Obama Plays Repatriate Games With U.S. Businesses

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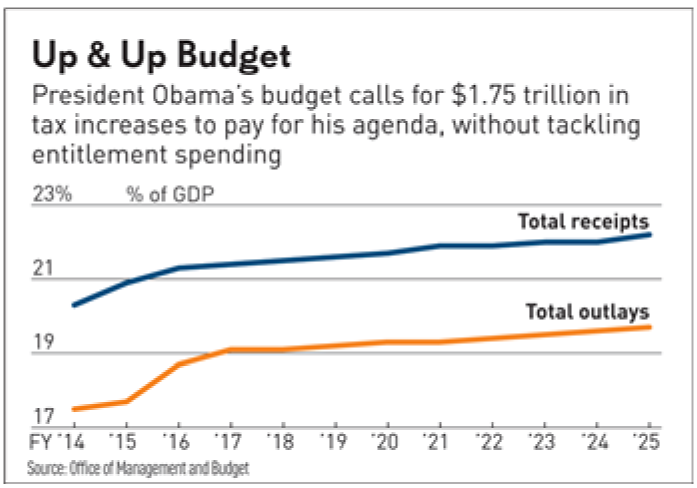
The big "pro-growth" initiative in President Obama's 2016 budget on Monday starts by hiking corporate tax revenues by 12% over five years, a move that critics say would make the tax system even less competitive.

The $268 billion in added revenue would supercharge the fading Highway Trust Fund without a gas tax hike and allow for $478 billion in transportation spending over six years.

The tax hike would target the foreign operations of U.S. multinationals and, thus, supposedly make it pain-free for U.S. workers. It would come from imposing a one-time 14% tax on $2.1 trillion in accumulated foreign-earned profits of U.S. companies that have never been taxed by the IRS. **Apple** (NASDAQ:AAPL) holds $158 billion overseas, out of a total $178 billion cash holdings.



But analysts see several problems with what amounts to a retroactive rule change:

These overseas profits accumulated over years aren't just sitting in a bank, but have been re-invested in operations.

To the extent that the tax hike curbs corporate cash accumulation, it will hit stock prices and curb dividends, says University of Maryland business professor Peter Morici.

From Bad To Worse?

The bigger issue is that instead of fixing what is widely agreed to be an uncompetitive corporate tax system, the Obama administration would make it even harder for U.S. firms, analysts say.

Business Roundtable President John Engler blasted the "proposed steep tax increases on businesses that will negatively impact their competitiveness — especially those businesses that compete in the global marketplace."

Major U.S. trading partners tax profits only where they are earned. But America taxes foreign earnings, only when U.S. companies bring the cash home. Those profits are then taxed at the 35% U.S. corporate tax rate, adjusted for taxes the companies paid in the country where they were earned. This system and rate encourages U.S. companies to leave such profits overseas.

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Because the U.S. headline rate is so much higher than in other industrialized nations, corporate tax reform never has been far from the top of the political agenda. If anything, its importance has grown as U.S. trading partners have cut their corporate tax rates.

Businesses, backed by Republican policy leaders, have pushed to make U.S. rules consistent with other major economies.

But the White House plan also would impose a permanent 19% minimum tax on all foreign-earned profits — without deducting taxes paid overseas.

"U.S. foreign subsidiaries suck exports out of the U.S." that go into finished goods overseas, says Chris Edwards, Cato Institute's director of tax policy studies.

Thus, by making the foreign operations of U.S. multinationals less competitive, American workers will also take a hit, he says.

While the White House's approach signals scant hope for comprehensive corporate tax reform, it's not just the Obama administration that's eyeing overseas profits as a way of filling a hole in the Highway Trust Fund.

Some bipartisan talks in Congress mulled a one-time 8.75% tax on foreign earnings, before the White House upped the ante.

In 2005, Congress passed a repatriation holiday, temporarily allowing companies to return overseas profits and pay just a 5% rate. That spurred companies to bring back $312 billion, yielding $16 billion in tax revenue.

But budget scorekeepers judge that such holidays widen deficits, in part because companies respond by keeping profits overseas in hopes of a future holiday.