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Rhetoric Surrounding Obama's International Tax Proposals Detracts From Real Debate, Practitioner Says

by Kristen A. Parillo

The political rhetoric surrounding the Obama administration's international tax proposals unfairly paints multinational corporations as tax evaders and detracts from the real debate about how the U.S. should reform the international tax system to make the country more attractive to multinationals, a U.S. practitioner said May 13 at a conference in Boston.

''The administration is confusing legitimate tax planning with tax evasion,'' said Douglas S. Stransky, a partner with Sullivan & Worcester, the firm that sponsored the second annual Worldwide Tax Update. Stransky, who noted his views don't necessarily reflect those of his firm, discussed the Obama proposals, announced May 4, that aim to reform the U.S. international tax system, most notably in the areas of deferral, foreign tax credits, the check-the-box regime, the qualified intermediary program, and international tax enforcement efforts. (For prior coverage, see *Doc 2009-10972* or *2009 WTD 92-3*.)

''I'm particularly disturbed by the lumping of multinational companies as abusers in the same bucket that you have tax evaders,'' he said. ''When you listen to the comments and read some of the press releases, you come away with the idea that the administration is more concerned about the amount of taxes paid rather than where they were paid.''

Stransky said the statement in the White House press release accompanying the proposals that U.S. multinationals have an effective U.S. tax rate of only 2.3 percent is misleading because it doesn't explain how much multinationals pay on a worldwide basis. The use of the word ''loopholes'' by both the administration and various lawmakers is also perplexing, he continued, because many of the provisions in the current tax laws have been in existence for decades.

''As many of you know how tax laws are passed, they go through lots and lots of evaluation before Congress votes on those tax laws,'' Stransky said. ''So I don't think, in my view, those are loopholes.''

The administration's assertions that the proposals will create U.S. jobs perpetuate the myth that investing abroad destroys American jobs, he added. ''On the contrary,'' he said, noting that one study by Harvard economists Fritz Foley and Mihir Desai and by James Hines of the University of Michigan estimates that for every 10 percent increase in U.S. multinationals' overseas payrolls, their American payrolls increase almost 4 percent.

Stransky also found troubling the administration's statement that multinationals will finally pay their ''fair share'' if the proposals are passed. Stransky explained that based on the administration's estimates that the proposals would bring in $210 billion in revenue over 10 years (money that is already included in Obama's budget), the proposals' revenue represents only six-tenths of 1 percent of the decade's projected revenue of $32 trillion.

''Worse, the Congressional Budget Office projects the deficit is going to grow to over $9.3 trillion,'' Stransky said. ''So let's be clear on what this is about — this isn't about creating jobs, this is about the administration needing money.''

'Real' Reform Needed

''I'm a little bit disturbed about the political rhetoric around the proposals, in particular the points with respect to the creation of new jobs and painting of multinational corporations as tax abusers taking advantage of loopholes,'' Stransky told Tax Analysts in an interview following his presentation.

Including proposals targeting individual tax evaders with proposals designed to reform the taxation of multinationals is harmful, Stransky said. ''People that hear that think it's all the same — this person is hiding money in a foreign bank account, this person is taking advantage of a loophole and not paying his or her fair share,'' he said. ''That is disturbing and takes away from the real debate.''

If the administration really wants to take up international tax reform, Stransky said, it should focus on what

direction the reform should take — whether the U.S. should continue with a residence-based system, adopt a territorial system, or implement a hybrid system.

Along with a discussion on whether to change the fundamental structure of the U.S. international tax system should be a debate on reducing the U.S. corporate tax rate, Stransky said. Those opposing a rate reduction would probably point to the administration's figures showing that U.S. multinationals have an effective tax rate of only 2.3 percent, ''which is clearly not the case,'' Stransky said.

He said those figures are probably based on tax provisions in companies' financial statements, which don't provide a true picture of the amount of U.S. taxes a company is actually paying. ''Furthermore, when the president talks about multinationals not paying a lot of tax, again, he's just saying this is U.S tax, and — let's assume that number is correct — he's not focusing on how much tax is being paid on a worldwide basis,'' Stransky said.

''Reading the [White House] press release, you would think that U.S. multinationals are not paying tax anywhere in the world and not paying tax in the U.S., and therefore that behavior has got to stop and these proposals are designed to stop that,'' he continued. ''Well, that just isn't true. And so why do you perpetuate that myth? I think it inflames.''

Stransky said the U.S. should consider lowering the corporate tax rate because the current 35 percent rate doesn't provide multinationals with much incentive to do significant tax planning in the U.S.

''Once you've taken your R&D [research and development] credit, once you've maximized your meals and entertainment deductions, and once you've assured yourself that you're taking all the deductions that you're entitled to in the U.S., there generally isn't any other tax planning you can do to give you a financial statement benefit,'' he said.

The reason most multinationals end up with low effective U.S. tax rates on their financial statements, Stransky said, is offshore tax planning rather than onshore planning. ''And a lot of the [Obama] proposals don't necessarily impact your ability to do offshore tax planning,'' he said. ''What they would do, however, is that to the extent you're taking U.S. benefits and now have to pay more U.S. tax, it of course mitigates some of the benefit you might have as a result of offshore tax planning.''

Increasing a multinational's effective U.S. tax rate also affects the company's earnings per share, Stransky added. ''What the president doesn't understand is that virtually every American has shares in public companies through one form or another — a 401(k), IRA, Roth IRA, direct investment, whatever,'' he said.

''If the earnings per share are reduced, then your investments in your 401(k) don't do as well,'' he continued. ''I'm not suggesting that tax planning encompasses everything, but tax is a cost, and so just like you wouldn't want to invest in a public company that had rampant spending on anything, you wouldn't want to invest in a public company that hasn't considered how it can reduce its costs.''

Most U.S. multinationals locate their operations offshore not for tax reasons — though that may factor into the equation — but because of business reasons, Stransky said. ''If it doesn't make business sense, if the company doesn't believe it can make money, they're not going to do it even if the tax rate is zero.''

Multinationals, he explained, will take into consideration a variety of factors, such as the availability of raw materials, a ready supply of less expensive labor, proximity to customers, and infrastructure. After considering those factors, a company may then ask tax advisers whether there is a way to arrange the structure in a way that will minimize the tax impact of what it's doing, Stransky said.

''At that point, the U.S. multinational may consider Jurisdiction A over Jurisdiction B and may decide to go to a particular jurisdiction because it's a lower tax jurisdiction,'' he said. ''Assuming from a business perspective all of that works, the pushing of jobs offshore isn't just a function of tax policy, it's a function of business policy.''

Many U.S. multinationals will choose to locate their operations in India, China, or Ireland over the U.S. simply because the cost of doing business is less expensive there, he said. ''That's why I say to give remarks to the public that say we're going to close these loopholes and bring jobs to America and stop creating incentives for companies to invest overseas just isn't true,'' Stransky said.

The administration should instead focus on making the U.S. international tax system more attractive to multinationals, he said. In addition to reducing the corporate tax rate, he said the government should consider actually expanding aspects of the deferral regime. Internal Revenue Code section 954(c)(6) — which provides that subpart F foreign personal holding company income generally does not include dividends, interest, rents, and royalties received or accrued from a related controlled foreign corporation — should be made permanent, Stransky said. Also, IRC section 956 — which treats a CFC's investment in U.S. property as gross income to its U.S. shareholder — should be amended to allow CFCs to invest in the U.S. tax free in some circumstances, he said.

''I wish the debate was framed with real facts and the reality of how companies do business in the world,'' Stransky said. ''And then from there, we talk about what changes to taxation should occur.'' ◆

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