U.S. News & World Report Op-ed: "A Way Forward on Corporate Tax Reform"

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OUR CORPORATE INCOME TAX SYSTEM MUST CHANGE IN ORDER TO SURVIVE IN TODAY'S GLOBALIZED ECONOMY.

The U.S. corporate income tax is broken. Our tax rate is the highest in the developed world, yet we collect less corporate tax revenue as a share of gross domestic product than many of our trading partners. The tax both discourages firms from investing in the United States and enables multinationals to avoid tax by reporting profits in low-tax countries.

The problem is that the U.S. can impose corporate tax only on income companies earn within our borders and income of companies legally based in the United States. Unfortunately, the geographic source of a company's income and its legal residence are not economically meaningful concepts, which makes it easy for companies to avoid taxes.

Let's start with residence. U.S. tax law defines a company's residence as the place where its charter was issued. But that legal home may have nothing to do with where the company's investments, employees, customers and shareholders are located. So the tax system encourages companies to switch from U.S. to foreign charters through "inversions," spurs buyouts of smaller U.S. firms by foreign-based competitors and diverts investment opportunities away from U.S.-chartered companies.

The source of a company's income is equally hard to pin down, especially for firms that make a large share of their profits from intangible assets such as patents or brand name reputation. Because these assets contribute to profits throughout the world no matter where they are located, multinational companies can easily avoid tax by shifting their intangible assets and the profits they generate to low-tax countries.

The solution is a tax system that places more weight on where a company's stockholders live than on the location of its income or its legal residence. It is easier to identify the residence of shareholders, and few will move abroad to avoid taxes.

We therefore propose slashing the U.S. corporate income tax rate to 15 percent and replacing the lost revenue with higher taxes on the worldwide investment income of U.S. shareholders. We'd tax American shareholders of publicly traded companies on their dividends and capital gains at full ordinary income tax rates rather than today's lower investment income tax rates. And, we'd tax capital gains each year as stock prices rose, even if an investor does not sell the stock. If stock prices fell, shareholders could fully deduct their losses.

To prevent double taxation, American shareholders would receive a tax credit for their share of the U.S. income taxes paid by the U.S. firms whose stock they own. However, foreign shareholders, nonprofit organizations and tax-preferred retirement plans would not receive the credit because they don't pay a second level of tax on their dividends.

Our plan would drastically reduce the tax system's reliance on the legal residence of corporations or where they ostensibly earn their profits. American shareholders would owe tax no matter where the companies they invest in are chartered or where they book their profits. Although the corporate income tax would still be tied to a firm's legal home and the location of its income, the problems of that system would be much less severe at a 15 percent tax rate. The plan would increase investment in the United States, encourage firms to book more profits here and make it more attractive for companies to be chartered domestically.

By keeping a 15 percent corporate income tax, we'd ensure that foreign shareholders pay some U.S. tax when they invest here. But the rate would be low enough that it wouldn't drive their money out of our economy.

Taxing gains as they accrue each year would encourage investors to sell stocks without worrying about having to pay taxes on the sale. That in turn would free up their money to invest in more productive firms.

We'd exempt small investors from paying capital gains or dividend taxes and provide transition relief for owners of companies that go public. We'd also have shareholders average their taxable investment income over many years so they wouldn't face a tax shock if their investments have a strong return in a given year.

We estimate that our plan would collect about the same revenue as current law. It would raise taxes slightly on the highest-income households and reduce them slightly for everyone else.

No corporate tax reform plan is perfect. But if the U.S. tax system is to survive in today's globalized economy, it will have to stop basing tax on the slender reeds of where profits are booked and where companies are chartered. Our plan offers one way forward.