May 06, 2009, 4:00 a.m.

A Tax Attack on America's Top Companies

Obama plans a $190 billion hit on U.S.-based multinationals.

By Jim Powell

In the name of tax reform, Pres. Barack Obama has announced $190 billion of tax hikes on many of the biggest U.S. employers. By reducing after-tax profits, these tax hikes could hammer stock prices that reflect investor expectations of future profits.

Among the employers in Obama's crosshairs: Aetna, Alcoa, Allstate, American Express, Berkshire Hathaway, Best Buy, Cisco Systems, Coca-Cola, Costco Wholesale, Dell, Dow Chemical, DuPont, Exxon Mobil, Ford, General Motors, GMAC, Hewlett-Packard, Honeywell, IBM, Intel, Johnson & Johnson, Kraft Foods, Kroger, McDonald's, Merck, Microsoft, Motorola, News Corp., PepsiCo, Pfizer, Proctor & Gamble, Safeway, Sears, Sprint Nextel, Supervalu, Sysco, Target, Time Warner, Walgreens, and Walt Disney.

The stocks of these companies are in millions of portfolios held by individual investors, mutual funds, and pension funds, as well as endowments at colleges, hospitals, museums, and other institutions. Obama's business-tax hike will hit Americans whose jobs and pensions depend on these companies' success — particularly in tough times. Colleges will have a harder time keeping tuition affordable if Obama hammers their portfolio holdings, and hospitals will be under more pressure too.

Obama claims his tax hikes will "level the playing field." He reasons that since U.S.-based companies doing business exclusively in the U.S. don't get to defer U.S. taxes on profits earned overseas, U.S..-based multinationals shouldn't be able to defer taxes either. He wants all U.S.-based companies to be fully subject to U.S. business tax rates that are among the highest in the world.

But U.S.-based multinationals are already paying taxes in the countries where they operate. Almost all countries impose taxes based on residency; you pay taxes where you live or operate. The United States is the major exception, imposing taxes based on citizenship. This means an American stationed abroad must pay taxes both to the country where he or she lives as well as to the United States — double taxation. Although an American can claim a credit on a U.S. tax return for foreign taxes paid, he or she will still have to deal with tax bills from two countries. In 2006, Pres. George W. Bush signed a tax increase on Americans living abroad, and the *New York Times* reported there was an increase in the number of Americans renouncing their U.S. citizenship.

This gives you an idea how corporate decision-makers are likely to feel about double taxation. A U.S.-based multinational company operating abroad must pay taxes to the country where it operates. Obama wants U.S.-based multinationals to pay taxes on their operations abroad as if those operations were in the U.S. The bottom line is taxes to two countries — heftier taxes, despite whatever credits might be applicable.

In the event Obama were able to impose such double taxation on the offshore operations of U.S.-based multinationals, the consequences could be devastating. U.S.-based business could be wiped out around the world because of the difficulty of competing with offshore-based rivals that have to pay taxes only to the (probably lower-tax) country where they have operations. Taxes are just another cost of doing business, and if they make the total cost of doing business excessively high, a company is bound to lose market share and ultimately withdraw from a market. Large numbers of U.S. jobs are related to business being conducted overseas, so if overseas business contracts, jobs are going to be lost here in America.

Obama, who lacks business experience, seems to imagine that the only reason U.S.-based multinationals have offshore operations is to achieve tax savings. Actually, a company is in a better position to compete with local firms if it has an operation close to its market, compared with a U.S. firm that ships its goods thousands of miles away. An offshore operation is more likely to understand local market conditions, tastes, and trends. Obama's double taxation would provide perverse incentives for U.S.-based companies to give up knowledge, relationships, and other advantages they spent years developing firsthand in world markets.

page
Another possibility is that Obama's double taxation triggers an exodus of U.S.-based multinationals that re-incorporate offshore. We have seen how, during the past several decades, high New York City taxes played a major role in the dramatic exodus of *Fortune* 500 headquarters to lower-tax states. More recently, we have seen how California's high taxes have stimulated an exodus of companies from that state, contributing to high-tech "clusters" elsewhere in the country.

Consider how double taxation would affect incentives facing U.S.-based multinationals that make more money abroad than they do in the U.S: General Motors, for example. Why would GM endure double taxation on its profitable overseas operations for the sake of its unprofitable U.S. operation? If Obama had his way with double taxation, we might wake up suddenly to find that GM had become a Swiss-based corporation that walked away from its U.S. operation, leaving it in the hands of the UAW and the U.S. Treasury (or maybe the post office). There could be many defections from the *Fortune* 500 list.

By undermining the profitability of U.S.-based multinationals, Obama's business-tax hikes would drive increasing numbers of Americans to invest in more profitable offshore-based companies. According to the Commerce Department's Bureau of Economic Analysis, U.S. investors already hold some $5.1 trillion of stock in offshore-based companies. This number could go up significantly. An accelerated outflow of capital from the U.S. would be bad news for U.S. capital markets and stock prices.

People and capital go where they're welcome, and when they no longer feel welcome, they move on. Obama can talk all he wants about why high taxes are fair taxes, but if they're significantly more burdensome than what's being imposed elsewhere, employers and jobs are going to go away, and all of us here will suffer.

— Jim Powell, a senior fellow at the Cato Institute, is the author of FDR's Folly *and* Greatest

Emancipations*, among other books.*

National Review Online - http://article.nationalreview.com/?q=OTU5MGFlMGNiMDVmZjI3M2YxNDY5ZGY1ZTk4MzU5YWY=