STATEMENT OF PAMELA F. OLSON
TO THE SENATE FINANCE COMMITTEE
ON BUILDING A COMPETITIVE US INTERNATIONAL TAX SYSTEM

March 17, 2015

Chairman Hatch, Ranking Member Wyden, and distinguished members of the Committee, I appreciate the opportunity to appear this morning as the Committee considers the importance of ensuring that our Nation's tax laws serve to make the United States competitive globally. I had the honor of serving as Assistant Treasury Secretary for tax policy from 2002 to 2004, and am currently US Deputy Tax Leader of PricewaterhouseCoopers LLP and leader of PwC's Washington National Tax Services practice. I am appearing on my own behalf and not on behalf of PwC or any client. The views I express are my own.

Introduction

The subject of this hearing is the legislative actions necessary for a competitive US international tax system, and I applaud the Committee for holding the hearing. It is my view that reform of our international tax rules is imperative to promoting the economic growth that will yield increased job opportunities and higher wages for the American people. Our tax system should serve to facilitate, not impede, the efficient, effective, and successful operation of American businesses in today's global marketplace. Success for America's globally engaged businesses is essential to the success of their workers as well as the many businesses on which they depend for goods and services. Unfortunately, it is increasingly the case that the divergence of our current tax system from the systems of the rest of the world makes it a barrier to their success and drives business away.

My testimony is focused on tax policy issues specific to making the United States a more hospitable environment for headquartering global operations and for domestic investment, both of which will lead to more American jobs and a rising standard of living. My testimony describes changes in the global economy that make international tax reform vital, changes in other countries' tax systems, the features of our tax system most in need of reform, and the implications and risks to the United States and US businesses of the global effort to address base erosion and profit shifting (BEPS) led by the Organisation for Economic Cooperation and Development (OECD).

A changing global economy

The changing global economic landscape must set the stage for considering the tax reforms necessary for American business to compete and succeed. But first some background is useful on the age of our international tax framework. Since the inception of the income tax in 1913, the United States has taken a worldwide approach to taxing the foreign income of US companies and their subsidiaries. Shortly after enactment, Congress added a foreign tax credit to reduce the adverse economic impact of a second layer of tax on foreign income. Limitations on the foreign tax credit soon followed. The general rule is that foreign income is subject to US tax only when it is repatriated to the United States, but there are many exceptions that dictate current US tax on foreign income. Those exceptions are found in subpart F of the Internal Revenue Code and date to 1962. Although a number of changes have been made to the subpart F rules over the last 50 years, the rules remain locked in a time when global business operations differed significantly from today. Congress' reform of the rules to reflect changes in the global economy, such as the exception for active financing income, has been limited and temporary. We have a tax system designed for rotary phones and telephone operators while we carry smartphones with

1000 times the processing power of the Apollo Guidance Computer that put man on the moon. The 21st century is calling. The rest of the world has answered and enacted a tax system that fits it. It is time we did the same.

The global economy has changed enormously since 1962. Globalization – the growing interdependence of countries' economies -- has resulted from increasing international mobility and cross-border flows of trade, finance, investment, information, and ideas. Technology has continued to accelerate the growth of the worldwide marketplace for goods and services. Advances in communication, information technology, and transportation have dramatically reduced the cost and time it takes to move goods, capital, information, and people around the world. In this global marketplace, firms differentiate themselves by being nimble around the globe and by innovating faster than their competitors.

The US role in the global economy has changed as well over the last 50 years. In 1962, the United States was the dominant economy, accounting for over half of all multinational investment in the world. US dominance has diminished as the significance of the rest of the developed world in the global economy has grown. In recent years, there has been a massive shift in economic power to emerging markets. PwC projects that the combined GDP of G7 countries including the United States will grow from $29 trillion in 2009 to $69.3 trillion by 2050, while the combined GDP of seven emerging economies (the E7) that include China, India, and Brazil will grow from $20.9 trillion to $138.2 trillion over the same period.

The changing US role reflects less the waning of the US economy than the rapid rise from poverty of the most populous parts of the globe. As President Obama noted in his State of the Union address, 95 percent of the world's customers live outside the United States. That represents more than 80 percent of the world's purchasing power. US businesses can't serve those rapidly growing markets by staying home. Facilitating US businesses in serving those markets increases the value of the assets of American businesses and leads to increased American jobs.

To thrive in the changing global marketplace, it is critical that we ensure our international tax system promotes the competiveness of US business in the global marketplace. A tax system that allows US companies to serve foreign markets more effectively will translate to increased success for American businesses, increased American jobs, and higher wages.

Today, there are few US-based businesses unaffected, directly or indirectly, by the operation of the US international tax rules. Advances in communication, information technology, and transportation have opened the global marketplace to small and medium sized businesses along with large globally engaged business. Businesses operating domestically provide goods and services to other businesses operating internationally. According to a recent study, the typical US multinational business in 2008 bought goods and services from 6,246 American small businesses; collectively US multinationals purchased an estimated $1.52 trillion in intermediate inputs from American small businesses.[1] Further, many small and medium sized businesses have their own direct foreign operations. Commerce Department data show that 26 percent of US multinational businesses meet the US government definition of a small or medium sized business.[2] The result is that all businesses, whether large or small, benefit from a tax

[1] Matthew J. Slaughter, "Mutual Benefits, Shared Growth: Small and Large Companies Working Together," a report prepared for the Business Roundtable, 2010.
[2] Matthew J. Slaughter, "American Companies and Global Supply Networks," prepared for the Business Roundtable, 2013.

system that promotes the global competitiveness of American businesses, and their success is linked to a strong global economy.

A globally competitive tax system is critical not only for US-headquartered companies to succeed but also to attract continued investment by foreign-headquartered businesses in the United States. Today the US operations of foreign companies employ 5.8 million American workers and account for 21.9 percent of all US exports of goods.[3] Tax policies that attract foreign capital to the United States will create American jobs and should be part of building a competitive US tax system.

A Changing Global View of Corporate Taxes

When the United States had a dominant role in the global economy, we were free to make decisions about our tax system with little regard to what the rest of the world did. As a practical matter, our trade partners generally followed our lead in tax policy. That is no longer the case.

Just as the global economy has changed, tax systems around the world have evolved. Governments in the developed and developing world have adopted policies that reflect a changing view of corporate income taxes. This changing view may have been occasioned by economics or practicality, but as discussed below, the result is a growing gap between the United States and the rest of the world.

In recent decades, the share of GDP attributable to intangible assets, such as patents, knowhow, and copyrights, has increased substantially. Unlike property, plant, and equipment, intangible assets are highly mobile and more likely to be exploitable on a global basis, increasing their value. This shift has been accompanied by the reorganization of economic activity around global value chains and strategic networks that flow across national borders. It has been estimated that roughly one-third of world trade takes place within multinational companies.[4] Trade between related parties accounted for 47% ($172 billion) of total EU-US merchandise trade in 2002 and increased to 50% ($307 billion) by 2012.[5]

The rise in the value of intangibles and the interconnected nature of the global economy leads to two points. The first point is that it is more difficult today to measure income earned within a country's borders and to tax it. Manuel Castells observed that:

> [A]s accounting of value added in an international production system becomes increasingly cumbersome, a new fiscal crisis of the state arises, as the expression of a contradiction between the internationalization of investment, production, and consumption, on the one hand, and the national basis of taxation systems on the other.[6]

As a practical matter, other countries have dealt with this issue by relying more heavily on consumption based taxes, such as value-added or goods and services taxes, that are applied to a tax base that is more easily measured and less mobile, to fund the government.

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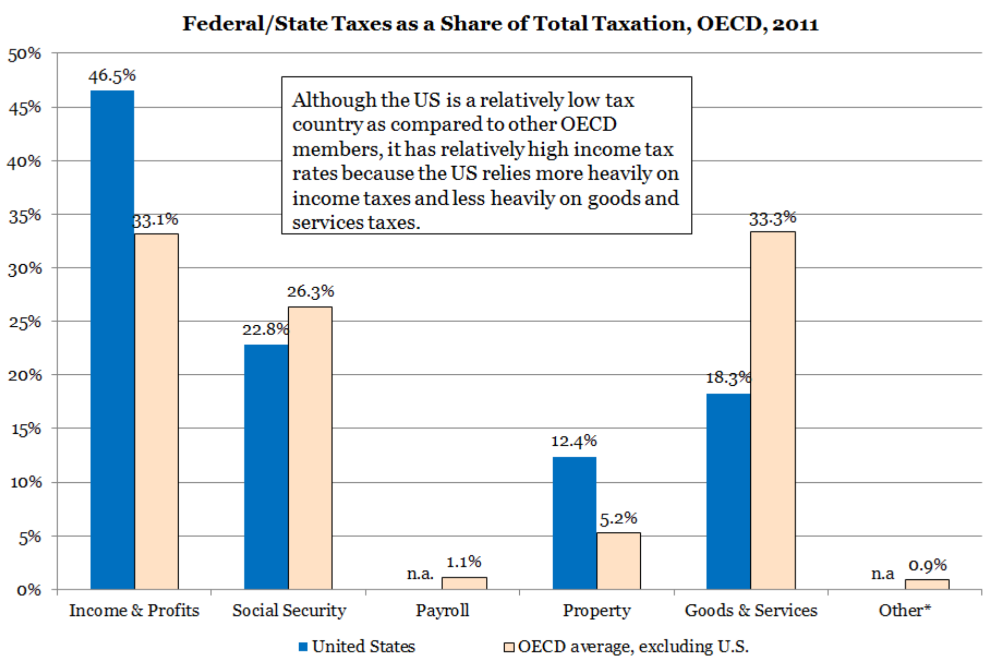
[3] US Department of Commerce, Bureau of Economic Analysis, November 2014.
[4] Pol Antràs, "Firms, Contracts, and Trade Structure," Quarterly Journal of Economics (2003), p.1375.
[5] C. Lakatos and T. Fukui, "EU-US Economic Linkages: The Role of Multinationals and Intra-firm Trade," Trade, Chief Economist Note, Issue 2, European Commission (2013).
[6] Castells, *The Power of Identity, The Information Age: Economy, Society, and Culture, Vol. II* (2nd ed., 2010), p.306.

The second point is tied to the rise in economic power of the rest of the world, which has broadened and deepened the markets in which capital can be raised and profitably invested. Capital is mobile. It is more easily deployed in a globally interconnected economy where much of the value comes from intangible assets that are also mobile.

Many foreign governments have recognized the global mobility of capital and intangible assets and have come to view business income taxes as a competitive tool that can be used to attract investment. By reducing statutory corporate income tax rates, adding incentives for research and development, innovation, and knowledge creation, and adopting territorial systems that limit the income tax to activities within their borders, governments have sought to attract capital that will yield jobs, particularly high-skilled jobs for scientists, engineers, and corporate managers. They've recognized the benefits that flow from making their country hospitable to investment from globally engaged businesses. These benefits include the creation of sustainable jobs, both directly and through the goods and services the businesses and their employees purchase.

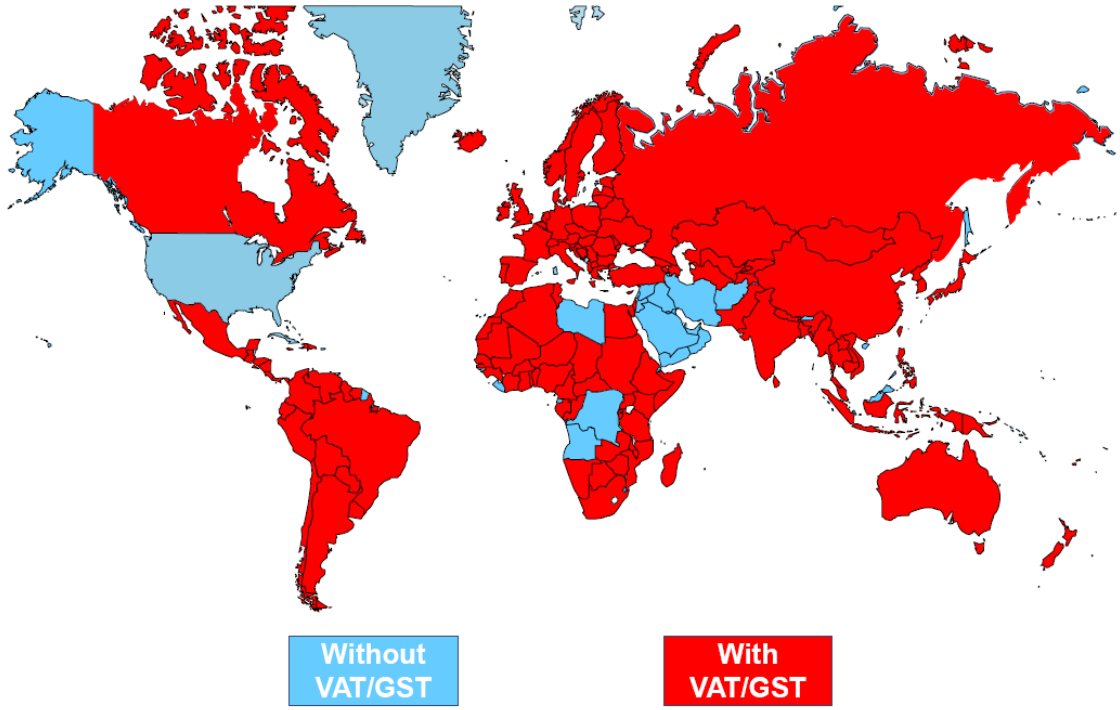
There are other reasons for governments to move away from reliance on the corporate income tax as a significant source of revenue. They include the fact that capital mobility affects the reliability of the corporate income tax and makes proposals to increase taxes on corporate income less likely to succeed. They also include the fact that economists have concluded that consumption-based taxes are the most efficient way of raising revenue, and the corporate income tax the most destructive form. These conclusions appear to have been accepted by foreign governments. Their increased reliance on consumption-based taxes positions them to raise the revenue required to fund government needs on a basis more conducive to economic growth than is the case in the United States.

The extent to which US tax policy is out of sync with the competitive and pro-growth tax policies of other nations can be seen in the chart below which shows the federal government's primary reliance on income taxes in contrast to most of the world's major economies, which rely to a significant degree on consumption taxes.



Source: OECD Revenue Statistics, 2013 Edition.
*Includes customs duties

Reliance on consumption taxes is not limited to OECD countries. Their widespread usage can be seen in the map below.



Although consumption taxes are often criticized as regressive, recent economic studies have concluded that the corporate income tax falls on labor to a significant extent. This has been recognized by economists at the Congressional Budget Office, the Joint Committee on Taxation, and the US Treasury Department. Estimates of the share borne by labor range from 20 percent to 70 percent.

Joseph Sneed observed nearly six decades ago:

> A tax on corporate income at the corporate level has a deep appeal to many people and assertions addressed to them to the effect that they, and not the corporations, pay the tax make little headway against the observable fact that corporate accountants prepare the returns and corporate treasurers write the checks in payment of the tax. To them a tax on corporate income is a tax on corporations which, more often than not in their opinion, are sufficiently evil to deserve their fate.[7]

Despite the economic studies, there continues to be a widespread and persistent perception that the corporate tax is somehow borne by the corporation without effect on its employees, customers, or shareholders, and without impact on its ability to succeed in an increasingly competitive global economy. When considering how to build a competitive international tax system that will create jobs in

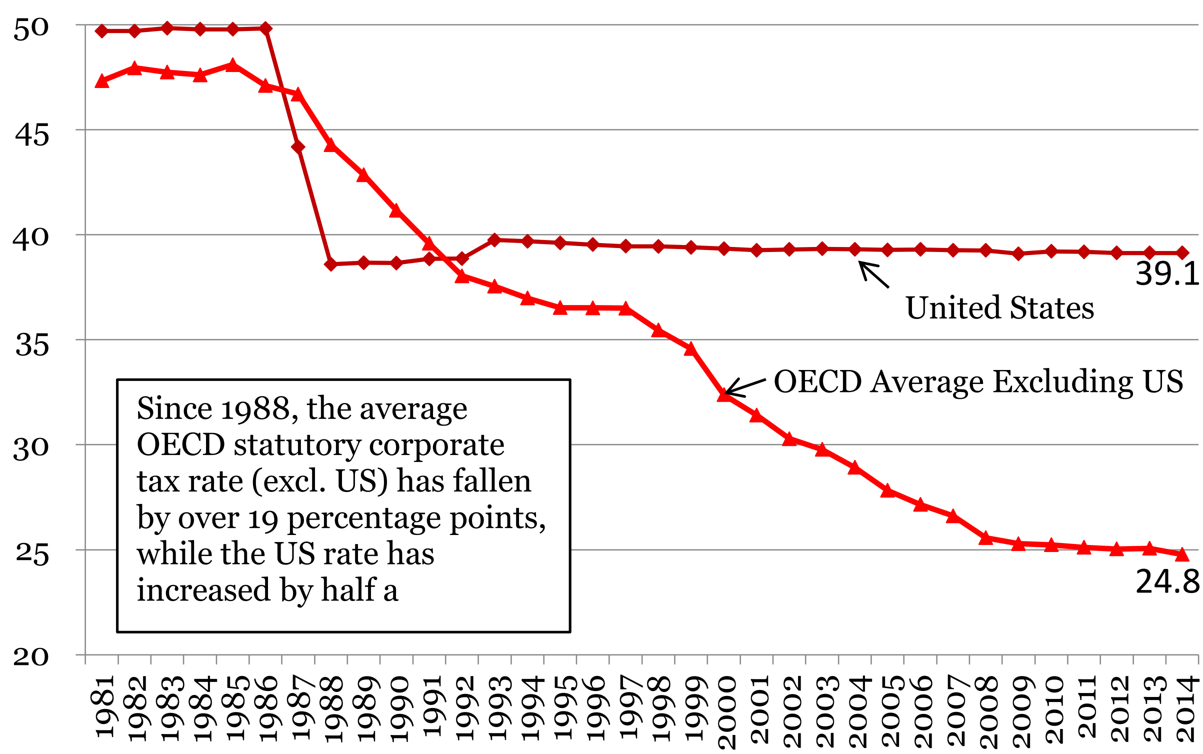
[7] Joseph Sneed, "Major Objectives and Guides for Income Tax Reform," in *Tax Revision Compendium*, Committee Print, Committee on Ways and Means (GPO, November 16, 1959), p. 68.

the United States, it will be important for the Committee to lay that myth aside. The reality is that our globally engaged businesses are the engine that delivers the products and services of America's workers to the world and the benefits of globalization to America's consumers.

US tax policy is out of sync with global trends

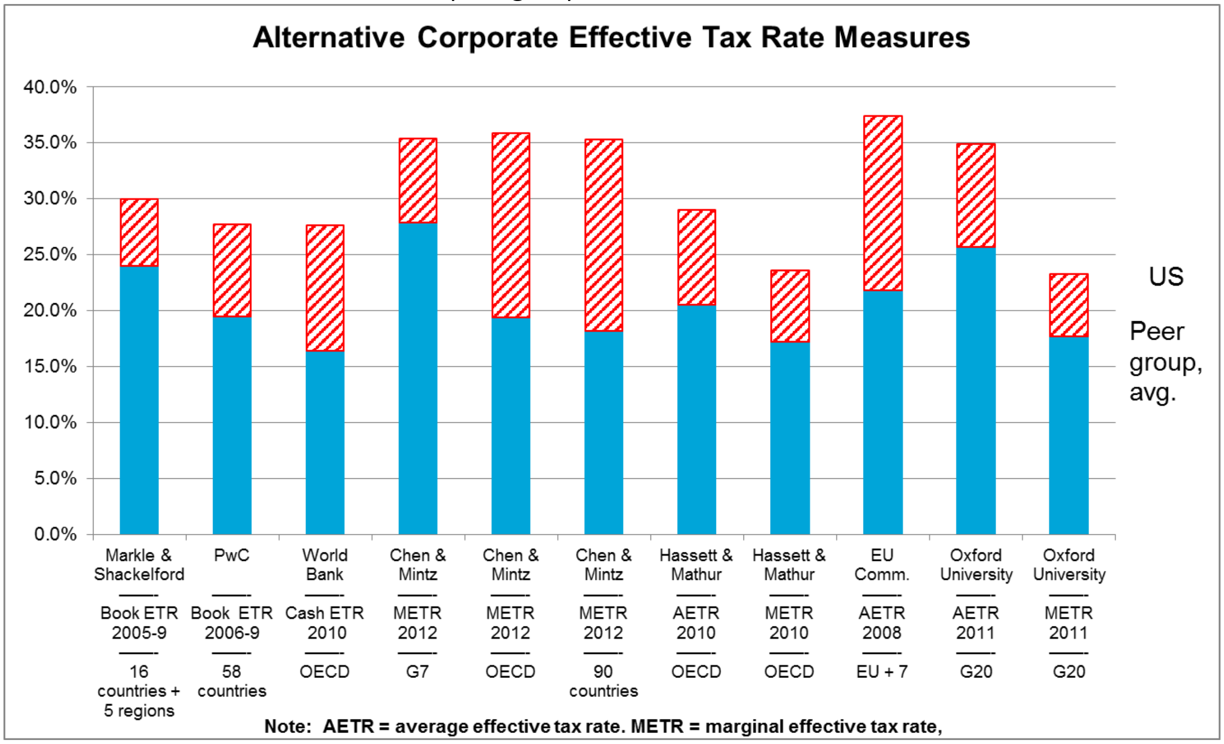
An understanding of the full impact of US international tax rules must begin by recognizing the fact that the United States has the highest statutory tax rate among major global economies. The top US statutory corporate tax rate, including state corporate income tax, is 39.1 percent, more than 14 percentage points higher than the 2014 average (24.8 percent) for other OECD countries, and 10 percentage points higher than the average (29.0 percent) for the other G7 countries.

Top Statutory (Federal and State) Corporate Tax Rates, OECD 1981-2014



Other nations have continued to implement tax reforms that will result in the non-US OECD average rate falling even lower in 2015. For example, the United Kingdom is scheduled to reduce its corporate rate from 21 to 20 percent and Japan is reducing its combined national and local corporate tax rate from 34.62 to 32.11 percent in April. Portugal and Spain also are scheduled to reduce their corporate tax rates, while among OECD countries, only Chile is moving to increase its rate to 27 percent by 2018 – still far below the US statutory rate.

US effective tax rates also are high relative to other developed economies. For example, a recent report issued by the Tax Foundation found that the United States has the second highest marginal effective tax rate on corporate investment in the developed world at 35.3 percent – behind only France.[8] The chart below references several recent studies that have consistently demonstrated the high effective tax rate of the United States relative to other peer groups.



US international tax rules also are out of sync with the rest of the world. As noted above, the vast majority of foreign governments have shifted their income taxes from a worldwide basis to a territorial basis that limits the tax base to income from activity within their borders; they have enacted anti-base erosion measures, but those measures are aimed at protecting their domestic tax base from erosion, not at preservation of a worldwide base. Every other G7 country and 28 of the other 33 OECD member countries have international tax rules that allow their resident companies to repatriate active foreign earnings to their home country without paying a significant additional domestic tax. This approach, sometimes referred to as a "participation exemption" or "dividend exemption" tax regime, differs markedly from the US worldwide tax system in which the foreign earnings of US companies are subject to US corporate tax with a credit for taxes paid to the foreign jurisdiction.

The United Kingdom and Japan, in 2009, became the most recent major economies to adopt territorial tax systems, leaving the United States as the only G7 country that has not adopted a modern territorial tax system. Of the 28 OECD countries with territorial tax systems, only two – New Zealand and Finland – have switched from territorial to worldwide tax systems, and both nations subsequently switched back to territorial tax systems. The growth in the number of OECD nations adopting territorial tax systems since 1986 when the United States last overhauled its tax laws is shown in the chart below.[9]

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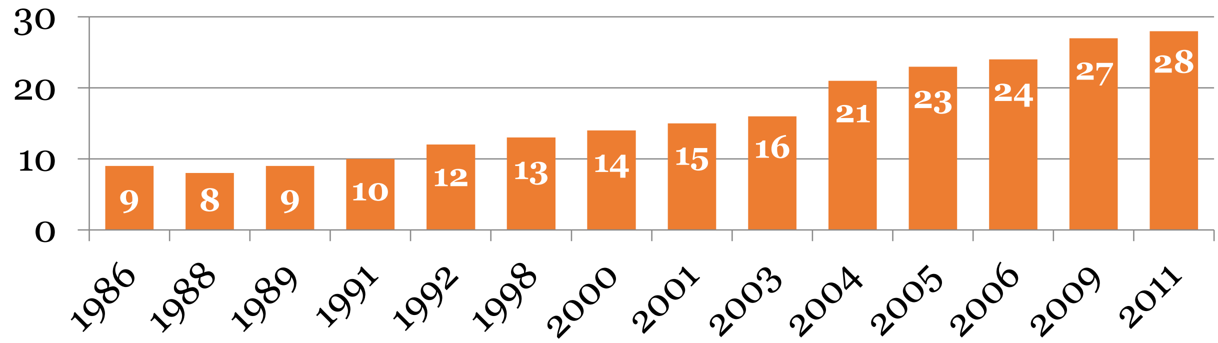
[8] Jack M. Mintz and Duanjie Chen, "US Corporate Taxation: Prime for Reform," Tax Foundation Special Report, Feb. 2015, No. 228.

[9] Source: PwC report, *Evolution of Territorial Tax Systems in the OECD,* prepared for the Technology CEO Council, April 2, 2013.

Number of OECD countries with Dividend Exemption (Territorial) Systems, 1986-2011



The high US statutory corporate income tax rate in combination with the worldwide income tax system has negative consequences for American businesses and workers in an increasingly global economy. First, it discourages both US and foreign companies from locating their more profitable assets and operations inside the United States. Second, it encourages both US and foreign companies to locate their borrowing in the United States, as the value of interest deductions is greater against a higher corporate tax rate. Third, it discourages US companies from remitting foreign profits to the United States.

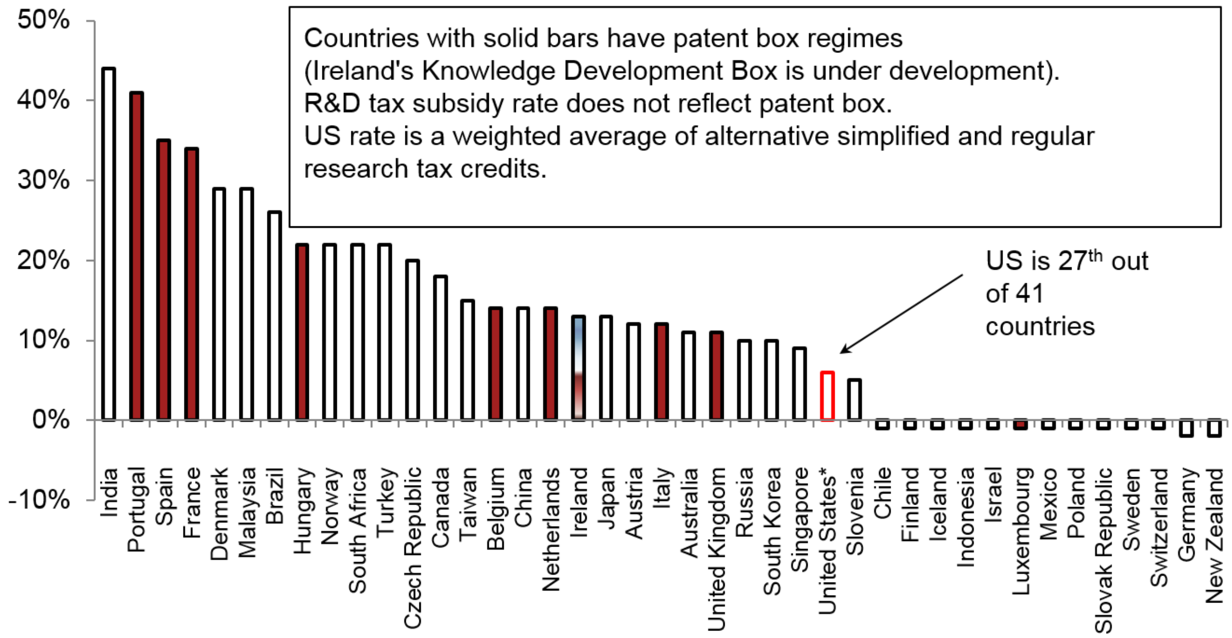
Evidence of the competitive disadvantage created by our international tax rules can be seen in the increase in foreign acquisitions of US multinationals and in the number of cross-border merger and acquisitions in which the combined company has chosen to be headquartered outside the United States. The current system tilts the playing field against US companies competing for acquisitions of foreign companies and US companies with foreign operations. If the ultimate parent company were incorporated in the United States, distributions of foreign income to the ultimate parent company would be subject to the US repatriation tax – a tax that would not apply (or could be mitigated) if the parent company were headquartered in a country with a territorial tax system. The tax system should create a level playing field that does not favor one owner over another. Our worldwide tax system essentially places a premium on the value of US companies' assets in the hands of a foreign bidder.

If the United States were to adopt a territorial tax system similar to those adopted by most other OECD countries, US-based companies would face the same effective tax rates in foreign markets as the foreign-based firms with which they compete. Eliminating the disadvantage US companies face by aligning our rules with the rest of the world would be a far more effective response than ad hoc efforts to build higher walls around a US worldwide tax system that places American companies and workers at a competitive disadvantage globally.

Other elements of a competitive tax system

The US tax system also lags behind many developed countries in other aspects that affect our global competitiveness. As shown in the chart below, the (expired) United States research credit is ranked 27th out of 41 countries in terms of the tax incentives provided for research and development activities.

Research credit and patent box regimes



In addition, an increasing number of countries are acting to provide "patent boxes" and related incentives for innovation, which also can be seen in the chart above.

Patent boxes have been considered as part of the harmful tax practices workstream in the OECD's BEPS action plan. The result of the debate is an agreement to permit patent boxes so long as they satisfy a nexus requirement that will link tax benefits to the performance of R&D activities. The nexus requirement thus may result in the relocation of R&D jobs from the US to foreign countries to obtain the enhanced benefits.

As Dr. Laura Tyson noted in her recent testimony before this Committee, other countries "are using tax policy as a 'carrot' to attract the income and operations of US companies with significant intangible assets and the positive externalities associated with them – including the spillover effects boosting innovation, productivity, and wages." [10] Two industries with particularly significant intangible assets and associated positive externalities are the technology and pharmaceutical sectors of the economy. Both industries are highly mobile and sell their products in global markets. The positive spillover effect on the local market noted by Dr. Tyson and other economists has led many governments to enact significant incentives for research-dependent operations in order to attract investment by technology and pharmaceutical companies. In the European Union in particular, many governments have concluded it is better to tax at a low rate the profits of these industries than to attempt to apply a higher tax rate and see these highly mobile activities leave the country to be performed in another location, costing the country tax revenue and the valuable jobs and spillover benefits that go with them.

[10] Dr. Laura D'Andrea Tyson, US Senate Committee on Finance hearing on "Tax Reform, Growth, and Efficiency," February 24, 2015.

The chart below details the patent box regimes available in the European Union.

EU Patent Box Regimes, 2015				
Country	**Standard Corporate Rate in 2015**	**Patent Box Rate in 2015**	**Fully Phased-In Patent Box Rate**	**Notes**
Belgium	33.99%	6.8%	6.8%	80% patent income deduction
Cyprus	12.5%	2.5%	2.5%	80% exemption for income generated from owned IP or profit from sale of owned IP
France	38.0%	15.0%	15.0%	15% tax rate on royalty income
Hungary	19.0%	9.5%	9.5%	50% deduction for royalty income from qualified patents
Ireland*	12.5%	n.a.	5.0% to 6.25%	The 2015 Irish budget proposes a "Knowledge Development Box." While the budget did not specify the reduced rate, it appears that a rate in the range of 5% to 6.25% may be under consideration
Italy	27.5%	19.25%	13.75%	30% exemption for income derived from qualifying intangible assets. Exemption increases to 40% in 2016 and 50% in 2017 and beyond
Luxembourg	29.22%	5.84%	5.84%	80% tax exemption of the net income deriving from the use and the right to use qualifying IP rights
Malta	35.0%	0.0%	0.0%	Full tax exemption for qualified IP income
Netherlands	25.0%	5.0%	5.0%	5% tax rate with respect to profits, including royalties, derived from a self-developed intangible asset
Portugal	29.5%	14.75%	14.75%	50% exemption for income derived from the sale or granting of the temporary use of industrial property rights (i.e. patents and industrial drawings and models)
Spain	28.0%	11.2%	10.0%	60% exemption for income derived from the licensing of qualifying IP rights. Corporate tax rate will fall to 25% in 2016
United Kingdom**	20.0%	12.0%	10.0%	
*Proposed				
**UK standard corporate tax rate will be reduced from 21% to 20% effective April 1, 2015.				

Dr. Tyson also noted the contrast between the carrot policies employed by other countries and the ‘stick’ approach of the minimum tax proposal put forth in the Obama Administration’s FY 2016 budget. As Dr. Tyson observed, the minimum tax approach would deprive US companies, but not companies based elsewhere, of the tax benefits of patent box regimes.

The current state of US international tax rules

To understand the disadvantage faced by US-based companies in the global marketplace, it is useful to understand the operation of the current US international tax rules.

Under the worldwide system of taxation, income earned abroad may be subject to tax in two countries – first in the country where the income is earned, and then in the taxpayer's country of residence. As noted above, the United States provides relief from this potential double taxation through the mechanism of a foreign tax credit under which the US tax may be offset by tax imposed by the source country. The complexity of the foreign tax credit rules – income and expense allocations and other limitations – combined with the relatively high US statutory rate limit their usefulness. As a result, even with foreign tax credits, US companies often incur significant taxes when repatriating active foreign earnings. The added tax burden can make it more beneficial to reinvest foreign earnings abroad and accounts for the earnings of US businesses designated as indefinitely reinvested abroad. For example, a US company earning active income in the United Kingdom subject to the 20 percent UK rate would pay an additional 15 percent US tax on that income if it were returned to the United States. As previously noted, the US tax system should create a level playing field, not one biased against reinvesting profits in the United States.

In addition to complex foreign tax credit rules, the United States has unusually broad and complex rules that impose current tax on the active income of foreign affiliates, subjecting them to high US tax rate on their foreign income even though the income remains abroad. As noted above, under US international tax rules, foreign income of a foreign subsidiary generally is subject to US tax only when such income is distributed to the US parent in the form of a dividend. The subpart F exceptions to this rule impose current US tax on certain income of foreign subsidiaries, and extend well beyond passive income to encompass certain active foreign business operations.

Protecting the domestic tax base

With the highest corporate tax rate among OECD countries, US-based multinationals have a significant incentive to keep their foreign earnings abroad. The Obama Administration has cited reports that the amount of accumulated foreign earnings of US companies exceeds $2 trillion. Although some of these earnings are in cash and liquid assets, a significant amount has been reinvested in expansion of the foreign operations of US businesses to serve emerging markets.

A territorial system similar to those in other advanced economies would allow US companies to invest their foreign earnings in the United States on the same basis as they invest them abroad and on the same basis as foreign companies invest in the United States. Rather than moving to territorial taxation, under which active foreign business income is taxed once at the foreign rate, the Obama Administration's recent budget proposal would impose immediate US tax on foreign business income if the foreign effective tax rate is less than 22.4 percent. The difference between the stated minimum rate of 19 percent and the actual 22.4 percent rate is due to the fact that the minimum tax would apply to the extent 19 percent exceeds 85 percent of the foreign effective tax rate.

Imposition of a minimum tax of this scale and structure would put American companies at a competitive disadvantage in global markets, especially those that earn a large share of their income in global markets with effective rates below 22.4 percent. In Europe, for example, a significant share of the foreign income earned by subsidiaries of US companies would be subject to the proposed minimum tax.

Of 28 EU countries, more than half had statutory tax rates below 22.4 percent in 2014, and effective tax rates generally were lower.

Other developed countries with territorial systems have adopted a variety of anti-abuse rules to discourage income shifting without imposing a minimum tax rate. Those anti-abuse rules are aimed at preventing the erosion of the domestic tax base, not at imposing a global minimum tax rate that would handicap their globally engaged companies with operations in lower tax jurisdictions. The experience of other nations shows that safeguarding the domestic tax base need not entail disadvantaging domestic businesses in the global marketplace. Examples of anti-abuse rules employed by other countries include "thin cap" rules that limit excessive interest expense deductions and rules aimed at taxing foreign passive income on a current basis. Some countries have chosen not to extend territorial tax treatment to foreign affiliates in specific tax haven jurisdictions. But no other country imposes a minimum tax on active business income such as proposed by the Obama Administration.

The OECD BEPS action plan discussed below includes more stringent controlled foreign corporation (CFC) rules (like those of subpart F) and minimum taxes as one of the anti-base erosion items for study. In addition, the transfer pricing paper on action items 8, 9, and 10 includes a US Treasury proposal regarding the minimum tax as a "special measure" to backstop transfer pricing rules. It is too soon to tell whether the OECD will embrace stronger CFC rules or the minimum tax, but public comments suggest that neither concept has been warmly received. If the United States were to enact a minimum tax while the rest of the world rejects the concept, it would push the United States even further from international norms to the disadvantage of US companies and their employees.

In addition to the minimum tax proposal, the Obama Administration's recent budget includes proposed limitations on interest expense deductions that would significantly tighten the limitations of current law. Thin cap rules are also one of the items in the OECD BEPS action plan discussed below. As the Committee considers international reform, it will be important to consider the difference in rate between the United States and other countries. The value of deductions decreases as the tax rate is reduced. Thus a lower US tax rate decreases the incentive to reduce US taxable income, and in itself is a strong base protection measure. As a result, domestic reform aimed at lowering the statutory tax rate complements reforms to modernize our international tax system. Limitations on interest deductions that go beyond international norms will further tilt the playing field against investment in the United States to the detriment of the American worker, a result that should be avoided.

Impact of the OECD's BEPS project on the US Treasury and tax reform

The OECD's BEPS project, launched in 2012 by G20 governments, including the United States, presents a challenge for the US Treasury negotiators and for US businesses and a threat to the US tax base. As the Committee is aware, the BEPS project is intended to forge a global consensus on how to address base erosion and profit shifting. In July 2013, the OECD issued a 15-point BEPS Action Plan[11] that is scheduled to be completed by December 2015. Several reports have already been issued, and the OECD is on track to issue the plan's final reports this year. Although nominally a project aimed at a narrow problem – the erosion of governments' tax bases and profit shifting – the reality is that the 15-point action plan opens the door to rewriting the rules of international taxation in nearly every respect, and doing so in a period

[11] OECD (2013), Action Plan on Base Erosion and Profit Shifting, OECD Publishing.
http://dx.doi.org/10.1787/9789264202719-en

of two years. Therein lay both the challenge and the threat as the United States considers a long-overdue reform of our nation's tax laws.

There is no doubt that the international tax regime is in need of an update, nor is there any doubt that international consensus is critical with respect to the allocation of taxing rights on cross border income. There is no better organization to facilitate the discussion necessary to achieve that consensus than the OECD. However, OECD history shows that building consensus takes time. True consensus around a single solution chosen from an array of technically complex options has proven difficult to achieve even with ample time for consideration and debate. The rapid pace of the BEPS project, with discussion drafts being released and finalized quickly (sometimes with less than 30 days allowed for public comments) is in sharp contrast to the traditional approach of OECD consensus building. Moreover, it is clear from public statements and unilateral actions of the governments participating in the BEPS project that their positions diverge significantly, making even more challenging the efforts to harmonize their views.

The difference between source and residence countries provides one example of the divergent views and the challenge the negotiators face. At the inception of the project in February 2013, the OECD paper referred to the "balance between source and residence taxation" as an issue the project was intended to address, perhaps in deference to expectations of the developing countries that are part of the G20 (but not the OECD) that BEPS would permit a discussion of the reallocation of taxing authority between source and residence countries. At the insistence of the United States, however, redrawing the line between source and residence was explicitly rejected in the BEPS action plan released in July 2013. While the explicit rejection was critically important, the allocation of taxing rights remains at the heart of many of the BEPS papers. Pandora's Box has been opened. The fact that redrawing the line is not part of the discussion has not diminished the participating governments' interest in doing so.

Given the reality of the fundamental rewrite of the international tax rules the BEPS project entails, failing to address divergent views head on means many issues hover beneath the surface unresolved. Even when there is basic agreement on issues, there can be disagreements over intent and meaning of words. In this case, the lack of resolution is likely to result in continuing intergovernmental disagreements once the ink has dried. Without agreement on clear rules, strains in resolving cross-border tax disputes – evident even before the BEPS Action Plan was initiated and reflected in the annual OECD report on mutual agreement procedure (MAP) statistics – are likely to increase.

While the BEPS project was intended to shore up the global consensus on the rules of international taxation, which was perceived to be unraveling, many governments have not waited for the BEPS process to play out and consensus rules to emerge. Harsh political rhetoric accompanying the effort has prompted some taxing authorities to seek an immediate increase in the tax paid by US companies through audit adjustment. Others are using the BEPS project to advance a domestic tax agenda and to claim their "fair share" of corporate tax revenues. The risk inherent in this trend is that as soon as one country moves ahead of the OECD consensus process, others are spurred to action, not wanting to be left behind. As a result, the danger of "global tax chaos marked by the massive re-emergence of double taxation," of which the OECD Action Plan itself warned, may have markedly increased.

Even our close ally and proponent of the BEPS project, the United Kingdom, moved ahead of the project, proposing a "diverted profits tax" that is scheduled to take effect on April 1. Under this proposal, a 25 percent tax – 5 percentage points higher than the UK corporate rate – would be imposed on profits that are considered to be artificially diverted from the United Kingdom. The proposed tests to determine whether this tax would apply are complex and subjective and appear to be aimed at US companies. While the UK government is expected to release additional details on these proposals before the end of

March, the basic structure of the UK diverted profits tax is likely to remain intact. The greater risk is that the UK approach may encourage other countries to propose similar policies affecting companies operating in their jurisdictions.

Issues regarding taxation of e-commerce were resolved in BEPS against a special set of rules for e-commerce. Just last month, however, a French government sponsored report[12] aimed at e-commerce recommended, among other things, the creation of a 'sharing rule for corporate profits.' The rule would reflect 'the number of users in the jurisdiction of the tax authority.' The report states that the existing taxation of multinationals 'based on transfer pricing and territorial definitions' is obsolete. The report suggests the sharing rule should be developed as part of the existing OECD BEPS and EU initiatives, and cites a number of US-headquartered multinational corporations as examples.

Additional countries, including Germany, Poland, Russia, Spain, Australia, Japan, India, Mexico, and Chile, have initiated unilateral actions since 2014 in advance of any formal consensus agreements under the OECD BEPS initiative. The French report highlights the risk of BEPS to the US tax base. Although BEPS is aimed at base erosion and profit *shifting*, it would appear that some governments believe BEPS should provide for profit *sharing*. When governments look for the corporate profits of which they would like a share, the targets are usually US companies.

This Committee has provided oversight to the BEPS project through a hearing in July of last year. Given that nothing is more fundamental to a nation's sovereignty than the right to tax, a point acknowledged by the OECD, it is important for the Committee to continue its oversight to assure that the OECD's historic goals of promoting economic growth and reducing regulatory burdens are given due consideration and not overrun by the unilateral actions of other countries in an effort to address concerns about base erosion and profit shifting. The extensive consultation with Congress involved in negotiating an international trade agreement should serve as a model in advance of any global effort to rewrite the international tax rules. As you noted during last year's hearing, Mr. Chairman, "we should not be rushed into accepting a bad deal just for sake of reaching an agreement."

Conclusion

The United States is operating in a global economy that increases both the competition American businesses and workers face and the opportunities available to them. At the annual Tax Council Policy Institute last month, Jon Moeller, CFO of Procter & Gamble, made the point that we cannot "pretend that if we don't have a competitive system it's going to be sustainably revenue-neutral." Since US tax laws were last reformed, our international tax rules in particular have fallen behind other countries' efforts to attract investment and promote economic growth. In the absence of action by Congress to enact a more competitive US international tax system, there will be an increase in the pace of US companies being acquired by foreign competitors, and our current worldwide tax system will continue to effectively subsidize the treasuries of other countries seeking to tax US multinationals. It is time for Congress to promote economic growth and enhance opportunities for the American people by enacting tax reform that, without increasing the deficit, reduces the US corporate tax rate, broadens the tax base, and establishes a competitive international tax system.

[12] France Strategie, "Taxation and the digital economy: A survey of theoretical models," Final Report, February 26, 2015, www.strategie.govr.fr