

COALITION FOR TAX COMPETITION

April 24, 2002

The Honorable Max Baucus
Chairman
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Baucus:

American-based companies must pay tax to the IRS on income earned in other nations. This "worldwide" system of taxing corporate income is very anti-competitive, causing many companies to give up their U.S. charters and instead become foreign-based companies. These "expatriations" are legal, but have become controversial. Lawmakers likely will choose from two options in deciding how best to respond to this development.

One option is tax reform. Lawmakers could take a number of steps to make the internal revenue code more competitive. The U.S. corporate income tax rate, for instance, is the fourth highest in the developed world. Lower tax rates would make America more attractive. Policy makers also could eliminate the corporate alternative minimum tax. Another option is to reduce the tax bias against investment by shifting from "depreciation" to "expensing." Last but not least, Congress could junk "worldwide" taxation and instead shift to a "territorial" system that would tax companies only on their U.S. income.

The other option is to preserve "worldwide" taxation and instead impose restrictions on the ability of companies to re-charter in other jurisdictions.

The first option – tax reform – is the correct answer. If bad tax law is driving companies to re-charter in other jurisdictions, the obvious solution is to improve U.S. tax law. This market-based approach will make America more competitive. Fiscal protectionism, by contrast, is bad policy. We all understand that high-tax California should not be allowed to stop companies from moving to low-tax Nevada. We also should understand that the federal government should not be able to stop companies from escaping bad U.S. tax law.

This issue already has been clouded by demagoguery. Some assert that companies choosing to re-charter in other jurisdictions will evade or avoid U.S. tax. This is not true. All corporations, regardless of where they are based, pay tax to the IRS on all profits they earn in the United States. Some also claim that "expatriation" is unpatriotic and hurts America. This is nonsense. Re-chartering helps U.S. workers and U.S. shareholders since the newly formed company still maintains its U.S. operations, but now is able to more effectively compete with businesses that operate overseas.

Corporate relocation is yet another reason why lawmakers should fix the internal revenue code. Companies are relocating because excessive tax burdens and worldwide taxation make it very difficult for U.S.-chartered firms to compete. Instead of making a bad system even worse by imposing more burdens on U.S.-based companies, lawmakers should reform the tax system. Lower tax rates and territorial taxation are just two of many options that would improve the internal revenue code.

Sincerely,

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