CORPORATE INCOME TAX SHOULD BE REPEALED

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Over the past year there has been increasing political chatter about tax reform, a topic long overdue and reaching crisis level. We have been listening to this debate and at the end of every discussion we are left wondering why there is so much diversity in perspective. Democrats view reform as a matter of "plugging a few more loopholes" and people who support tax reduction on business are branded "regressive" oppressors of the poor, "racist, sexist, homophobic, xenophobic, Islamaphobic, you name it" and "a basket of deplorables."[1] But what both sides are not seeing is that the United States tax code is not only obsolete, it is suicidal, and it must be fixed immediately. Political posturing must come to a stop and action is required. It is now a topic that must take center stage in the Presidential campaigns.

Times have changed. When I started my career in tax law, it was just after the Tax Reform Act of 1986 (P.L. 96-514) (TRA of 86) that was enacted during the Reagan administration. It was a comprehensive redraft of the Internal Revenue Code, and the first major comprehensive legislation to the IRC since 1954. When the TRA of 1986 was enacted, corporate income tax rates were lowered from a top rate of 49.8% to an average top rate of 35%. State income taxes add another 5%-6% to these numbers. By the time the TRA of 86 changes were fully enacted the average federal and state income tax for a US corporation was 40%. By 1988, it put the United States in the position of having one of the lowest corporate income tax rates in the G20 and OECD ("Organization for Economic Development and Cooperation"). This can be seen in the table below:

	1985	1986	1987
Australia	46.0%	49.0%	49.0%
Austria	55.0%	55.0%	55.0%
Belgium	45.0%	45.0%	43.0%
Canada	49.4%	49.8%	48.6%
Denmark	50.0%	50.0%	50.0%

[1] Hillary Clinton in speech at a New York fundraiser on September 9, 2016. https://www.washingtonpost.com/politics/clintons-deplorables-remark-sums-up-a-deplorable-election-season/2016/09/10/78977694-777b-11e6-be4f-3f42f2e5a49e_story.html

Finland	61.8%	51.5%	51.5%
France	50.0%	45.0%	45.0%
Germany	60.0%	60.0%	60.0%
Greece	49.0%	49.0%	49.0%
Ireland	50.0%	50.0%	50.0%
Italy	46.4%	46.4%	46.4%
Mexico	42.0%	42.0%	40.6%
Netherlands	43.0%	42.0%	42.0%
New Zealand	45.0%	48.0%	48.0%
Norway	50.8%	50.8%	50.8%
Portugal	55.1%	50.3%	48.1%
Spain	35.0%	35.0%	35.0%
Sweden	56.6%	56.6%	56.6%
Switzerland	31.9%	31.7%	31.7%
United Kingdom	40.0%	35.0%	35.0%
United States	49.8%	49.8%	44.2%
Simple Average	**48.2%**	**47.2%**	**46.6%**
Weighted Average	**49.1%**	**48.4%**	**45.7%**
	1985	**1986**	**1987**

The TRA of 1986 was significant, but it still left us with a tax system that was based on taxation of worldwide earnings. It also kept in place the provisions of Subpart F of the 1954 Code (§§ 951-965). The US system also relies on a cumbersome set of rules that give taxpayers a tax credit for foreign income that is taxable when remitted or “deemed to be remitted” under Subpart F. These credit rules, if not correctly managed, will ensure double taxation. This will occur especially if the US company is a limited liability company, partnership, or S Corporation, in which case its earnings are taxable to the individuals who own them. This is because the tax code denies individuals the benefit of a type of tax credit known as “deemed paid credits”.

These are the tax credits that relate to income taxes paid by foreign operations on their taxable income.

A lot has changed in the 30 years since TRA 86 was enacted and businesses have become more globalized. In 1986 a multinational business was a loose confederation of companies that were largely self-sufficient and independent in operation while today global companies are made up of "centers of excellence", "toll manufacturers", "treasury centers", and "trading hubs." These companies all work across national borders as an integrated machine that processes raw materials into finished goods and ships to markets all over the world. The US tax code, however, was built to tax a different world, a world before globalization.

Additionally, since 2000, many countries have reduced their income tax rates. The United States is the exception in that in 1986 the United States had the lowest tax rate in the G20 while today it has the highest.

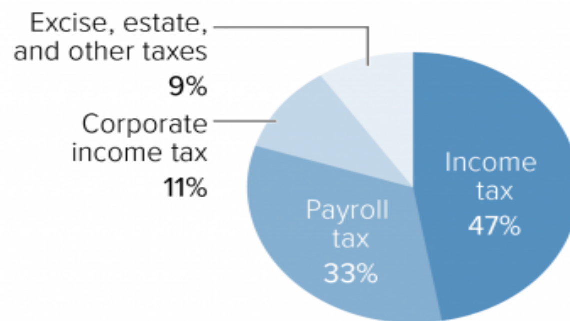
Location	2012	2013	2014	2015	2016
Cayman Islands	0	0	0	0	0
Isle of Man	0	0	0	0	0
Bulgaria	10	10	10	10	10
Gibraltar	10	10	10	10	10
Cyprus	10	12.5	12.5	12.5	12.5
Ireland	12.5	12.5	12.5	12.5	12.5
Hong Kong SAR	16.5	16.5	16.5	16.5	16.5
Singapore	17	17	17	17	17
Switzerland	18.06	18.01	17.92	17.92	17.92
Czech Republic	19	19	19	19	19
Hungary	19	19	19	19	19
Russia	20	20	20	20	20
United Kingdom	24	23	21	20	20
Denmark	25	25	24.5	23.5	22
Austria	25	25	25	25	25
China	25	25	25	25	25
Luxembourg	28.8	29.22	29.22	29.22	29.22
Australia	30	30	30	30	30
Italy	31.4	31.4	31.4	31.4	31.4
Japan	38.01	38.01	35.64	33.06	32.26
Brazil	34	34	34	34	34
United States	40	40	40	40	40
Africa average	29.02	28.29	27.85	28.03	27.46
Americas average	28.67	28.35	27.96	27.14	27.86
Asia average	22.89	22.05	21.91	21.91	21.97

Europe average	20.42	20.6	19.68	20.24	20.48
Oceania average	28.6	27	27	27	26
North America average	33	33	33.25	33.25	33.25
Latin America average	28.3	27.96	27.52	26.61	27.29
EU average	**22.51**	**22.75**	**21.34**	**22.15**	**22.09**
OECD average	**25.15**	**25.32**	**24.11**	**24.77**	**24.85**
Global average	**24.4**	**23.71**	**23.64**	**23.68**	**23.63**

Our tax code is obsolete. In fact, it is not only obsolete, it is suicidal. As a result of our obsolete tax code, United States multinational businesses are at a significant disadvantage over their non-US based competitors. This is because US companies can only reinvest about 60% of their profits after tax, where their foreign counterparts can reinvest over 75%, and in many cases as much as 95% of their profits. As a result, it is estimated that US multinational companies have approximately $3 trillion of capital sitting offshore to be reinvested in creating jobs and manufacturing capacity offshore. Also, because it is so expensive to bring their profits back to the United States, US based companies are moving off-shore, through what are called "inversions" to get to their money and move into a tax structure that is competitive in a global market.

Because of our obsolete tax code, with its high tax rate, complex anti-deferral rules under Subpart F, and cumbersome tax credit provisions, our tax code is now suicidal. It is killing jobs and investment. It is killing our economy and forcing American companies to move offshore.

Yet what is lost in this entire discussion is the fact that according to the Office of Management and Budget on average corporate income tax makes up only about 7%-11% of the entire federal budget depending on the year. At that level, the resources to file tax returns, and enforce the complex rules may well offset the revenue. The Congressional Budget Office estimates the costs of collection is on average 22%-26% of all revenue collected. Of this corporation income tax, being the most complex, would logically have a collection cost that is higher than individual income tax. Over 80% of the federal revenue comes from individual income and payroll taxes. The breakdown on tax revenue, for example in 2015 was as follows:



The solution is obvious: eliminate the corporate income tax altogether. This makes sense if you consider that if you reduce the tax rate without greatly simplifying the calculation of taxes, the cost to collect the reduced tax will absorb a large percentage of the revenue from the tax. Tax rate reduction only works when in conjunction with simplification of taxation.

This is a concept that would undoubtedly be rejected by career politicians, mostly from the Left. For example, the Minister of Finance for Germany, Herr Schaeuble, said on July 7, 2016 that he was opposed to the trend in the European Union to reduce tax rates saying that it is a "race to the bottom." When I read his words, I could not help but hear Margaret Thatcher saying "the problem with socialism is that eventually you run out of everyone else's money." Indeed, this is Herr Schaeuble's problem and is consistent with the reaction Democrats have in the United States. They refer to a proposal to reduce tax rates as "Corporate Welfare".

The bureaucrats are rebelling. The high tax countries are demanding lower taxing countries to raise their tax rates. On August 30, 2016, the European Union's antitrust regulator demanded that Ireland recoup roughly €13 billion ($14.5 billion) of unpaid taxes accumulated over more than a decade by Apple Inc. The European Commission, Competition Agency, under Commissioner Margrethe Vestager, declared that Ireland's ruling to Apple, a ruling that led Apple to invest millions of Euros and create approximately 6,000 jobs amounted to "illegal state aid", and as its punishment Ireland must now take €13 billion ($14.5 billion) it does not want.

It is also interesting that the "penalty" is applying a method of taxation that does not exist under any Irish or international law. The Commission has set out in its decision the methodology to calculate the value of the undue competitive advantage enjoyed by Apple. In particular, Ireland must allocate to each branch all profits from sales previously indirectly allocated to the "head office" of Apple Sales International and Apple Operations Europe,

respectively, and apply the normal corporation tax in Ireland on these re-allocated profits. This apportionment based formula is not law anywhere. The Commission made it up to achieve a result. Seldom right, but never in doubt.

The root of the problem is that career politicians cannot do arithmetic. They are therefore often wrong, but never in doubt. They are willing to net negligible revenue for the US Treasury after tremendous effort and cost, and miss the opportunity for tremendous income tax revenue from individual and payroll tax. Our corporate income tax is stifling our economy and killing jobs by overburdening corporate working capital with income taxation.

For example, on August 31, 2016, Jack Lew, the Secretary of Treasury, agreed the Apple case highlights a need for tax reform, but then he continued to conclude we need to raise taxes by cutting off all deferral to fix it.[2] He views it as an issue of plugging a loophole. The "loophole" he is referring to is the current inability of the IRS to tax profits in US affiliates, that relate to business that is entirely outside the USA, until the profits are loaned or remitted to the USA parent. This would be equivalent to throwing fuel onto the fire. The US corporate tax code is already out of line with the tax rates of the G20 and OECD. Moving them further out of line, and expanding the tax base to grab US corporate assets is not the solution.

If the corporation income tax is eliminated there would be tremendous economic growth, job creation, and other benefits. Consider the possibility that all the inverted companies will repatriate to the United States. Consider the possibility that the many companies currently headquartered in Ireland, Hong Kong, Singapore and Switzerland and other low tax locations would relocate to the United States. Consider the job creation, investment, and inevitable economic growth.

When the Tax Reform Act of 1986 was enacted, the unemployment rate was 7.2%. A lot of critics of the reform, said that reducing tax rates would bankrupt the government.[3]Reagan countered these critics by arguing the creation of income wealth and jobs would counteract the reduction in tax rates and the overall revenue to the US government would increase: when the tide rises all ships go up.

Here is what happened? Unemployment dropped significantly following the TRA 86. So, jobs were created.

Unemployment rate Year	Annual
1983	9.6
1984	7.5

[2] http://www.wsj.com/articles/treasury-secretary-lew-criticizes-eu-decision-to-issue-apple-14-5-billion-tax-bill-1472653403

[3] New York Times, <u>*Critics Await Tax Revolution*</u> By Steven Prokesch Published: August 19, 1986

Unemployment rate Year	Annual
1985	7.2
1986	7.0
1987	6.2
1988	5.5
1989	5.3
1990	5.6
1991	6.8
1992	7.5
1993	6.9
1994	6.1
1995	5.6
1996	5.4
1997	4.9
1998	4.5
1999	4.2
2000	4.0

The federal deficit went down every year except 1991 and 1992 (Gulf War 1 years) until 1998 when deficits disappeared all together and we had four straight years of surplus budgets.[4]

1985	$212.3 Billion Deficit	$472.83 Billion Deficit
1986	$221.2 Billion Deficit	$484.03 Billion Deficit
1987	$149.7 Billion Deficit	$315.82 Billion Deficit
1988	$155.2 Billion Deficit	$314.17 Billion Deficit
1989	$152.5 Billion Deficit	$294.97 Billion Deficit
1990	$221.2 Billion Deficit	$405.87 Billion Deficit
1991	$269.3 Billion Deficit	$474.12 Billion Deficit
1992	$290.4 Billion Deficit	$496.41 Billion Deficit

[4] Whitehouse.gov - Historical Tables (Table 1.1)

1993	$255.1 Billion Deficit	$423.05 Billion Deficit
1994	$203.2 Billion Deficit	$328.8 Billion Deficit
1995	$164 Billion Deficit	$257.86 Billion Deficit
1996	$107.5 Billion Deficit	$164.12 Billion Deficit
1997	$22 Billion Deficit	$32.84 Billion Deficit
1998	$69.2 Billion Surplus	$101.76 Billion Surplus
1999	$125.6 Billion Surplus	$180.72 Billion Surplus
2000	$236.4 Billion Surplus	$329.25 Billion Surplus
2001	$127.3 Billion Surplus	$172.26 Billion Surplus

During the past several years, however, under the Obama administration, deficit budgets have been over $1 trillion:[5]

2009	$1413 Billion Deficit	$1578.77 Billion Deficit
2010	$1294 Billion Deficit	$1421.98 Billion Deficit
2011	$1299 Billion Deficit	$1384.86 Billion Deficit
2012	$1100 Billion Deficit	$1148.23 Billion Deficit
2013	$680 Billion Deficit	$699.59 Billion Deficit
2014	$485 Billion Deficit	$490.89 Billion Deficit
2015	$438 Billion Deficit	$438 Billion Deficit

The data clearly shows the dynamic formula was the correct one. The naysayers were wrong. But why were they wrong? Because the naysayers of the dynamic model were not able to do the arithmetic so they discarded the principle. This is how career politicians do things.

It is time to fix this. In fact, it is way overdue.

[5] Id.

The solution is remarkably simple. It would require a change to only two code sections: 26 USC §§11(b) and 55(b). If the tax rate tables in these code sections (§ 11 is regular corporation income tax, and § 55 is "alternative minimum tax") are amended to make all rates zero, the entire solution would be complete. Fixing the problem does not require any significant changes beyond these two code sections. States would also need to consider doing the same amendment(s) and that would effectively eliminate corporation income tax altogether.

If 10% of revenue goes away from eliminating federal income tax on corporations and 3% of costs to collect go with it, the net loss is 7%. If that 7% loss, however, creates 10% growth in the economy, for example, the wage increase would 8% because taxes on wages and individual income is over 80% of the federal budget (10% growth in 80% is 8%). Federal net revenue would increase without any new taxes or tax rate increases. Some might argue that a 10% growth is unrealistic, but considering there is already an estimated $2+ trillion of corporate capital sitting offshore that can be reinvested in the US and the high income jobs created when the C-Suite jobs return to the US, 10% growth is conservative. Additionally, if a corporation has excess profits, by not having the income tax, there are more profits to invest in growth or return to shareholders, who then pay tax on the dividends they get.

The biggest reason to pause before making this change is that so much money and investment will rush to America that it might create job shortages and inflation. However, with the rush to invest in the US, the dollar will greatly strengthen, and likely offset a lot of the inflationary pressure.

Why is this not obvious to career politicians? The answer is because most career politicians lack the business acumen to understand the need for tax reform and the simplicity of solving the problem. Instead of contriving job killing regulations and policies that run investment and jobs offshore, wouldn't job creation, capital investment and a strengthening dollar make more sense?

Our current tax code is not only obsolete, it is suicidal. We must fix this immediately because the need for a fix is twenty years overdue. If we do not modernize our corporate tax code, all Americans will be working for foreign companies. Our great brands will all be foreign owned and global headquarters will leave with each inversion.

This topic must take on greater importance.

About the author:

Greg Bryant is the Managing Partner of BILTgroup, a boutique law firm focused on international tax and law. He brings his clients the benefit of over 25 years of hands-on experience in Big 4 and executive management, helping companies from start-ups to Fortune 100 companies expand into new markets and navigate operational and tax risks inherent with global markets. He is a CPA as well as an attorney.

Greg helps companies that are expanding into global markets. He helps them navigate the challenges of moving goods, services and intangible property across borders. From his experience in law, finance and taxation, Greg knows the importance of aligning tax structures and transfer pricing with operational flows and treasury management. The alignment of tax to operations and treasury ensures less touch-points, less tax costs, less complexity, more liquidity, better cash management and strong economic fundamentals to support tax efficiencies.

He also helps companies and individuals who are dealing with tax controversy matters that involve investments or operations outside the U.S. Greg has handled several large tax matters, including the challenge of a $12 million assessment in the Federal Fiscal Court of Germany, the country's highest fiscal court, and the challenge of a $6.7 million transfer pricing dispute assessment in Tanzania. He also handles cases concerning foreign bank accounts.

Greg also helps companies investing in the U.S. by advising on managing federal and state tax risks as well as transfer pricing and can help companies to access tax incentives for investing in energy efficiency and exporting from the US

Prior to launching BILTgroup, Greg has held previous positions as Chair of International Tax with Williams Mullen. And was also a Partner with Cherry Bekaert LLP, where he was practice leader of the National Corporate Tax group; PricewaterhouseCoopers LLP, where he was Senior Manager of the Washington National Tax Services and later the Director of Value Chain Transformation in Washington National Tax; GlobalTax, where he was founder and Managing Director; and Alliance One International Inc., where he was Vice President of Taxes and Shared Services.

Mr. Bryant earned a B.S. in accounting and a B.A. in political science from the University of South Carolina. He received his juris doctor from the University of South Carolina Law Center and his LLM, Master of Tax Law, from the Georgetown Law Center in Washington, D.C. He is a Certified Public Accountant and a member of the Pennsylvania Bar (not licensed in North Carolina).