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Proposals for International Tax Reform: Is There A Middle Road?

NOVEMBER 17, 2016 — REUVEN AVI-YONAH

There is a wide, bipartisan consensus that the century-old U.S. international tax regime is broken. The approach to taxing U.S.-based corporations on all income excluding their foreign subsidiaries posed no major threats from 1918 through almost the end of the twentieth century. However, the present day paints a very different picture. The United States has the highest corporate tax rate in the Organization for Economic Cooperation and Development (OECD), the rich nations' club, which at 35 percent imposes a burden on corporations earning income mostly in the United States. At the same time, U.S.-based multinationals pay very low effective tax rates on foreign income earned through their subsidiaries, leading to a strong incentive to shift profits out of the United States. Finally, the United States is among the few countries to fully tax dividends paid by foreign subsidiaries to their domestic parents, leading to the "trapped income" phenomenon in which over $2.5 trillion of low-taxed earnings of those subsidiaries cannot be repatriated because of the tax on repatriations. Rather, they have to be declared as "permanently reinvested" overseas despite increasing difficulties to find somewhere to place the money constructively.

From these concerns, a broad consensus among both policymakers and academics has developed about what should be done: reduce the corporate rate, broaden the base by taxing offshore profits, and eliminate the tax on repatriations, which affects behavior in negative ways mentioned above without raising revenue.

There are two possible solutions to the problem of income being trapped offshore, unable to be repatriated without paying the current high U.S. tax rate. One is to follow most OECD countries by adopting territoriality, i.e., exempting dividends from foreign multinationals from tax even when repatriated. The problem with this approach is that its result would further encourage income shifting as long as the foreign income benefits from a lower tax rate.

The second solution, which is advocated below, is to abolish deferral—ending corporations' avoidance of tax payments on foreign profits via tax havens while repatriating those profits back to the United States—in conjunction with a lower corporate tax rate. This would solve the trapped income problem without encouraging shifting, and if the rate is low enough (around 20–30 percent), it would be similar to the effective rates of our major competitors and thus not subject U.S. multinationals to a competitive disadvantage.

This, however, is a short-term solution. In the medium-term, it would be preferable to undertake a more radical tax reform that eliminated the current distinction between U.S.- and foreign-based multinationals. In a globalized world, this distinction is largely artificial and leads to problems like corporate expatriations ("inversions"). The second solution proposed below is to tax multinationals on a destination basis, i.e., based on their sales into the United States. Such a "destination based corporate tax" (DBCT) eliminates the distinction between multinationals based on location of incorporation, treats multinationals as a unitary enterprise, and does not create an incentive to shift profits since it relies on the location of consumers, not of profits.

Ultimately, this paper aims to suggest two proposals for solving the current problems of the U.S. international tax regime that can be implemented on a bipartisan basis. To do so, the first section below will provide some context. The next section will survey recent reform proposals by both U.S. Representative Dave Camp (R-MI) and President Barack Obama. Lastly, the paper will discuss plausible avenues for reform after the presidential election, beginning with short-term proposals (preferably, abolishing deferral at a lower rate), and continuing with medium-term ones (adopting a destination based corporate tax).

Context of the "U.S. International Tax Regime"

The United States has long stood out for its world-wide taxation of U.S. resident corporations (defined as corporations incorporated in one of the states). This rule goes back to origins of the U.S. corporate tax in 1909, which was designed as a way to improve progressivity (when most of the U.S. federal revenue derived from regressive tariffs at the border). Since the U.S. Supreme Court held an individual income tax to be unconstitutional, the corporate tax was introduced as an indirect way of taxing the rich (who then, as now, made up most shareholders). This required taxation based on ability to pay, and that in turn meant that all income "from whatever source derived, including foreign income, should be taxed.

However, until 1962, there was no U.S. tax on foreign source income of foreign subsidiaries of U.S. multinationals, so that if such income could be earned through subsidiaries, there would be no tax until the income was distributed to the U.S. parent as a dividend. This "deferral" meant that there was an incentive to shift profits from the United States to foreign jurisdictions, and some of the early transfer pricing cases attempted to deal with such shifting. In 1962 Congress enacted Subpart F, which addressed shifting more comprehensively by taxing the U.S. parent currently on some types of easily shifted income. However, the basic deferral regime was left in place, because most U.S. multinationals operated in high tax jurisdictions so there was little incentive to shift.

This situation changed in the 1990s, first because most foreign jurisdictions cut their corporate taxes below the U.S. rate, and then because the adoption of the "check the box" rule in 1997 undermined Subpart F and made it easy to shift profits from the United States and from other high tax jurisdictions to tax havens. "Check the box" is a regulation (since incorporated in the tax code) that effectively exempts income from current U.S. taxes when it is shifted between foreign subsidiaries of a U.S. multinational (i.e., from high to low tax foreign jurisdictions). The inadvertent result has been to also encourage shifting income from the United States to low tax foreign jurisdictions like Ireland, Luxembourg, or Singapore. Deferral has now become one of the largest U.S. tax expenditures, with over $2.5 trillion of income accumulated in foreign subsidiaries of U.S. multinationals and subject to very low tax levels, frequently in the single digits. These earnings cannot be repatriated without incurring the 35 percent tax on dividends.[1]

Overall, the effective corporate tax rate on large U.S. multinationals is about the same as the effective tax rate on large EU multinationals, in the low to mid 20 percent range. But this is somewhat misleading because it includes corporations like Walmart with extensive U.S. operations and a high overall tax rate, as well as corporations like Apple with more foreign operations and a low overall tax rate.[2] What is remarkable is that the U.S. and EU multinationals have similar rates even though most EU countries do not tax repatriated dividends (i.e., they adopt territoriality). This similarity is because the EU jurisdictions have tougher Subpart F-like rules, and because the U.S. multinationals do not in fact repatriate low taxed income. These data show that there is currently no competitive disadvantage to U.S. multinationals, but that the trapped income problem is real.

Table 1. Average Effective Tax Rates for Each Region by Year			
Year	**Europe**	**United States**	**Revenue Ratio (U.S./EU)**
2001	39%	33%	1.19
2002	49%	32%	1.06
2003	34%	24%	0.99
2004	31%	27%	1.02
2005	34%	30%	1.2
2006	32%	31%	1.16
2007	31%	32%	1.25
2008	46%	56%	1.22
2009	37%	30%	1.21
2010	31%	24%	1.25
2001-2010	35%	31%	1.16

Source: Avi-Yonah, Reuven S. "The Effective Tax Rate of the Largest US and EU Multinationals." Y. Lahav, co-author. Tax L. Rev. 65, no. 3 (2012): 375-90.

There are two ways of addressing the trapped income phenomenon. One, which is advocated by most U.S. multinationals, is to deviate from the rule that U.S. corporations are taxed on all income and adopt "territoriality," i.e., not tax dividends from foreign subsidiaries even when distributed. The problem is that this narrow territoriality will further exacerbate the existing incentive to shift income out of the United States, because there will no longer be a

concern that shifted income cannot be repatriated. The other option is to abolish deferral and tax all income of United States multinationals currently, with a credit for foreign taxes up to the United States rate. This is the better option, and it should not affect competitiveness as long as it is combined with a lower corporate tax rate.

Recent Reform Proposals

This section will briefly describe the international tax reform proposals advanced by House Republicans in 2014 and by President Obama in 2016. While these proposals are quite different, there are common areas that can form the basis for a feasible bipartisan solution.

The Camp Proposals

In 2014, former U.S. House Committee on Ways and Means Chairman Dave Camp (R-MI) released a Discussion Draft of the "Tax Reform Act of 2014" (TRA14).[3] These proposals are still relevant because they represent the most likely GOP starting point for negotiations for short-term reform. However, while many parts of the proposal seem quite sensible as an effort to bring back the "spirit of 1986" (i.e., reduce the rate while broadening the base, as in the Tax Reform Act of 1986), the international tax reform proposals are deeply flawed and based on obsolete assumptions that U.S. multinationals were facing in 2014.

The TRA14 international tax proposals are based on the assumption that because most other OECD countries have adopted a limited version of territoriality, i.e., a "participation exemption" for dividends out of the active income of Controlled Foreign Corporations (CFCs), the United States must follow suit to preserve the competitiveness of U.S.-based MNEs. Territoriality in this context means an exemption for dividends even when they are distributed to the U.S. parent corporation, creating an exception to the general rule of taxing on all income. But this assumption is wrong, for three reasons. First, the empirical data indicate that under current law U.S.-based MNEs do not face a competitive disadvantage despite the fact that they are nominally taxed on a worldwide basis without a participation exemption.[4] Second, the G20/OECD Base Erosion and Profit Shifting (BEPS) project suggests that the effective tax rates of both U.S. and foreign MNEs are headed up, not down. Third and most importantly, reducing the U.S. corporate tax can be done without putting U.S.-based MNEs at a competitive disadvantage even if deferral were completely eliminated, and this has the added advantage of eliminating both lock out (i.e., the disincentive to repatriate earnings of foreign subsidiaries to the U.S. parent because of the tax on dividends, which is the main problem the participation exemption is designed to solve) and the incentive to shift profits out of the United States (which this version of TRA 14 does little to address). Abolishing deferral instead of adopting a participation exemption also does not put domestic U.S. corporations at a competitive disadvantage to U.S.-based MNEs.

The TRA 14 International Proposals

The TRA14 international proposals are divided into three sections. Title IV, Subtitle A (sections 4001–4004) establishes a participation exemption. Title IV, Subtitle B (sections 4101–4104) modifies the foreign tax credit system to reflect the participation exemption. Title IV, Subtitle C (sections 4201–4212) contains modifications to Subpart F and the anti-BEPS rules. Below, these sections are explained in more detail to illustrate their continued relevance and how they compare to the Obama proposals.

Title IV, Subtitle A (Sections 4001–4004): Participation Exemption.

TRA14 adopts a limited version of territoriality by allowing 95 percent of dividends paid by a foreign corporation to corporate U.S. shareholder to be exempt. The 5 percent hair cut is in lieu of limits on deductions allocable to exempt income. This provision is estimated to cost $212 billion, but as discussed below this may be an underestimate. The rationale is competitiveness and eliminating lock-out, but as discussed below lock-out can be eliminated in other ways without affecting competitiveness.

There are over $2.5 trillion of such accumulated low-taxed E&P, and since it has been earned already and (mostly) not taxed by other countries, why not tax it at the new 25 percent rate, or even the current 35 percent? This could generate hundreds of billions in one fell swoop without affecting incentives or competitiveness, thereby reducing the budget deficit and allowing revenue neutral financing of an extension of unemployment insurance, infrastructure spending, or other one time projects.

TRA14 makes permanent the 954(c)(6) look through rule for dividends, interest and royalties received by one CFC to another. This is the provision that codifies “check the box” and that makes it easy to shift profits from high to low tax jurisdictions. This is scored as only reducing revenues by $13.1 billion, but the true cost is probably higher as discussed below.

Title IV, Subtitle B (Sections 4101–4104): Foreign Tax Credits Changes.

Section 4101 repeals the indirect foreign tax credit (FTC), which is not needed because we will not be taxing dividends from foreign subsidiaries. The indirect credit is the credit a U.S. parent currently receives for foreign taxes paid by its subsidiary. This would presumably formally override our tax treaties, all of which require the indirect credit, so they will need to be renegotiated, which may be difficult. However, section 960 is not repealed, so that there would be an incentive to create Subpart F deemed dividends to benefit from the credits attached to them, especially given the change to the allocation of deductions described below that would increase foreign source income and raise the FTC limit.

Title IV, Subtitle C (Sections 4201–4212): Subpart F Modifications and Anti-BEPS Provisions.
Section 4201 excludes from Subpart F income (i.e., income that is currently taxed even without repatriation) any foreign income subject to the full U.S. tax rate of 25 percent, except that base company sales income is excluded if it is subject to a 12.5 percent tax (as in Ireland) and foreign base company intangibles income is excluded if it is subject to tax at a 15 percent rate. These rates are quite low; allowing the Irish 12.5 percent rate to eliminate the application of Subpart F is an invitation to base erosion and profit shifting (BEPS), as discussed below.

Section 4202 (the "Ireland provision") explicitly excludes from base company sales income (which is currently taxed) any income from a treaty jurisdiction, or any jurisdiction with an effective rate of 12.5 percent. This allows all the U.S. MNEs that took advantage of the Irish rate to shift profits from both the United States and other countries to continue to do so. Moreover, where a CFC earns such income, only 50 percent of that income is subpart F income. The other half, even if subject to zero foreign tax, is eligible for the 95 percent participation exemption when the earnings are distributed to its U.S. corporate shareholders.

Section 4211 is the main anti-BEPS provision. It creates a new category of Subpart F income, foreign base company intangible income (FBCII), which is the excess of the CFCs gross income over 10 percent of the CFCs adjusted basis in depreciable tangible property. At the same time the CFC gets a deduction for a declining percentage of income (going down from 55 percent to 40 percent) from sales of goods and services to foreign customers. The idea is to allow exemption for normal returns to investments in tangible property and to reduce the tax rate on sales to foreign customers to 15 percent, while preventing base erosion.

This provision is very complex, and has little to do with intangibles. It aims at taxing economic rents (i.e., income unique to a given multinational and not subject to competition) from sales primarily into the United States, but to some extent to foreign countries as well. However, ultimately 40 percent of the rents would be exempt. This complexity is designed to preserve competitiveness but there are far simpler ways of doing so. Moreover, the provision translates into a 15 percent tax rate applied to rents from exports but a 25 percent rate on rents from imports, which raises serious WTO compatibility issues. The provision only raises $115.6 billion over the ten-year budget window.

What about Base Erosion and Profit Shifting?

Under section 4211, a CFC's FBCII is includible in the income of its parents except for 10 percent of its basis in tangible property and 40 percent of its income from the sale of goods to foreign customers. This is equivalent to a current 25 percent tax on sales to the United States and 15 percent on sales abroad (after reducing the latter income by 10 percent of the basis of related tangible property). Under section 4201, FBCII is excluded altogether if it is subject to an effective

foreign rate of 15 percent, and foreign base company sales income is excluded if subject to tax at the Irish 12.5 percent rate or if it is earned in any treaty jurisdiction. In addition, active financing income is taxed at 12.5 percent (section 4201), and 954(c)(6) (section 4004), which allows for tax-free shifting of profits from one CFC to another, is made permanent. The entire proposal thus amounts to taxing CFCs in full on income from sales to the United States but at a lower rate (12.5 percent–15 percent) on sales abroad.

While better than current law which permits effective rates of less than 5 percent on the income of CFCs, these provisions, in addition to the participation exemption, are an incentive to shift profits from the United States and other higher tax jurisdictions to Ireland and similar countries (for foreign base company sales income and active financing income) or to any jurisdiction with a tax rate of 15 percent (for FBCII). There are many countries that would be happy to oblige by setting their rate at 15 percent, which is why I think there would be greater revenue losses from the exemption and smaller revenue gains from the anti-BEPS provisions than suggested by the official revenue estimates.

The Obama Proposals

President Obama's Budget for Fiscal Year 2016 contained three major proposals to address the current mess. First, the president proposed to reduce the corporate tax rate to 28 percent (25 percent for some domestic manufacturing activity), while raising the dividend and capital gains rate to 28 percent.

Second, the president proposed to impose a one-time transition tax of 14 percent (i.e., half the new normal rate) on previously accumulated offshore earnings of U.S.-based multinationals, and then let them repatriate those earnings without further tax. Finally, the president proposed to impose a per-country minimum tax of 19 percent on the future earnings of CFCs of U.S. multinationals. In addition, the budget contains many previously proposed items, including a reduction of the threshold to be treated as an inverted company (and taxed as a U.S. corporation) from 80 percent to 50 percent if the combined enterprise continues to be managed from the United States.

These proposals are problematic. Taxing the past accumulated earnings (the $2.5 trillion) at half the rate is an unjustified windfall, since these earnings have already been earned and are not subject to competitive pressures. Establishing a minimum tax of half the normal rate on future foreign earnings maintains the incentive to shift profits from the United States, since the U.S. rate will be much higher and there will be no risk that the profits cannot be repatriated given that the president supports territoriality. As discussed below, competitiveness can be addressed without maintaining such a huge incentive to shift profits out of the United States.

Predictably, the proposals have been denounced by the Business Roundtable as anti-competitive and by others as a giveaway to the multinationals. But Congressional Republicans have been more positive, because these proposals are in fact quite similar to the tax reforms proposed by Camp, with the main difference being the rates. Camp would have cut the overall rate to 25 percent, imposed a 3.5–8.75 percent tax on past earnings, and taxed future earnings at 12.5–15 percent. Thus, it is quite possible that the two sides could compromise somewhere in the middle between the two positions.

Future Reforms

This section will discuss proposals that could be implemented by the next administration. It will first discuss short-term proposals that build on the bipartisan consensus identified above and that could be implemented immediately. It will then discuss longer term proposals that require fundamental changes to the international tax regime (i.e., tax treaties as well as WTO rules).

Short-Term Reforms

The Camp and Obama proposals seem to offer starkly contrasting visions of how to reform the taxation of foreign source income earned by U.S.-based multinationals (MNEs). Both acknowledge the problem, which is that U.S.-based MNEs currently have over a trillion dollars of "permanently reinvested" income offshore, which they cannot bring back to the United States without incurring a 35 percent tax penalty. However, they seem to offer radically different solutions: Under the Camp Proposal, a participation exemption will enable U.S.-based MNEs to bring back the income without paying significant tax. Under the Obama Proposal, deferral will be abolished and U.S.-based MNEs will have to pay a minimum tax on foreign source income earned by their controlled foreign corporations (CFCs) as it is earned. The result would be that the tax penalty on repatriating such income would be reduced because dividends would only be subject to tax at the difference between the statutory rate (reduced to 28 percent under the Obama Proposal) and the minimum rate.

However, a closer look reveals that these proposals have more in common than meets the eye. Specifically, the Obama Proposal's minimum tax on foreign source income of CFCs is perfectly compatible with exempting such income from further tax when it is repatriated, as the Camp Proposal envisages. Conversely, the provisions to prevent income shifting in the Camp Proposal can in practice result in precisely the minimum tax on the foreign source income of CFCs that is the centerpiece of the Obama Proposal. This level of agreement suggests that a compromise embodying elements of both proposals should not be impossible to reach when tax legislation is enacted after the election.

Ignore for a moment the treatment of previously accumulated income, which is basically a transition issue (and, perhaps,

one on which the parties could reach a compromise by settling on a rate somewhere in between 5.25 percent and 28 percent on the trillion dollars of currently deferred income). For the future, there is nothing in the Obama Proposal that would preclude adopting a participation exemption for income that was subject to the president's minimum tax. Let's assume that the minimum tax rate is set at 25 percent (i.e., 3 percent less than Obama's proposed rate for domestic income). In that case, adopting a participation exemption would only mean giving up on the additional 3 percent and eliminating the indirect credit and adopting the 5 percent haircut and interest disallowance provisions of the Camp Proposal would presumably be enough to compensate for any loss of revenue.

Conversely, the anti-income shifting provisions of the Camp Proposal are consistent with the Obama Proposal. The excess intangible provision is identical to the one in the Obama Proposal and in the Administration's budget. The minimum tax on income from intangibles (defined broadly to include patents, copyrights, but also other intangibles), is very similar to the Obama Proposal's overall minimum tax, especially if one assumes that most of the income shifted overseas results from the exploitation of intangibles. The Camp Proposal on limiting interest deductions and the 5 percent haircut are similar to the Obama Proposal's limits on deductions associated with deferred income.

Finally, the practical effect of the Camp Proposal is quite similar to the Obama minimum tax provision. Under the Camp Proposal, any foreign source income that is not earned from real business operations in the "home country" and that is not subject to a foreign tax rate of at least 10 percent will be subject to current inclusion (at 25 percent) and not eligible for the participation exemption. Under the Obama Proposal, all income of CFCs will be subject to a minimum tax of, let's say, 25 percent. The difference between the two is that income from operations in Ireland, for example, which is taxed by the Irish at 12.5 percent will not be includible under Camp but will be under Obama. But income from real tax havens, which is subject to no tax and does not result from business operations therein, would be subject to tax under both.

The Obama Proposal has a chart showing income of CFCs of U.S.-based MNEs in selected countries relative to those countries' GDPs. It shows that the income of CFCs in the Bahamas is 43 percent of its GDP, Bermuda 646 percent, British Virgin Islands 355 percent, Cayman Islands 547 percent, Jersey 35 percent, Liberia 61 percent, and the Marshall Islands 340 percent of GDP.[5] All of that income would be subject to current tax under both the Camp and the Obama Proposals.

But we can do better than both the Camp and Obama proposals. Consider the following facts:

- The nominal tax rate of the G20 is almost never lower than 20 percent and in most cases is between 20 percent and 30 percent.

- The effective tax rate of MNEs based in the G20 is close to the nominal rate, even after participation exemptions are taken into account.

- The G20 have led the anti-BEPS effort in OECD.[6]

Under these conditions, why should the United States reward Ireland and other jurisdictions that have a low tax rate by enabling shifting profits to them, when economically these profits are earned in the large developed economies?

Instead, we should simply determine what is the corporate rate that would put U.S.-based MNEs on a level playing field with the G20, and impose that rate on all future income (past income should be taxed at the full 35 percent, since that does not affect competitiveness). If the rate is 17 percent, so be it, as long as it is imposed on both U.S. and foreign income.[7] This will be much simpler than the very complex TRA14 anti-BEPS proposals, and would be better than the Obama proposal, which leaves a major differential between U.S. and foreign income.

TRA14 says that the rationale for departing from the over a century old rule of taxing U.S. resident corporations on all income from whatever source derived is to "allow U.S. companies to compete on a more level playing field against foreign multinationals when selling goods and services abroad" and to "eliminate the 'lock-out' effect that results from the U.S. residual tax under current law, which discourages U.S. companies from bringing their foreign earnings back into the United States."[8] The above proposal would achieve both of these aims while also preventing BEPS and not putting domestic U.S. businesses at a competitive disadvantage compared to U.S.-based MNEs.

Medium-Term Reforms

Recent Republican business tax reform plans, including the proposals advanced by Speaker Paul Ryan (R-Wis.)[9] can be summarized as follows: All the Republicans would like a lower business tax rate, ranging from 14.5 percent to 28 percent. Most of them would apply that rate to all businesses. Most of them would allow expensing of capital expenditures. Many of them would eliminate deductibility for interest, and others would restrict it. Most of them support territoriality with a one-time tax on past offshore earnings of U.S.-based multinationals. All of them support a deduction for wages.

These plans sound familiar, because they are all versions of the "Growth and Investment Tax" (GIT) of the 2005 Bush tax reform advisory panel proposal.[10] Under GIT, all businesses would be subject to tax at a rate of 30 percent, with expensing of capital expenditures and a deduction for wages, but no deduction for interest.

The advantage of these features of GIT is to eliminate the biases of the current corporate tax. Extending the tax to all businesses eliminates the bias against the corporate form. Eliminating the interest deduction eliminates the bias in favor of debt financing. Treating interest, dividends and capital gains the same at the recipient level eliminates the bias among types of distributions (under GIT they were all subject to a 10 percent rate, but this would be too low for Democrats to accept, since GIT was distributionally as well as revenue neutral).

GIT had one more feature that in my opinion is an advantage over the current proposals. The current Republican proposals (except for Ryan) are origin based, i.e., they include exports and allow a deduction for imports. This is why they also include territoriality in the narrow sense of a participation exemption for dividends from CFCs.

The problem is that origin based taxation is prone to transfer pricing problems, and requires a robust Subpart F to prevent income shifting, which is complicated to enforce. GIT, on the other hand, was destination based: exports were exempt from tax and imports fully taxable. This means that GIT was truly territorial, i.e., taxing only income derived from sales into the United States, and did not require transfer pricing or Subpart F (or the foreign tax credit).

As the 2005 panel recognized, GIT, as well as the current GOP proposals, can be seen as a subtraction method VAT. A tax that applies to all businesses, with no interest deduction but expensing of capital expenditures, is a VAT, even if it allows for a deduction for wages. And if it is a VAT, it can be border adjustable (exempt exports and be imposed on imports) under the WTO rules.[11] It can also be imposed in full on corporations selling goods into the United States without a permanent establishment, since it is not subject to tax treaties.

Such a corporate tax reform could be supported by Democrats. The main differences between it and the current corporate tax is (a) that interest is non-deductible, a position Democrats can support; (b) that capital expenditures are deductible. This feature means that the normal return to capital is exempt, but under current interest rates the normal return is minuscule, and even if rates rise the main target of the corporate tax was always rents, which are taxed under the GIT. It is sufficient to tax normal returns to capital at the individual level since individuals are less mobile than businesses and subject to deemed realization if they expatriate.

Border adjustability is a major advantage. The effective corporate tax rate under GIT is less than the nominal rate because of expensing (i.e., currently deducting all corporate expenditures which currently can only be depreciated over time). That would attract businesses into the United States rather than driving them out, as under the current system. And if the tax is border adjustable, these businesses would be incentivized to export more and import less, leading to more American jobs.

Under the current rules, if an EU enterprise manufactures goods in the EU and exports them to the United States it is

not subject to either corporate tax (because of territoriality) or VAT (because the VAT is border adjustable and the US has no VAT). If a U.S. enterprise manufactures goods in the United States and exports them to the EU it is subject to both corporate tax (since the United States imposes tax on worldwide income) and VAT (on the import into the EU).

Under these conditions it makes sense for the United States to adopt the GIT, i.e., a business tax that allows for a deduction for wages, has no deduction for interest, expenses capital expenditures, and that is border adjustable. As I have argued elsewhere,[12] such a "destination based corporate tax" is the best cure to tax competition because the consumer base is immobile.[13]

Republicans have traditionally been opposed to a U.S. VAT. But they may be in favor of replacing the corporate tax with the GIT. Democrats may be willing to join if (as suggested above) the tax rate on wages is sufficiently progressive and the rate on dividends, interest and capital gains is high enough.

Thus, a combination of high capital gains and dividend rates on the individual rich and a GIT at the business level is the best option for medium-term bipartisan tax reform.

Conclusion

In the short to medium-term, there appears to be a significant possibility of bipartisan corporate and international tax reform because of the underlying similarity of the Obama and Camp proposals. They both tax past accumulated income at a low rate, and then adopt a limited version of territoriality with a minimum tax on future income, combined with an overall lower corporate rate.

The main problem with both proposals, however, is that they maintain a large gap between the U.S. tax on domestic and foreign income. Such a gap, together with the adoption of limited territoriality, would maintain the current incentive to shift profits out of the United States with no concern that they cannot be repatriated. The underlying bipartisan consensus described above can be implemented in a better and simpler way if the United States were to abolish deferral and apply the same low rate to all income currently. If that rate is low enough (around 20–30 percent), it will not create a competitive disadvantage, because it will be similar to the effective rate paid by our main competitors. For the same reason such a reform will not create significant incentives to invert, especially if strong anti-inversion measures are adopted, redefining corporate residence as location of headquarters and a corporate level exit tax would also be beneficial (as this is why there are no inversions in the EU).

If the United States taxed all of the $2.5 trillion low-taxed foreign income, it is possible to raise a significant amount

revenue. With the modest transition tax rate of 14 percent as suggested by the Obama Administration, $299 billion in revenue would be generated over ten years (2016–2025), as shown by estimates from the Center on Budget and Policy Priorities.[14] According to existent research, if the United States were to repatriate the $2.5 trillion and tax that amount at 28.8 percent (which falls within the 20–30 percent range referenced above), about $717.8 billion in revenue could be generated over the ten year budget window.[15] Despite this wide berth of tax rates on repatriated profits, substantial revenue generation is possible across the spectrum of rates that would be debated in the legislative process, especially if coupled with permanent reform to the international tax system.

In the longer term, we should adopt a destination basis corporate tax, in which liability will depend on sales into the U.S. market. This solution eliminates the distinction between U.S. and foreign multinationals, and addresses the fundamental tax competition issue, since the market is not subject to competitive pressures. Because it does not depend on the location of the corporate parent, this solution is superior. Admittedly, it is also a more radical reform that requires significant modification of both tax treaties and WTO agreements; luckily, there is a rarefied support drawing from both sides of the aisles that renders this effort—along with more progressive business tax reform—all the more attainable.

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Notes

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6. Avi-Yonah, "Hanging Together: A Multilateral Approach to Taxing Multinationals," in Thomas Pogge and Krishen Mehta (eds.), *Global Tax Fairness*, 113 (2016).

7. At 17 percent the corporate tax would probably be a revenue loser even if we tax the previously accumulated offshore earnings at 35 percent, but in the context of broader tax reform such a loss can be offset by increasing the rates on dividends and capital gains. Since individuals are less mobile than corporations it makes sense in a globalized world to impose higher tax rates on individuals than on corporations.

8. TRA14 Discussion Draft, Section by Section Summary, at 142 (section 4001).

9. A Better Way: Our Vision for a Confident America," Speaker.gov, June 24, 2015, https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf.

10. The President's Advisory Panel on Federal Tax Reform, "Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System," Brookings, November 2005, https://www.brookings.edu/wp-content/uploads/2015/10/presidents_advisory_panel_report_2005.pdf.

11. The 2005 panel made GIT border adjustable but did not assume border adjustability for revenue estimating purpose because of uncertainty whether GIT would pass muster under WTO rules. But WTO rules are not immutable; the distinction between direct and indirect taxes is unclear and the border adjustability of VAT was negotiated in 1994. The United States should not refrain from adopting a tax reform that is in its best interest because of a WTO challenge that may never materialize.

12. Reuven S. Avi-Yonah, "The Case for a Destination-Based Corporate Tax," *Int'l Tax J*. 41 (2015), 11, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2634391.

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