CENTER FOR FREEDOM & PROSPERITY

Facts about a Territorial Tax System for American Business

America's system of taxing the worldwide income of U.S.-based companies needs reform. The current system, which taxes income corporations earn in other jurisdictions, makes it difficult for U.S. firms to compete in global markets by adding an extra layer of tax. Combined with America's high tax rate, worldwide taxation has even driven some U.S. companies to move their charters to jurisdictions with better tax law. Here are the key facts:

FACT: American companies not only pay tax to the IRS on income earned in the United States, but they also are liable for tax on income earned in other nations – even though that income already is subject to all applicable taxes in those other nations (much as foreign companies pay tax to the IRS on income earned in the United States).

FACT: The United States is one of a handful of nations that uses this system, known as worldwide (or sometimes known as global) taxation.

FACT: American companies usually are allowed a "credit" for the taxes they pay to foreign governments, but this offers scant relief because America's corporate tax rate is so high compared to other nations.

FACT: Moreover, worldwide taxation of corporate income accounts for a huge share of corporate compliance costs. Complexity would be reduced if the United States taxed U.S.-source income and other governments taxed the income earned inside their borders.

FACT: Territorial taxation is based on the common sense notion that governments should tax only the income earned inside their borders. Extra-territorial taxation is antithetical to free-market tax policies and inconsistent with all major tax reform plans.

FACT: This reform would dramatically boost the competitiveness of U.S. companies while fulfilling international trade obligations because many competitors are headquartered in nations with territorial tax systems. By boosting competitiveness, American exports will surge.

FACT: All free-market tax reform proposals, such as the flat tax, the consumed-income tax, and various sales tax proposals, are based on the principle of territorial taxation. This system is easier to enforce and would reduce tax evasion, while simplifying the IRS Code.

FACT: Because of the American policy of world wide taxation, American business relies on a provision known as "deferral" to stay competitive in the global market. American business can defer paying taxes on certain income if it is reinvested overseas. The Obama administration has talked about eliminating deferral and this would likely cost thousands, if not millions of American jobs.

More Information on back of page…

For More Information:

Coalition for Tax Competition February 2002 Letter to Treasury Secretary Paul O'Neill
http://www.freedomandprosperity.org/ltr/ctc2/ctc2.shtml

Market Center Blog: President's Chief Economic Adviser explains benefits of tax reform and territorial taxation
http://www.freedomandprosperity.org/blog/2004-12/2004-12.shtml#215

Microsoft Issues Job Threat to Obama Over Tax Plan
http://www.tax-news.com/asp/story/Microsoft_Issues_Jobs_Threat_To_Obama_Over_Tax_Plans_xxxx37222.html

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