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Monday, May 04, 2009

Obama Goes in the Wrong Direction on Taxes [\[Stephen Spruiell\]](#)

President Obama used the occasion of Tax Day to call for a simpler tax code. It sounded good until we got the details:

President Barack Obama will flesh out a proposal included in his February budget blueprint seeking to curb the practice of parking foreign earnings in offshore tax havens indefinitely. By some estimates, \$700 billion or more in U.S. corporate earnings have accumulated in overseas accounts in recent years. [...]

In one big change, the administration is aiming to curb a practice commonly known as "deferral," which U.S. multinationals use to shave their tax bills on their overseas operations.

Under current law, U.S. companies can defer taxes indefinitely on the many of the profits they say they have earned overseas until they "repatriate" that money back to the U.S. The administration seeks to sharply limit the tax deductions that companies taking advantage of deferral can take.

Chris Edwards and Dan Mitchell provided an excellent explanation of the deferral issue in thier book *Global Tax Revolution*. The U.S. is one of the few OECD countries that formally taxes its corporations on the profits they make overseas. It is true that deferral is a loophole in this system; companies don't pay the tax unless they repatriate the profits. But the right reform would be to scrap the tax on foreign profits and return to a "territorial" system. As Edwards and Mitchell explain:

Under a pure [system of worldwide taxation], for example, a U.S. company would pay a 35 percent tax on a factory it owned in Ireland. Meanwhile, a French company would pay only the 12.5 percent Irish tax on profits at a factory in Ireland because France has a territorial tax system. The effect would be that U.S. companies would face a severe disadvantage in the Irish market compared with companies from France and elsewhere.

Of all the "simplifications" that our tax code badly needs, Obama has (of course) picked the one that would have the most adverse effect on U.S. businesses — in the midst of a recession, no less. Nor is the legislation likely to make the tax code "simpler": The administration is asking for at least one carve-out that we know of, and Congress will probably add more:

Overall, the deferral proposal would raise about \$60.1 billion through 2019, according to the administration's estimates. Unlike a similar proposal in the House, it wouldn't affect research deductions, a likely victory for some industries

such as pharmaceuticals.

So by "simpler," Obama actually meant "more complicated" and "less competitive."

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