated. The "statutory" U.S. corporate tax rate, which is the official rate before any tax breaks are applied, is the highest in the developed world and has remained largely unchanged for three decades. Unlike most other developed countries, the United States has a "worldwide" tax system through which it taxes foreign profits. Yet the tax code allows corporations to defer these taxes if foreign profits stay abroad. Congress has also approved a number of tax breaks to encourage certain corporate decisions, such as capital investment or research and development (R&D). Over the past three decades, these breaks have grown more generous and the share of profits earned abroad has increased so that the "effective" tax rate U.S. corporations actually pay has been steadily declining.

One consequence is that, even with the rich world's highest corporate tax rate, the United States does not raise as much corporate tax revenue as most other rich countries. And while U.S. corporate profits have reached record highs, the share of federal tax revenues coming from corporate taxes remains at historic lows. The high tax rate at home, combined with the deferral for overseas profits, also encourages corporations to hold profits abroad in lower-tax countries rather than returning the money to the United States for investment or distribution to shareholders. Some corporations are also able to shift profits so they appear to have been earned in offshore tax havens. Finally, individual corporations pay highly uneven tax rates depending on whether they qualify for these tax breaks, with research-intensive multinational companies paying much lower rates, for example, than domestic retailers.

Long-term government inaction is mostly to blame. The way the United States taxes foreign profits was established in the 1960s. The last major tax overhaul was in the mid-1980s. While the U.S. government has stood still on corporate tax reform, most advanced countries have been lowering corporate tax rates, reducing tax breaks, and changing how they tax foreign profits.

Both political parties and President Barack Obama agree on the general contours of a likely reform that would move the tax system in the right direction: cutting the corporate rate, broadening the base, and taxing foreign profits differently. This year, House Ways and Means Committee chairman David Camp (R-MI) released the most detailed and ambitious tax reform proposal in decades. However, the congressional leadership has said comprehensive tax reform is off the table at least until after the 2014 midterm elections. But since Americans increasingly support a tax overhaul, there may be growing political payoffs for politicians who can deliver tax reform.

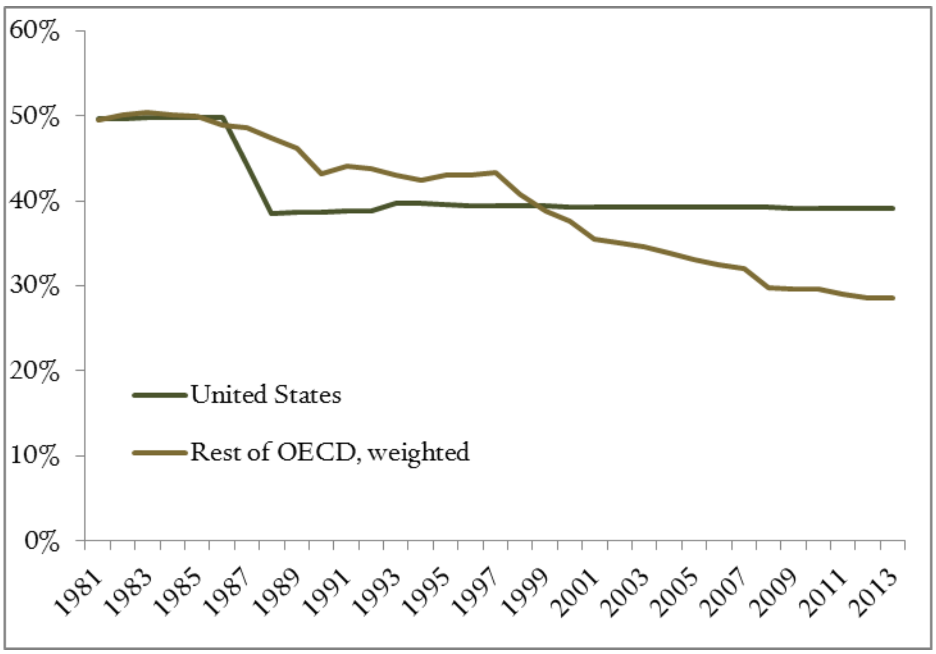
WHERE THE UNITED STATES STANDS

An ideal corporate tax system strikes the right balance among seemingly competing objectives. Policymakers who are concerned about competitiveness usually favor lower corporate taxes. Taxes slice into profits that could otherwise go toward productive investments, shareholder dividends, or employee wages. Corporations work to minimize their tax burden in order to maximize their profit margins and outcompete rivals. Countries want their corporations to be as competitive as possible; if a country's corporate taxes are high by international standards, their corporations are at a disadvantage. Countries also want to make sure they remain attractive destinations for corporations to locate, invest, and employ workers, and high taxes can affect those corporate decisions. But corporate taxes also pay for services—infrastructure, an educated workforce, stable rule of law—that corporations need to flourish. At the same time, under the current system, some types of companies pay high federal taxes while others pay scarcely any at all.

High Statutory Tax Rate, but Average Effective Tax Rate and Below-Average Revenues

Within the rich world, the United States has the highest statutory corporate tax rate. The federal rate is 35 percent and the average state rate is 4 percent, adding up to a 39 percent total tax rate. The United States had one of the lower statutory corporate tax rates in the world the last time the rate was significantly cut in 1986. But while the U.S. rate has remained flat, other countries have been lowering their statutory rates over time (see Figure 1).

Figure 1. U.S. Statutory Corporate Tax Rate Versus Rest of the Organization for Economic Cooperation and Development (OECD), weighted



Source: OECD.

U.S. corporations, however, seldom pay the full statutory rate. Corporations can claim tax breaks that lower the effective tax rate, which is the rate they actually pay. When comparing effective tax rates, U.S. corporations on average pay closer to 27 percent, which is roughly on par with what other corporations pay in similarly advanced economies.[1]

Yet the United States collects relatively little corporate tax revenue. Statutory rates are lower in the rest of the OECD, yet those countries raise more corporate tax revenue—2.8 percent of gross domestic product (GDP) on average in 2009 compared to the United States' 1.9 percent.[2]

Low Tax Rate on Rising Foreign Profits

The United States stands apart most from other developed countries in the way it handles foreign profits. All corporations have to pay the local corporate tax rate in the countries in which they are doing business. For U.S. corporations, those same foreign profits are, at least in theory, subject to U.S. federal taxation. Taxing foreign profits is usually referred to as a "worldwide" tax system. The majority of rich countries are moving toward more "territorial" tax systems under which they exempt most foreign profits from taxation. Many U.S. corporations claim this creates an unfair playing field abroad since foreign competitors, in theory, face a lower overall tax burden.

Yet, in practice, U.S. corporations rarely pay much in U.S. taxes on foreign profits because they receive a credit for taxes paid abroad and are allowed to defer tax payments as long as those profits are retained abroad. The U.S. tax is only levied if and when profits are repatriated to the United States. As a consequence, U.S. corporations keep most of their foreign profits abroad—as much as $2 trillion is currently retained offshore.[3]

Even including taxes paid to foreign governments, U.S. corporations face a lower overall tax burden on foreign profits than they do on domestic profits. The best available estimate suggests U.S. corporations face an effective tax rate (including all foreign and U.S. taxes) of just 15.7 percent on their foreign profits.[4] The U.S. government collects only 3.3 percent in taxes on those profits.[5]

Table 1. U.S. Corporate Tax Rates Compared

Statutory tax rate*	39.1 %
Average effective tax rate (i.e., what U.S. corporations actually pay)	
…on *all* profits**	27.1 %
…on *foreign* profits, including foreign and U.S. taxes***	15.7 %
…on *foreign* profits, only U.S. taxes***	3.3 %

Sources: *OECD (2013), **Gravelle (2012), ***Gravelle (2011).

Foreign profits have been steadily increasing so that in the 2000s they constituted close to 20 percent of all U.S. corporate profits, double their share in the 1970s. Primarily because of this, the average effective corporate tax rate paid by U.S. corporations has been *steadily declining*—even though the U.S. statutory rate has remained essentially unchanged for three decades.[6]

Huge Variation in Tax Rates for Individual Corporations

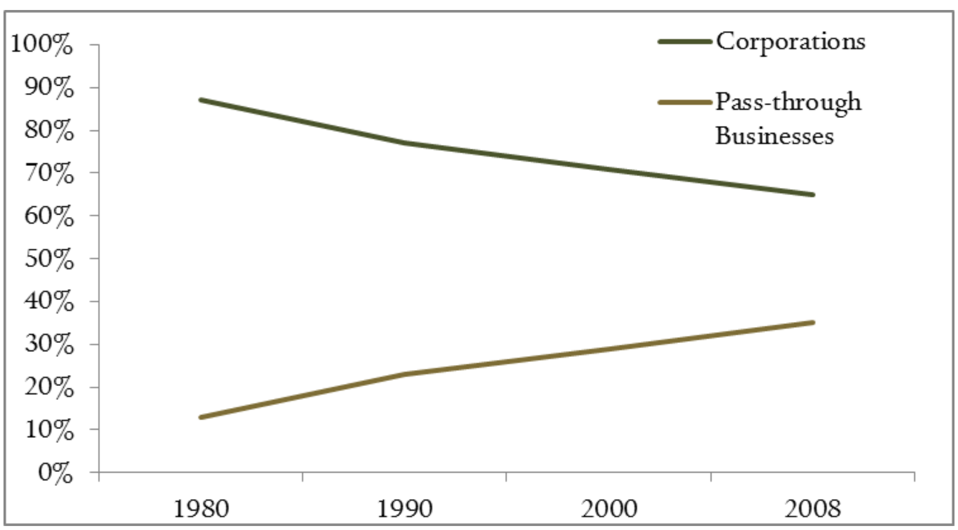
But, like the statutory tax rate, the average effective tax rate is a misleading indicator because it hides the tremendous variation in what individual U.S. corporations actually pay due to tax breaks. In the United States, the largest tax break is the deferral on foreign profits, followed by accelerated capital depreciation, the domestic production credit, and the R&D credit. The share of corporate profits coming from abroad has grown steadily, making the deferral tax break more substantial now than in the past. The remaining three big-ticket credits have also grown more generous in the 2000s.[7] Taken together, these credits benefit, for example, manufacturing, technology, or exporting companies more than retail companies. Thus, in the late 2000s, General Electric, which has large capital and R&D investments and earns large foreign profits, paid an average of just 3.6 percent over three years, while Target, whose sales are heavily retail and domestic, paid 37.2 percent in taxes.[8] A generation ago, the gap in effective tax rates was narrower.

Different tax rates for different types of corporations are not always a bad thing. Some tax breaks correct for market failures. Many economists argue, for example, that businesses involved in R&D generate more benefits for society than retail businesses. And because R&D is highly speculative, or carries substantial costs and risks for businesses, these businesses would underspend on R&D if it were not for government subsidies like the R&D credit. The tricky part is finding the right subsidy level and keeping it well targeted. The R&D credit could be better targeted.[9] More corporations (and small businesses) are claiming the credit and reaping larger breaks. Yet too many normal business expenses are leaking into R&D credit claims that should only include truly scientific and technological research. The merit of specific tax breaks aside, the larger question is whether society is benefiting enough to justify the hugely uneven tax rates that exist between corporations like General Electric and Target.

More Noncorporate Profits

There has also been huge growth in business activity in firms that do not pay corporate taxes. The corporate tax is essentially a tax on big business. Only about 15 percent of U.S. businesses file as corporations, and among these, a tiny proportion pays the lion's share of all corporate taxes. In 2008, approximately 83 percent of all corporate taxes came from the 0.1 percent of corporations that earned over $250 million in profits.[10] Conventional corporations (called "C" corporations for tax purposes) still make up the majority of the country's business receipts. But their share is down from what is was in 1980, while an increasing share is made up of businesses whose profits can "pass through" to lower individual tax rates (see Figure 3).

Figure 3. Share of Total U.S. Business Receipts, Corporations Versus Pass-through Businesses



Source: IRS.

The problem is that many of these pass-through businesses closely resemble "C" corporations that are subject to the corporate tax. Policy changes, mostly to help small businesses, have made it easier for firms to enjoy all the benefits of corporate status like limited-liability protection without paying corporate taxes. But today some of these firms are not so small when it comes to profits, particularly "S" corporations. These corporations, which cannot have more than one hundred shareholders, account for most of the business growth in pass-through firms. "S" corporations with annual earnings over $50 million account for roughly 30 percent of all "S"-type corporate revenue.[11] According to one analysis, these firms pay an average tax rate that is 6 percentage points lower than a firm that is subject to the corporate tax.[12] The Congressional Budget Office (CBO) estimates that if all "S" corporations and limited-liability businesses were taxed at the corporate rate, federal revenues in 2007 would have been $76 billion higher.[13] It is not uncommon for other developed countries to have similar rules allowing tax pass-throughs for businesses, but those businesses tend to have much smaller profits and play a smaller role in their economies than in the United States.[14]

More Profit Shifting to Tax Havens

Deliberate tax avoidance by holding profits in tax havens is also eroding the corporate tax base. Corporations can alter profits made in high-tax countries so they appear to have been earned in low-tax countries, a tactic called "profit shifting." Most large countries have statutory corporate tax rates above 20 percent. Tax haven countries tend to be small and have rates far below that. Ireland, for example, has a 12.5 percent corporate tax rate while Bermuda has no corporate tax at all. A U.S. corporation can start a foreign subsidiary in a tax haven for allocating profits, lending money, or housing intangible assets like patents and trademarks. This is especially useful for technology companies like Apple or pharmaceutical companies like Pfizer that rely heavily on intangible income. Corporations can move intangible assets abroad for reasons other than taxes, for example, to align the location of such assets with the markets in which they will be used. But most profit shifting (in dollar volume) occurs through the manipulation of intangible assets.

Profit shifting also contributes to uneven effective tax rates on foreign profits. Corporations relying on intangible assets can drive their overall tax burden on foreign profits down to zero if they are smart about parking those assets in tax havens. But corporations relying on immovable tangible assets, such as oil or mining operations, cannot shift profits to tax havens, and face steep local taxes that are often higher than the U.S. statutory rate.[15]

Such tax avoidance is widespread. The five most popular tax havens account for 1 percent of the global economy, but 24 percent of reported foreign profits by U.S. multinational corporations.[16] The problem is getting worse; the gap has grown over time between the location of U.S. corporate investments and the location of their reported profits.[17] According to a Congressional Research Service report, profit-shifting tax avoidance is estimated to cost the federal government up to $60 billion annually in lost revenue.[18]

This problem is not exclusive to the United States. All major developed countries are facing eroding corporate tax bases because of profit shifting. Though firm statistics are hard to come by, anecdotally at least, U.S. corporations like Apple and Google appear to benefit the most from these tactics.[19] U.S. laws are also more lax when it comes to profit shifting. Countries that have been moving toward territorial tax systems and cutting rates have also been tightening anti-avoidance laws, the United Kingdom being the major exception. If the German government sees that the location of investments and sales is out of balance with reported profits, tax authorities can quickly move to tax the profits in question. Japan recently began taxing profits reported in countries with corporate tax rates below a certain threshold. In Italy, profits are taxed if reported in "blacklist" tax havens. Although it is difficult to know how effective these new anti-avoidance measures are in practice, such policy changes imply that other advanced countries are more serious than the United States about combating profit shifting. In the 1990s and through 2004, the United States actually loosened its foreign profit anti-avoidance rules and has taken few major steps to reverse course to date.[20]

Corporate Tax Burden Is Flat, While Profits Are Up

The share of all federal tax revenues coming from corporate taxes has remained steady since the 1980s, at about 11 percent.[21] The relative tax burden levied on individual tax payers has also been flat. Yet the relative ability for corporations and individuals to pay taxes has moved in opposite directions. Corporate profits as a percent of GDP are at record levels and, except for normal business cycle fluctuations, have been increasing since the 1980s. Wages as a share of GDP have been falling.

COMPETITIVENESS IS NOT THE MAIN PROBLEM

In the popular press and within the business community, the U.S. corporate tax system is often accused of weakening U.S. economic competitiveness. Indeed, in a World Economic Forum (WEF) survey of executives, U.S. respondents ranked taxes as the most problematic factor for doing business in the United States.[22] And according to the WEF's competitiveness index, besides government debt, U.S. performance is ranked poorest on taxes.[23] In a 2011 Harvard Business School survey of ten thousand alumni working in senior business positions, simplifying the tax code was the most-cited recommendation for improving U.S. competitiveness, while reducing U.S. corporate taxes was third.[24]

But other evidence suggests competitiveness is not the main problem with the current corporate tax system. U.S. companies that do much of their business overseas normally pay much less in taxes than corporations that do most of their business within the United States. With such a low effective rate on foreign profits, it is not clear that U.S. corporations operating abroad are facing significant disadvantages compared with competitors based in other countries with territorial tax systems. According to one study that calculated the global tax burden of the largest two hundred European- and U.S.-based multinational corporations, U.S. corporations were no worse off and perhaps even better off than their European counterparts.[25]

In theory, U.S.-headquartered corporations could reduce their tax burden by reincorporating in a country with a territorial tax system, and there are a few cases in which this has happened.[26] But there is little evidence that this is occurring on a large scale, perhaps due to the many avenues already available for reducing tax liabilities.[27] Nor is there any trend toward new companies incorporating abroad. Other factors like lower wages, proximity to fast-growing markets, and government investment incentives are much larger inducements for U.S. corporations to invest overseas than is tax policy.

Although research has indeed found that the U.S. corporate tax rate encourages corporations to invest more abroad than they otherwise would, the effect is relatively small. According to one study, if the U.S. corporate tax rate is one percentage point higher than the rate in another country, U.S. corporations' employment in that country tends to be higher by 1.6 percent and sales higher by 2.9 percent.[28]

The corporate tax does not have a significant influence on overall economic output. Two authoritative studies have projected that lowering the corporate tax rate closer to rates in the rest of the developed world would raise U.S. output by two-tenths to four-tenths of 1 percent of GDP.[29]

THE REFORM DEBATE

The golden rule of tax reform is to lower rates and broaden the base. The two usually go together because of revenue constraints; the lower rates lead to less revenue, and eliminating tax breaks is the most common and politically palatable way to offset the lost revenue. The tax overhaul of 1986 attempted to do just that, and most serious corporate tax reform proposals today share the same approach.

There is growing consensus among economists that, compared to a personal income or consumption tax, the corporate tax is most harmful to investment—and therefore to productivity and economic growth.[30] Critics of the corporate tax argue that it is a "double" tax, since corporate profits are taxed again when they are paid out as dividends. Ideally, taxes would only be applied once to the same income. Many economists would like to do away with the corporate tax altogether and to have all income taxed as individual income or to tax consumption instead of income.

There are important differences in how conservatives and liberals have viewed corporate tax reform. Conservatives tend to want to keep the corporate tax burden low and also worry about how the corporate tax may distort business behavior. Liberals have historically been more comfortable using the corporate tax system to encourage certain economic and business outcomes. Tackling climate change may mean giving a tax break to green energy companies, for example, and tax policy could be used to discourage companies from outsourcing jobs.

Current Proposals

Most of the problems facing the corporate tax system have accumulated from years of inaction on tax policy. The economy has changed, but lawmakers have failed to update the corporate tax system with it. To be sure, lawmakers have contributed to the growing unevenness in tax rates over time by sweetening some big corporate tax breaks for specific industries. But the U.S. corporate tax system has remained largely frozen in time since the last major overhaul in 1986. The rules that govern how to tax foreign profits were written in the 1960s, long before U.S. corporations became true multinational entities and earned large foreign profits, and long before they began shifting intangible assets abroad to tax havens.

The good news is that in theory both Republicans and Democrats favor reforms that would modernize the U.S. corporate tax system by lowering rates, broadening the base, and changing how foreign profits are taxed. This would make the system more coherent and effective rates more even, as well as bring the United States closer in line with other rich countries. And policymakers from both sides of the aisle want to curtail profit shifting, so that corporations like Apple would not be able to shift as much money to tax havens. One of the biggest differences is that the main proposals in Congress favor revenue-neutral comprehensive reform, while President Obama favors generating additional revenue.

The bad news is that for now there is little political will to push through a tax overhaul that would require harsh trade-offs in repealing coveted tax breaks to pay for rate cuts.

The Camp Plan

In early 2014, Representative David Camp, House Ways and Means Committee chairman, released a proposal for redoing the entire federal tax code. If enacted, it would constitute the most sweeping tax reform since 1986. It would lower the federal statutory corporate rate to 25 percent, putting the U.S. rate closer to the OECD average. The proposal, which will be revenue-neutral within ten years, would eliminate most of the biggest corporate tax breaks, including accelerated depreciation and the domestic production credit. A new hefty tax would be placed on banks, and some pass-through businesses would see their tax bill go up. For foreign profits, it would move the country toward a more territorial system. Most foreign profits would be exempt from taxation, but there would also be stronger anti-avoidance rules—such as placing a minimum tax on foreign intangible (i.e., patent or trademark) income and limiting the amount of money that could be borrowed on behalf of a foreign subsidiary. Existing foreign profits retained abroad would be subject to a one-time "toll" tax at a lower rate, and those revenues would be used to fund highway maintenance and construction. In a big change from previous Republican proposals, the Camp plan raises the overall tax burden on corporations to pay for even larger rate reductions among individual taxpayers.

The Obama Plan

President Obama laid out his tax plan in his FY15 budget request. It proposes lowering the corporate rate less than Camp's plan, moving it from 35 percent to 28 percent, which would still leave the U.S. rate the third-highest in the OECD behind Japan and France. The Obama plan would also repeal accelerated depreciation and levy more taxes on banks and pass-throughs. But compared to Camp's plan, Obama would repeal fewer big tax breaks. The domestic production credit, for example, would remain. Obama's plan, like Camp's, would place a one-time tax on unrepatriated foreign profits to be used on infrastructure and would strengthen anti-avoidance rules. But it would also strengthen the existing worldwide tax system instead of shifting to a territorial system; accounting metrics would be tweaked so that the share of foreign profits that cannot be deferred—and therefore would be subject to domestic taxation—would increase. And Obama included provisions making it harder for U.S. corporations to reincorporate in another country. Though it is unclear if his FY15 budget request would increase the tax burden on corporations, it would raise more revenue from corporate taxes than any of the previous budget requests Obama has submitted to Congress during his presidency.

The Baucus Plan

The most prominent tax reform proposal offered by a congressional Democrat is the one penned in 2013 by Senator Max Baucus (D-MT) before he stepped down as chair of the Senate Finance Committee earlier this year. It closely mirrors Obama's plan. The main differences are that it claims to be revenue-neutral by ten years out, would place a higher toll tax on existing foreign profits, and would replace deferral on foreign profits with a minimum tax of either 18 or 24 percent.

The Camp, Obama, and Baucus proposals, all unveiled this year, represent real progress on the road to corporate tax reform. To be sure, to date none have made it far in the legislative process; the congressional proposals are just "draft" documents and Obama's recent presidential budget requests have not had much of an effect on Congress's actual budget decisions. And congressional leadership from both parties has said comprehensive tax reform is not possible until at least after the midterm elections in 2014.[31] Few Republicans have publically supported the Camp proposal, if even just in principle. But compared to other proposals released during Obama's tenure, these are far more comprehensive and detailed, and more accurately lay out the arithmetic for adopting different tradeoff options in any tax reform agreement. When Republican House speaker John Boehner called Camp's proposal "the beginning of the conversation" on tax reform, that is no small feat after an era when tax reform has been a third rail of politics.[32]

The politics are understandably hard. Rate cuts may be a relatively easy sell, but rolling back major tax breaks to pay for it is not. For example, policymakers across the political spectrum champion the cause of U.S. manufacturing. But since manufacturing has been a winner with the current tax breaks, any reform of the corporate tax system would likely hurt that sector. And since manufacturing is the sector of the economy most subject to international competition, it would be difficult to sell a tax increase on manufacturers as somehow "pro-competitive." The R&D credit is also popular with the public and economists generally believe it generates substantial spillover benefits for the U.S. economy. There are huge benefits to the depreciation tax credit, too. A 2007 Treasury report argued its repeal may actually harm investment in the long run and would offset any advantages of lowering the statutory rate.[33] Domestic investment in the United States has been weak over the past decade, which would argue for continuing to encourage investment through the tax system.[34]

The difficult arithmetic and politics make tax reform a delicate dance. Case in point is the less-than-warm reception of Camp's proposal, which rolled back nearly all the big-ticket tax breaks to pay for the 25 percent rate cut. But without repealing them, using base-broadening to pay for rate cuts is all but impossible. Repealing them would touch off an epic battle with certain corporate interests. If any corporate tax reform has to be revenue-neutral, there are few politically easy options to broaden the tax base.

Other Policy Ideas

Tax Holiday

Corporations have pushed for a tax holiday that would allow them to voluntarily repatriate foreign profits housed abroad. This is different from the congressional and presidential proposals, which would set a mandatory tax on all unrepatriated profits. Policymakers temporarily lowered the tax rate on foreign profits to 5.25 percent in 2004, with the expectation that corporations would use the repatriated money for new domestic investment and job creation. But instead, firms mostly used the tax holiday to increase dividends for shareholders.[35] The companies that benefited the most actually cut their employment rolls the following year. There are also concerns that another holiday could set a dangerous precedent by which corporations would park more profits abroad awaiting the next repatriation holiday. One possibility, proposed by Congressman John Delaney (D-MD), is to allow voluntary repatriation of foreign profits at lower tax rates only if those profits are used to buy infrastructure bonds, which could fund job-creating construction and infrastructure upgrades.[36]

Formula Apportionment

Another policy option is to tax profits based on a formula indicating where corporate spending takes place instead of where profits are reported. To give a rough example, if 20 percent of a corporation's payroll expenses and investments are located in the United States, the U.S. government would tax 20 percent of its global profits. Though no federal policymaker has endorsed the method, several U.S. states use formula apportionment to calculate corporate taxes for business activity within their borders. The European Union has been taking steps to adopt formula apportionment for internal business activity as well. A different possibility is to tax foreign profits only in countries with tax rates below a certain level, as Japan is doing.

National Consumption Tax

The United States is the only advanced country without a national consumption tax, the most common form being a sales or value-added tax (VAT). Sales taxes in the United States have historically been the preserve of state and local governments, and they have resisted a national sales tax for fear that it would cannibalize their tax revenues. Many small-government conservatives are also opposed to creating a new federal tax instrument. Other advanced countries rely much more on consumption taxes to raise tax revenue. Including all excise and state and local sales taxes, consumption taxes raise just 15 percent of all U.S. tax revenue.[37] In the rest of the OECD, the share is twice that. Under world trade rules, VATs could also be rebated when a company exports from the United States, offsetting any competitive disadvantage from the additional tax burden. One of the biggest challenges with corporate tax reform is finding enough revenue to offset rate cuts, and a VAT could help make up the difference.

International Cooperation on Information Sharing and Transparency

Some tax scholars are skeptical that any anti-avoidance provisions or rate reductions will make a real dent in profit shifting. Corporations with armies of highly paid tax lawyers will find ways to exploit tax rate and policy differences. Even if Congress found a revenue-neutral way to lower the federal rate to 25 percent, the U.S. national rate would still be more than twice the Irish rate, for example. And if the United States lowers rates, other countries may respond by lowering their rates further, as they did the last time the U.S. federal government cut corporate rates in 1986.

But no large advanced country wants a race to the bottom in corporate tax rates. One response has been new efforts by countries to cooperate through tax information exchanges and transparency. Tax transparency makes profit shifting more visible. Policymakers would then have the political leverage to strengthen anti-avoidance provisions. Tax auditors would have the public backing to be more aggressive. And image-conscious corporations might be compelled to change their ways.

This is similar to what happened with Starbucks in the United Kingdom. The company had not paid any taxes in the United Kingdom for five years until its tax-avoidance strategies made front-page news and sparked a consumer boycott. In 2013, Starbucks announced it would be paying British taxes to console consumers.[38] Amid the public furor, conservative prime minister David Cameron promised to crack down on such avoidance.[39] When the UK occupied the rotating Group of Eight (G8) presidency, Cameron put corporate tax avoidance at the top of the agenda and instructed the OECD to do more to combat it.

The OECD has been leading the charge on tax transparency for some time. In the 1990s, it began identifying and exposing harmful tax practices. In 2009, it expanded its efforts to include a review of each country's tax system to evaluate the legal and regulatory framework, including transparency of tax calculations and payment information. One hundred and twenty countries are now participating in the review process. Under international pressure, all major tax havens have agreed to share tax information with higher-tax countries. The number of bilateral tax information–exchange agreements signed has soared, which allow countries to request information to verify their corporations' business dealings abroad, including bank statements, interest payments, and employee wages.[40] As recently as

2008, only a handful of these agreements were signed per year. Today that rate is several hundred per year.

In 2013, the Group of Twenty (G20) tasked the OECD to come up with an explicit plan on how to tackle profit shifting. At the kickoff meeting, the leader of this OECD project claimed the "golden era" of international corporate tax avoidance was coming to a close.[41] That may be wishful thinking, but more transparency will certainly help policymakers keep closer tabs on where and how corporations are reporting their profits.

The U.S. system could benefit from more transparency. The U.S. Internal Revenue Service already has reams of data that collectively could shed light on U.S. corporate profit shifting. But the information is not systematically analyzed or made publicly available. Just this past year, the European Union passed legislation requiring public disclosure of corporations' country-by-country profit and tax information.

CONCLUSIONS

Congress may be shelving tax reform for now, but there also may be growing political payoffs for politicians who can deliver it. Corporate tax avoidance has attracted more media attention, most notably after Apple CEO Tim Cook testified in front of a Senate panel, trying to defend the highly successful U.S. company against accusations of "tax gimmickry."[42] Although few Americans understand the complexities of corporate tax rules, 72 percent of Americans say the nation's tax system needs major changes or should be entirely reconstructed, a substantially higher share than the 24 percent who said so in 2005. It is an opinion equally shared among Republicans, Democrats, and all demographic groups.[43]

While working together on the congressional "supercommittee" in 2011, the two heads of the major tax-writing authorities in the House and Senate said the greatest common ground on major tax code revisions was on corporate taxes. Congressional leadership changes in the coming year also auger well for reform, particularly with Senator Ron Wyden (D-OR) taking over from Senator Baucus to chair the Senate Finance Committee. Wyden is a seasoned tax-policy expert with a keenness for detail.

The general contours of a likely reform have been drawn—cutting corporate rates, evening out effective rates, and taxing foreign profits differently. But there are still difficult political compromises ahead before the United States can move forward on corporate tax reform.

Endnotes

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