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Taxes Are Keeping $2.1 Trillion Out of the Country

American Companies Face the Highest Tax Rates in the West

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With both the Republican and Democrat primary seasons kicking into high gear, two trends are abundantly clear:

1. Because of acute gridlock, the prospect of meaningful legislation becoming law during 2016 is approximately zero.
2. There is significant policy uncertainty in the air regarding the next Administration and Congress on a variety of important economic issues.

Thus, it is an opportune time to assess growth-oriented legislation possibilities for the post-election cast of characters that will appear on Capitol Hill in 2017.

On this front, the lowest-hanging fruit screaming for bi-partisan action concerns corporate tax reform. After all, the United States now has the highest corporate tax rate in the industrialized world, with a total federal and state levy of more than 39 percent. Astoundingly, even Europe, which historically has been known for their own burdensome taxes, has an average rate below 24 percent, with major Asian economies even lower.

Importantly as the vast majority of economists would acknowledge, corporations really do not pay taxes, with the burden being reflected by higher prices for consumers, lower returns for shareholders, and lower compensation for employees.

The punitive US rate has triggered a variety of negative consequences, with numerous studies showing that it is a heavy drag on the economy and also reduces investment job creation, and wage growth. It has also led to what has become an accelerated trend of companies engaging in "tax inversions" by reincorporating in lower-tax countries.

The latest iteration of this phenomenon involves Johnson Controls' recently proposed acquisition of Ireland-based Tyco International. As a result of this inversion, the company will be subject to a substantially lower tax rate. In fact, over the past three years, Tyco faced an average tax rate of 12 percent versus an effective rate of 29 percent for Johnson Controls, according to S&P Capital IQ. Thus, it is no surprise that corporations are on the move toward more hospitable tax climates.

Another glaring problem with the current US scheme is that it relies on a worldwide tax system, which requires companies to pay taxes on their foreign profits twice, first in the country where the income is generated, and then in the US, if and when the profits are repatriated.

This double taxation is a relic of a bygone era, with the global trend being toward territorial tax systems that do not attempt to double-tax a firm's foreign profits. The result has been over $2.1 trillion (and counting) in earnings being hoarded overseas to avoid a second layer of taxation. For instance, recent data show GE with $119 billion stockpiled abroad, while Microsoft tips the scales at $93 billion.

This is certainly not a surprise, as companies have an obligation to enhance shareholder value and are simply responding logically from an economic standpoint. As John Chambers, chairman of Cisco Systems, recently said, "I'd prefer to have the vast majority of my employees here (in the US); and our tax policy is causing me to make decisions that I don't think is in the interest of our country or even in our shareholders, long term."

Thus, reform should be at the top of the list during the first 100 days of the next administration, as bi-partisan support is a strong possibility. The key pillars of the legislation should include:

1. A nominal, one time repatriation penalty, similar to the 2004 law that imposed a 5.25 percent rate.

2. While a permanent rate of zero would be the most economically productive, realism dictates that a low, flat, mid-teens rate, which would fall significantly below the OECD average, would be more palatable.
3. Full and immediate expensing for the cost of all capital expenditures, including plants, equipment, etc.

While this would not solve all of our economy's ills, as much work needs to be done regarding comprehensive tax, regulatory, and budgetary reform, it would be a significant step towards putting us on a more growth-oriented path that would result in more capital formation, job creation, and income growth.

This article first appeared in the Atlanta Business Chronicle.

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