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Testimony of

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Chairman Beyer, Ranking Member Lee, and Members of the Committee: Thank you for inviting me to share my views on the relationship between tax policy and our economy. Changes in our tax system are vital for encouraging U.S. job creation, economic growth, and inclusive economic prosperity.

Building a Solid Foundation for Job Creation

Simply put, raising adequate government revenue is a prerequisite for funding the nation's most urgent priorities and shoring up the fundamental economic strengths that are central to job creation. Resources are needed to build roads and bridges, to invest in education and training, to fund research, to mitigate climate change, and to support families throughout their lives, from tackling child poverty to maintaining a support system for the elderly.

These investments are important to all of us, including the business community, and business leaders have consistently advocated for a robust response to the problems of climate change as well as substantial funding commitments to infrastructure, research, education, and training. At present, however, the United States raises less revenue than required to fund our government: after the tax cuts of recent years, federal tax revenues are equal to only about 17 percent of GDP. (The last time the U.S. balanced the federal budget, receipts were about 20 percent of GDP.) We are in the bottom quintile of OECD countries in terms of revenue raised relative to GDP, across *all* levels of government.[1]

We raise particularly low levels of revenue on capital income. The Joint Committee on Taxation (JCT) reports that, in 2018, U.S. multinational companies (MNCs) paid an average tax rate of

[1] See the OECD Revenue Statistics database: https://stats.oecd.org/index.aspx?DataSetCode=REV#.

only 7.8 percent on their worldwide income.[2] In contrast, JCT finds that our top ten trading partners levied an average tax rate of 18.1 percent. Even before the Tax Cuts and Jobs Act (TCJA) was enacted in 2017—when the U.S. corporate tax rate was 35 percent—U.S. MNCs still paid an average tax rate (16.0 percent) that was lower than our top ten trading partners (19.2 percent). Similarly, a recent Reuters study found that U.S. MNCs pay effective tax rates that are much lower than those of MNCs in other countries. For the 52 largest U.S. MNCs, effective tax rates are 8 percentage points below their peers (companies named as competitors in filings) that are headquartered in foreign countries. Adoption of Administration tax proposals would lower, but not eliminate, the U.S. MNC tax advantage to 3 percentage points.[3]

At present, corporate income tax revenue as a share of GDP is about 1 percent, far lower than the share raised by our trading partners. For many years, the typical Organization for Economic Cooperation and Development (OECD) country has raised about 3 percent of GDP from corporate taxation, whereas in 2018 and 2019 (before the pandemic occurred), the United States raised only 1 percent of GDP from the corporate income tax. Even before the 2017 TCJA, the United States was below peer nations, collecting only 2 percent of GDP from the corporate income tax. Indeed, corporate income tax revenues as a percentage of GDP have been trending downwards in the United States since the 1950s.[4]

Table 1: Corporate Income Tax Revenues Relative to GDP

	United States	OECD Average[5]
Post TCJA: 2018/2019	1.0	3.1
5 Years before TCJA: 2013-2017	2.0	2.9
2000-2012	2.0	3.0

Source: OECD Revenue Statistics.

Corporate income tax revenues are low despite the fact that U.S. companies produce very high corporate profits, both in historic and comparative terms.[6] Indeed, the United States' corporate sector is the most profitable in the world, dominating every common metric of company success. In 2019, U.S. corporations accounted for 37 percent of the profits that accrued to the world's 2,000 largest companies, despite having a much lower share of world GDP (see Figure 1 below).[7] The outsized role of the U.S. corporate sector has been apparent for decades: over the prior 15 years, U.S. profit shares were at similar levels although they moved with exchange rates (since values are all measured in U.S. dollars).

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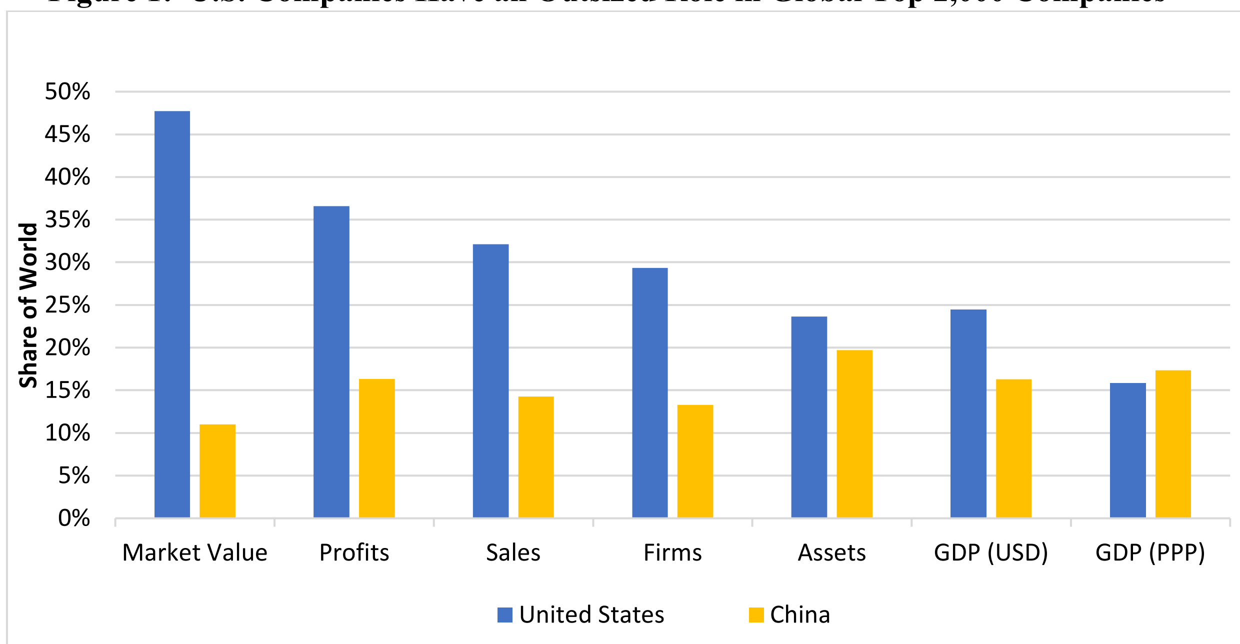
[2] This is the most recent year for which they have reported data.
[3] For the JCT study, see Table 3 on page 58 here: https://www.jct.gov/publications/2021/jcx-16-21/. The Reuters study was reviewed by outside academics; it ignores tax subsidies for manufacturing and clean energy as well as tax increases affecting foreign MNCs. See https://www.reuters.com/world/us/even-after-biden-tax-hike-us-firms-would-pay-less-than-foreign-rivals-2021-06-22/.
[4] Data from Urban-Brookings Tax Policy Center. 2021. "Corporate Income Tax as a Share of GDP, 1934-2019." See https://www.taxpolicycenter.org/statistics/corporate-income-tax-revenue-share-gdp-1934-2019.
[5] The average for G7 countries is very similar.
[6] The United States also has a large pass-through business sector, but the U.S. economy also shows robust corporate profits, both in comparative and historic terms.
[7] The second most dominant country on the Forbes Global 2000 list is China.

Figure 1: U.S. Companies Have an Outsized Role in Global Top 2,000 Companies



Source: 2019 data from the Forbes Global 2000 list published in 2020; GDP data from the World Bank.

In addition to large corporate profits, the United States has experienced very strong income growth at the top of the income distribution even as average tax rates for this group have fallen. According to Congressional Budget Office data, the share of aggregate income (before taxes and transfers) earned by the top 5 percent of the income distribution increased from 20.6 percent in 1980 to 30 percent in 2018 (the most recent year with data), while the average federal tax rate faced by those in the 96th to 99th percentile dropped from 27.1 percent to 24.2 percent over the same time period.[8]

In short, raising adequate government revenue is essential for the long-term competitiveness of the U.S. economy because it finances the public investments that are needed to maintain the considerable strength of America's business environment. Asking for somewhat larger tax contributions from the country's wealthiest households and most profitable companies will help meet that important long-term goal.

Levelling the Playing Field

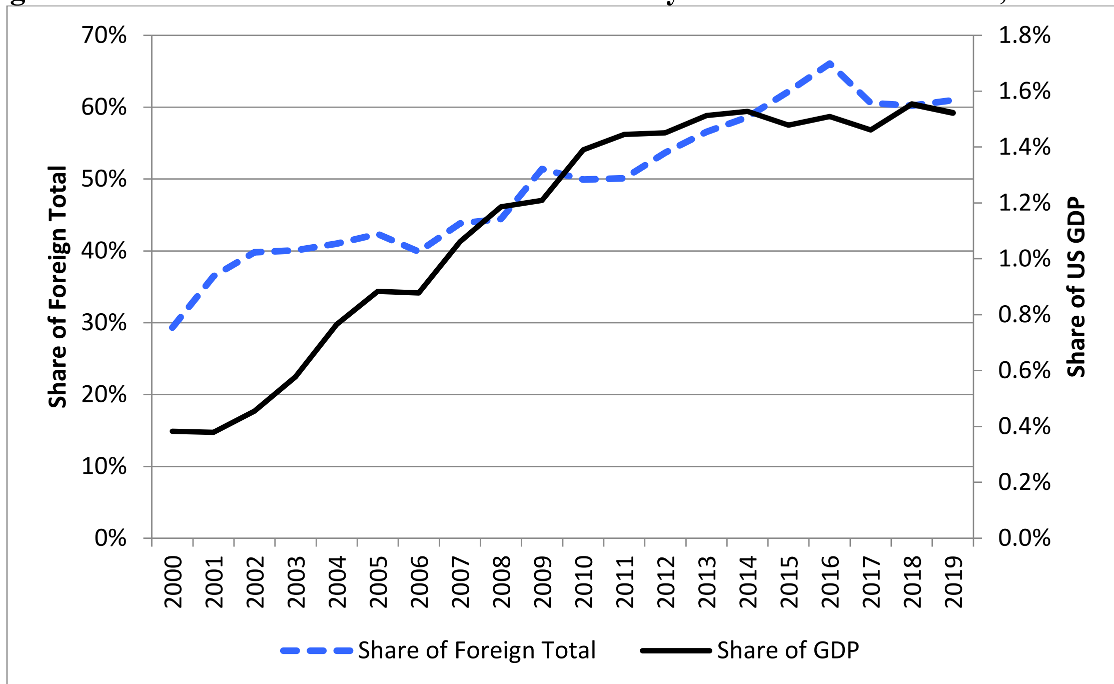
Under current law, a global intangible low-taxed income (GILTI) minimum tax applies to the foreign income of U.S. multinational companies. Unfortunately, offshore investment is encouraged by a feature of the GILTI minimum tax that exempts the first 10 percent return on foreign tangible assets. Under GILTI, owning greater *foreign* tangible assets (referred to as "qualified business asset investment" or "QBAI") increases the amount of foreign profit that is tax-free. There is already some limited evidence that U.S. companies are responding to these

[8] Congressional Budget Office. 2021. *The Distribution of Household Income, 2018*. Report No. 57061. The tax rate of the top 1 percent in the CBO data is somewhat higher, but it also drops over this period.

incentives by increasing their offshore investment.[9] Foreign activities are also encouraged by a GILTI tax treatment that allows a 50 percent deduction relative to domestic income. So foreign income is sometimes tax exempt, and sometimes taxed at half the rate of domestic income.[10]

In addition to incentivizing offshore investment and business activity, current law also strongly encourages profit shifting outside of the United States, shrinking the U.S. corporate tax base. Although the 2017 Tax Cuts and Jobs Act included a global minimum tax, it was not a sufficient incentive to counter other aspects of the law that increased profit shifting, such as the complete exemption of some foreign income from U.S. tax. As illustrated on Figure 2, the already large share of U.S. multinational income booked in low-tax jurisdictions is unchanged post-TCJA.

Figure 2: Share of U.S. MNC Income in Seven Key Low-Tax Jurisdictions, 2000-2019



Note: Data are foreign investment earnings from the U.S. Bureau of Economic Analysis (see https://www.bea.gov/international/di1usdbal). The seven most important low-tax jurisdictions in these data are Bermuda, the Caymans, Ireland, Luxembourg, the Netherlands, Singapore, and Switzerland. These shares are mechanically higher than they would be in some data sources since the data are reported on an after-tax basis.

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[9] For example, Beyer et al. (2021) find that for U.S. MNCs subject to higher GILTI inclusions, higher levels of pre-TCJA foreign cash are associated with increased post-TCJA foreign property, plant, and equipment investments. They do not find a similar increase in domestic property, plant, and equipment. Atwood et al. (2020) find the GILTI provisions introduced new incentives for U.S. MNCs to invest in foreign target firms with lower returns on tangible property so that they might shield income generated in havens from U.S. tax liability under the GILTI minimum tax. See https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3818149 and https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3600978.

[10] Depending on the countries of operation, the tax rate applied to this income for some firms can be somewhat higher than half the U.S. corporate income tax rate (rising up to 13.125 percent) due to limits on foreign tax credits.

Perversely, current law creates an “America last” tax system, since even high- or medium-taxed foreign income is tax-preferred to domestic income because it can be blended with low-tax income and taxed at a 50 percent discount relative to U.S. tax rates. That is why a “country by country” GILTI system is so crucial; if the minimum tax can no longer be avoided by blending, the incentives to report income in both high-tax foreign countries and havens are greatly reduced. Under the OECD/G20 inclusive framework agreement reached in July, 134 countries (and all members of the G20) have agreed to a “country by country” administration of a minimum tax.

Current U.S. corporate and international tax reform proposals have the potential to end offshoring incentives found in current law and dramatically reduce profit shifting incentives for both U.S. and foreign MNCs. These measures will considerably reduce the tilt in the playing field that favors foreign business activity relative to U.S. business activity, encouraging U.S. job creation and investment.

In addition to reworking the parts of our tax code that favor foreign business activity over domestic business activity, these proposed reforms would also reduce the ways in which our tax system favors large MNCs relative to small businesses. Large multinational companies have profit shifting opportunities that lower their tax burdens relative to those of purely domestic businesses, which makes it difficult for smaller businesses to compete with their larger competitors and further increases the market concentration of U.S. industry. Of note, market concentration has also played an important role in the shrinking labor share of income, since larger, “superstar” firms tend to use less labor than their smaller counterparts. Thus, a competitive economy goes hand in hand with U.S. job creation.[11]

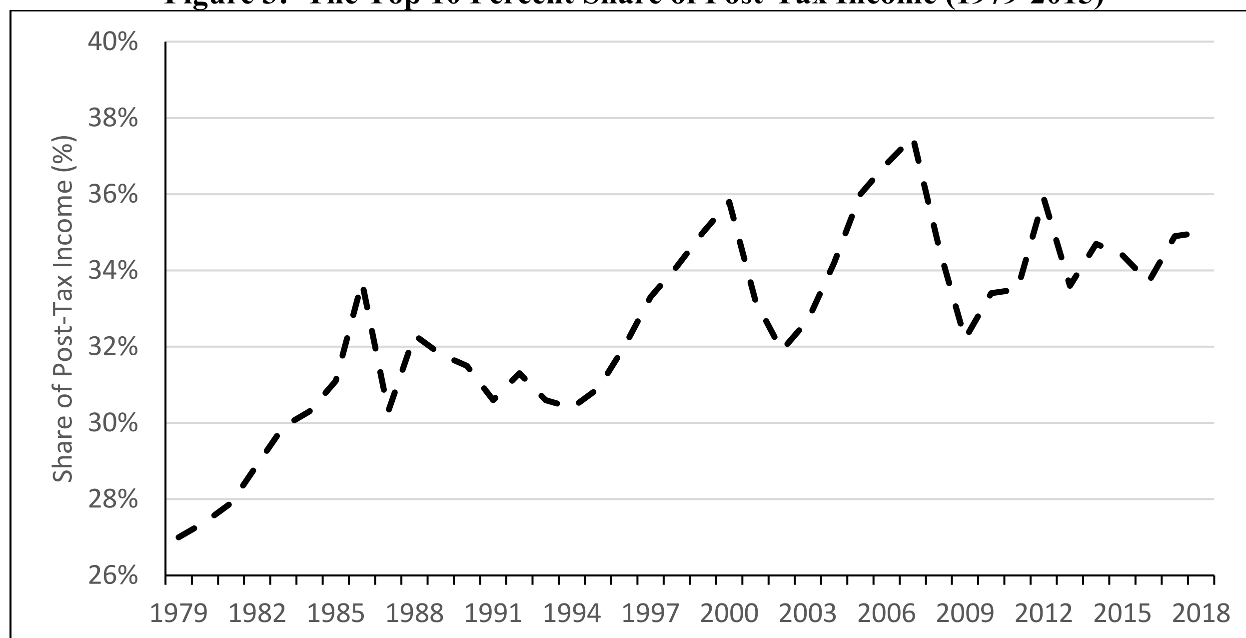
Creating Inclusive Economic Growth

Most scholars agree that increases in income inequality over the prior four decades have been both large and troubling, although scholars disagree on the magnitudes of these trends.

Over the same time period, those at the top of the income distribution have benefitted from multiple reductions in tax rates: several steep cuts in the top income tax bracket (particularly in the 1980s), large cuts in the top income tax rates applied to dividend income and long-term capital gains, reductions in the reach of the estate tax, and sharp reductions in the corporate income tax rate in 1986 and 2017, which also mostly benefit those at the top of the distribution. While there have also been some instances of tax increases borne by those at the top of the income distribution, those households who have most benefitted from economic growth in recent decades can afford to contribute more to financing urgent fiscal priorities.

[11] See Autor, D., Dorn, D., Katz, L. F., Patterson, C., Van Reenen, J. 2020. "The Fall of the Labor Share and the Rise of Superstar Firms." *The Quarterly Journal of Economics*, 135 (2):645–709; Autor, D., Dorn, D., Katz L. F., Patterson, C., and Van Reenen, J. 2017. "Concentrating on the Fall of the Labor Share." *American Economic Review*, 107 (5): 180-85.

Figure 3: The Top 10 Percent Share of Post-Tax Income (1979-2015)



Source: Congressional Budget Office. 2021. "The Distribution of Household Income, 2018 (Additional Data for Researchers)." Report No. 57061.

At the same time, many workers and families have struggled to make ends meet. Under the American Rescue Plan (ARP) and current proposals, large expansions of the child tax credit (CTC), the earned income tax credit (EITC), and the child and dependent care tax credit (CDCTC) will help address the economic needs of typical Americans. Expansions in the CTC are already pushing childhood poverty to historically low levels and benefitting millions of children. The EITC expansion rewards work for those workers without children at or near the poverty level. And the CDCTC makes childcare more affordable, incentivizing parents' labor force participation and strengthening the financial position of working families.

A 21st Century Tax System Architecture

There are many ways that our tax system needs to be modernized to address the needs of the 21st century. The mobility of capital means the taxation of MNCs is subject to large tax competition pressures. The existential threat posed by climate change makes it critical to both remove features of our tax code that subsidize fossil fuel production and consumption and to add tax incentives for the production and consumption of clean energy. In both areas, cooperation with other countries pursuing the same goals can yield double dividends. Our actions encourage other countries to take firm actions of their own, solving longstanding global collection action problems including mitigating greenhouse gas emissions and tax base erosion.

One crucial element of tax reform in this area is ensuring that the tax base is as broad as possible. Broadening the tax base allows us to efficiently raise revenues to meet U.S. fiscal needs without relying on high tax rates. In the international tax arena, that means substantially reducing the discrepancy between the tax treatment of domestic and foreign income. By raising the GILTI rate that applies to foreign income, we can reduce the erosion of the corporate tax base due to

international profit shifting. It also means addressing the profit shifting of foreign-based MNCs operating in the United States by reforming inbound base protection laws.

In the domestic tax arena, it is likewise important to reduce preferences in our tax code that favor capital income over income from working. Beyond that, it is essential to address the tax gap, which is forecast to total about $7 trillion over the coming decade. This large tax gap creates both inefficiencies and inequities. Honest small businesses who pay their tax obligations in full compete with businesses whose owners shirk their tax responsibilities. Workers who earn solely wage or salary income overwhelmingly report that income accurately and face higher tax burdens than the taxpayers who have more opaque sources of income, where tax evasion is both easier and far more common. Those at the top of the income distribution are disproportionately responsible for the tax gap, and providing the Internal Revenue Service (IRS) with the resources and information that they need to promote compliance will result in a tax system that is more progressive.[12]

Proposals to fully fund the IRS, and to increase financial reporting of taxpayers, will benefit American taxpayers across many dimensions. First, the IRS will have the resources necessary for answering taxpayer questions and ensuring that taxpayers receive the benefits they are entitled to. Second, compliant taxpayers will have a lower probability of costly audits since additional information, as well as increased technological capability, will enable the IRS to more accurately target audits toward tax evaders. Third, the revenue potential from these reforms is substantial, and the hundreds of billions of dollars raised by working to close the tax gap will result in one or more beneficial consequences for typical taxpayers: lower taxes, less debt, better government services, or any combination of these results. In short, a strong and stable tax administration system is an essential part of fiscal sustainability.

In summary, the present moment is a very consequential one for the future of tax policy. We have an opportunity to create a modern tax system for the 21st century that is both efficient and fair. These reforms will help level the playing field across multiple dimensions: reducing tax preferences for foreign business activity relative to domestic business activity, reducing tax preferences for large businesses relative to small ones, treating income from wealth more like income from work, and reducing the advantages for tax evaders compared to honest taxpayers. These changes will make our tax system fairer by asking for larger contributions from those who are best equipped to pay more while lessening tax burdens on typical American workers and families.

These tax changes will also help fund the urgent fiscal priorities that address today's greatest needs: investments in infrastructure, research, worker education and training, and climate change mitigation. Such investments are essential to the creation of a prosperous U.S. business environment and inclusive economic growth benefiting all Americans.

[12] See https://home.treasury.gov/news/featured-stories/the-case-for-a-robust-attack-on-the-tax-gap.