Senate Committee on Finance
U.S. Senator Orrin Hatch (R-UT), Ranking Member
http://finance.senate.gov

FOR IMMEDIATE RELEASE September 8, 2011

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HATCH STATEMENT AT FINANCE COMMITTEE HEARING EXAMINING EFFECTIVE SOLUTIONS FOR INTERNATIONAL TAX REFORM

WASHINGTON – U.S. Senator Orrin Hatch (R-Utah), Ranking Member of the Senate Finance Committee, today delivered the following opening statement at a committee hearing examining effective solutions for international tax reform:

I would like to thank Chairman Baucus for calling this hearing today.

Working our way through the thicket of the international tax system is a critical step on the road toward comprehensive tax reform.

The United States international tax system dates back to the period between 1918 and 1928. As part of the Revenue Act of 1918, the United States became the first country to enact a system in which income taxes paid to a foreign country on income earned outside of the United States could be credited against U.S. income taxes. And ten years after that, in 1928, the League of Nations introduced draft model income tax treaties, the basis of which are still used today by the United States.

Well, a lot has changed since the 1920s.

At that time, the United States had been the world's largest economy for only about 30 years, having surpassed Great Britain in 1894. Today, the United States still has the world's largest economy, but just last year China supplanted Japan as the world's second largest, with predictions that China's economy will approach the size of the U.S. economy within 20 years.

Throughout the 1920s, the U.S. was running budget surpluses. Today, of course, the United States is running huge budget deficits.

In the 1920s, in the aftermath of World War I, the United States was a net creditor nation. By the mid-1980s, the United States became a net debtor nation — a status that it retains today.

During the 1920s, federal revenues averaged about four percent of GDP. In recent history, from 1971 to 2010, revenues have averaged 18 percent of GDP.

Yet despite the changes that have taken place in the United States and around the world since the 1920s, the basics of our international tax system have pretty much remained the same for over 80 years.

In any discussion of international tax reform, the fundamental issue remains unchanged. When income is earned in one country by a resident of another country, both the country where the income is earned and the country where the resident resides have legitimate claims to tax the income. Some tax scholars have referred to this issue as "the essential dilemma of international taxation." Arguably, one of the basic goals of an international tax system is to resolve the competing claims of the source country and the residence country in order to avoid the double taxation that can result when both countries exercise their taxing powers.

In the 1960s, the competing international tax theories of capital export neutrality and capital import neutrality were developed. *Capital export neutrality* occurs when the overall burden of taxation on capital owned by residents of a particular country is the same whether that capital is invested at home or abroad. Capital export neutrality has generally been associated with worldwide taxation coupled with a credit for foreign income taxes.

In contrast, the theory of *capital import neutrality* holds that the international tax system should have equal tax treatment for all capital invested within a particular country regardless of the residence of the investor.

Capital import neutrality has generally been associated with territoriality – the idea that a particular country, as a general rule, should only tax income earned within its borders. Other international tax theories have developed over time, including the theory of *national neutrality* emphasizing the importance of American economic well-being in tax policy and, more recently, the theory of *capital ownership neutrality*, the goal of which is to have tax rules that do not distort ownership patterns.

Today, we are reading and hearing about some of the tax issues that U.S. multinational corporations face when doing business abroad — issues that many believe are due to our outdated international tax system. To illustrate, many U.S. multinational corporations earn money overseas, and typically want to bring that money back home to the United States. However, our international tax system discourages, and some would say penalizes, U.S. multinational corporations from repatriating foreign earnings by imposing a 35 percent residual U.S. tax at the time of repatriation.

As a result, several high-profile U.S. multinational corporations are sitting on large piles of cash earned from foreign operations. Yet these same corporations are actually borrowing money. One of the reasons for this borrowing is that their cash is trapped offshore, and these corporations will be subject to a 35 percent U.S. tax for repatriating their cash back to the

United States. One way of alleviating the problem of cash that is trapped offshore is for the U.S. to reform its international tax rules by, for example, adopting a territorial tax system.

I am very interested to hear what our witnesses have to say today with regard to our international tax system and how reform of the system will advance the goals of simplicity, fairness, and economic growth, while increasing the competitiveness of US companies. In the modern global economy, we simply cannot afford to perpetuate policies that put *our* companies at a competitive disadvantage. We need to recognize that the world has changed, and we need to institute a tax system that will encourage companies to locate in our great nation.

We certainly do not need to place those that do so at a competitive disadvantage.

Again, Chairman Baucus, thank you very much for this important hearing, the latest in a series of critical discussions about tax reform.

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