

# Federal Taxation of Overseas Income

## Limiting Deferral Would Severely Hamper U.S. Global Competitiveness

### Summary

#### Background

Global demand for U.S. products and services and operations by U.S. companies in foreign markets makes millions of high-paying American jobs possible. American companies are motivated to invest and operate overseas primarily in order to target foreign markets, which represent more than 75 percent of the world's purchasing power. Because U.S. foreign affiliates frequently rely on supplies from the U.S. parent company, foreign investment expands U.S. jobs and exports. U.S. companies doing business overseas are estimated to add \$2.5 trillion to the U.S. economy. Contrary to the misconception that U.S. companies operate overseas primarily in low-wage countries, U.S. Department of Commerce data shows that 79 percent of the production of all U.S. foreign affiliates took place in high-income foreign countries.

#### Federal Policy

U.S. tax rules follow a principle of "worldwide taxation," under which a U.S. company is subject to U.S. tax on its worldwide income no matter where the income is earned, including the income of any foreign subsidiaries or affiliates. U.S. companies face one of the highest corporate tax rates in the world. The average combined tax rate countries in the Organisation for Economic Co-Operation and Development (OECD), made up of 30 countries promoting democracy and economic growth, is 26.7 percent, while the U.S. rate is 40 percent.

To help level the playing field, the United States generally does not tax a worldwide U.S. company on the active foreign income of its foreign subsidiary until those earnings have been paid, typically as a cash dividend, to the parent company. Because the parent company may delay payment of U.S. tax until it has received the payment, this permits deferral of U.S. tax on that income. Deferral generally results in the U.S. subsidiary paying the same effective rate of tax on its operations as paid by foreign-owned subsidiaries.

The United States, however, does not permit deferral for certain types of foreign income under subpart F of the Internal Revenue Code. "Subpart F income" includes passive income, such as dividends and interest, as well as certain active income earned by foreign subsidiaries. No other country has restrictions on deferral for active income as extensive as the United States.

#### Recent Policy Activity

In spring 2009, the Obama administration's budget included a tax proposal to raise \$210 billion over the next 10 years by placing additional limitations on deferral, stating "corporate loopholes" and "tax havens" allow corporations to avoid paying their fair share of taxes.

The California Chamber of Commerce and numerous others, including many Silicon Valley-based high-tech companies, expressed strong opposition to the tax proposal. It would increase taxes more than \$200 billion on U.S. companies, upset global competitiveness and result in job loss. The tax proposal was reported to have been placed on hold in fall 2009, but is likely to be revived as the Obama administration was recently quoted as remaining committed to the issue.

### CalChamber Position

The CalChamber opposes unwarranted tax increases on U.S. multinational companies, including limiting deferral.

### Reasons for Position

- Limiting deferral will severely hamper global competitiveness of U.S. multinational companies, impede economic growth, result in job loss and lead to less U.S. and state tax revenue.
- Limiting deferral will move the United States in the opposite direction from the rest of the industrialized world.

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