FINANCIAL POST

Terence Corcoran: America's corporate tax nightmare

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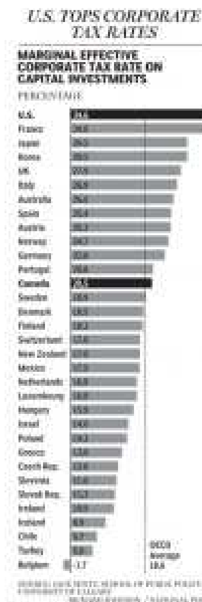
High U.S. tax rates are distorting investment decisions



In his State of the Union address and in comments since, U.S. President Barack Obama has demonstrated a remarkable ability to talk around the corporate tax policy nightmare taking shape across America. Not only are U.S. corporate tax rates now essentially the highest in the world, other elements of U.S. tax policy are distorting investment decisions.

Much has been said about the fact that U.S. corporations are sitting on as much as US$2-trillion in cash. But some new research suggests as much as US$1-trillion may be sitting on U.S. corporate books outside the United States, money that American businesses are reluctant to bring home to distribute or invest — because high U.S. corporate tax rates and rules discourage repatriation of foreign profits.

The President's idea of corporate tax reform is to get out a shotgun and hunt down corporate loopholes that he and other Democrats claim are draining U.S. government coffers and undermining growth.

He was at it again last week, taking aim at his favourite corporate target: "We shouldn't provide special treatment to the oil industry when they've been making huge profits," he said, ignoring the fact that there are no special oil industry loopholes to be found. As for across-the-board cuts in U.S. corporate taxation, Mr. Obama said he wouldn't sign on to any reductions in corporate tax rates until the existing loopholes are removed.

In Mr. Obama's view, America needs high corporate tax rates to reduce astronomical deficits — a fiscal strategy that plays to the anti-corporate crowd that still seems to dominate the Obama adminstration. But here's an idea: If the administration doesn't like U.S. corporate interests influencing the debate, maybe they'll take some guidance from a Canadian, Jack Mintz, head of the School of Public Policy at the University of Calgary.

In a paper released yesterday by the Cato Institute in Washington, Mr. Mintz produced the latest data on corporate taxation around the world. For some countries, including Canada, the numbers look good. Since 2005, the marginal corporate tax rate on new capital investment has dropped by five percentage points to 20.5%. In other countries, from Germany to Italy and Denmark, marginal corporate rates have been cut by as much as nine percentage points. As the nearby table shows, the result is an American disaster in the making. And as such, there is no reason for complacency in Canada. Even though Canadian corporate tax rates have dropped and are expected to continue to fall in coming years, the high U.S. corporate tax rate remains a threat to the health of the Canadian economy.

In a speech in Toronto yesterday, Mr. Mintz noted that Canada is part of a North American economic region that very much depends on U.S. economic expansion and success. Canada's lower tax rate might provide a competitive advantage against the United States, but the gains from that advantage will be slim if the U.S. corporate tax rate remains outrageously uncompetitive with the rest of the world. "A poor economic environment in the United States can hurt Canada through trade. Canada and Mexico benefit from a competitive North American region."

If the U.S. fails to attract investment due to high marginal tax rates on corporate profits, Canada will lose out. In political terms, Canadians should have as great an interest in pushing U.S. corporate tax reform as they have in lowering Canadian rates.

The perverseness of the U.S. high-tax regime was reinforced by a recent paper from the Sloan School of Management's Michelle Hanlon. In the paper — *The Real Effects of Accounting Rules: Evidence from Multinational Firms' Investment Location and Profit Repatriation* — Ms. Hanlon and others demonstrate that U.S. corporate tax rules and the world's highest corporate tax rates shape U.S. corporate investment decisions.

The high marginal tax rate — almost 35% — is a problem in itself. But the United States is the only country in the world that taxes its corporations on the basis of world profits. Every dollar earned abroad must bear a 35% tax rate. If the profits are earned in Canada, the corporation would pay 20.5% to Canadian governments, but then be forced to pay 14.5% more when profits are distributed back to the United States.

To avoid paying that U.S. tax, corporations are allowed to defer payment and also keep the profits abroad, where the money continues to earn income at reduced foreign tax rates. The perverse effect is to promote cash hoarding by U.S. corporate interests abroad. Some say as much as US$1-trillion may be sitting

offshore, tax deferred, as executives continue to make money without paying U.S. tax.

Mr. Obama may be hoping to get his hands on that cash storehouse to lower the U.S. deficit. But if he does, it would be a major blow to U.S. corporate balance sheets. As Jack Mintz suggests in his Cato report, closing loopholes isn't the answer. "The aim of corporate tax reforms should be to create a system that has a competitive rate and is neutral between different business activities." He called for a sharp drop in U.S. corporate rates of 10 percentage points — something that would be as good for Canadians as it would be for America.

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