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Student Handout #4: **Washington Post, “U.S. Firms Keep Billions Overseas; Kerry’s Plan Spotlights Huge Untaxed Earnings”**

The Washington Post
By Jonathan Weisman

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With sales up 5 percent last year, Merck & Co. was not satisfied: To hold down costs, the pharmaceutical giant shed 3,200 jobs as 2003 drew to a close, and announced that an additional 1,200 positions would go this year.

But Merck's picture abroad was quite different. It made 1,300 new hires in 2003 outside the United States, on top of the 900 brought on the year before. Company documents indicate that Merck had a cumulative $18 billion in foreign earnings untaxed by the end of last year, $3 billion more than in 2002. And the company said it had no intention of ever paying U.S. taxes on that burgeoning sum.

"Foreign earnings of $18.0 billion . . . have been retained indefinitely by subsidiary companies for reinvestment," Merck's annual filing with the Securities and Exchange Commission said. "No provision is made for income taxes that would be payable upon distribution of such earning."

Last week, Sen. John F. Kerry (Mass.), the likely Democratic nominee for president, made such lucrative income-tax deferrals a focal point of his campaign, asserting that they are driving companies to expand abroad. Merck's numbers appear to back that up, and so do those of several other big U.S. companies.

By the end of its 2003 fiscal year, Hewlett-Packard Co. had "indefinitely" deferred taxation on $14.4 billion of foreign earnings, according to SEC filings, a move that helped lower its effective tax rate from the statutory corporate income tax rate of 35 percent to 12 percent.

Domestic employment at Intel Corp. slipped by more than 3,300 people last year, but it grew by more than 4,300 abroad. By the end of 2003, the company had $7 billion in cumulative foreign earnings, $700 million more than it had sheltered in 2002, according to SEC filings. The semiconductor powerhouse stated that it "intends to reinvest these earnings indefinitely in operations outside the U.S."

The Kerry campaign said U.S.-based multinational corporations are deferring taxation on $12 billion in foreign earnings each year, a figure that may be low, corporate tax experts say. Corporate tax revenue in 2003 fell for the third straight year, to its lowest in a decade. As a percentage of the economy, business taxes last year reached the second-lowest level since the Great Depression. Few doubt that tax avoidance has been a reason for meager corporate tax collections, and the deferral of taxes on foreign earnings may be one of the biggest factors.

"It's probably next to impossible to get a read on how big the number is, but it's fair to say it's a big, big deal," said Douglas A. Shackelford, an accounting professor at the University of North Carolina's Kenan-Flagler Business School who has studied the issue.

Since Kerry announced his corporate-tax-reform proposal, tax experts have debated its impact on the U.S. job market and its consequences for U.S-based multinationals. But liberal and conservative tax policymakers now appear to agree on one point: The byzantine U.S. system of foreign business taxation is in need of major change.
"This is a largely broken system, rife with abuse," said Gene B. Sperling, a former economic aide to President Bill Clinton who advises Kerry and is an architect of the candidate's plan.

"There is a real problem here," said Gary C. Hufbauer, an international tax expert at the Institute for International Economics, who is skeptical of Kerry's proposal. "U.S. firms doing business in the U.S. are taxed more heavily than many of their foreign competitors. That's demonstrably true."

Under Kerry's plan, U.S.-based companies would have to pay taxes immediately on virtually all foreign profits that are not taxed by another country. Firms could still defer taxation on profits from subsidiaries set up abroad to serve local markets, but if a U.S. company sets up overseas to ship goods back home, taxes would be due in full.

The $12 billion in additional taxes would be used to lower the corporate tax rate to 33.25 percent, from 35 percent. By closing a major loophole used by only the largest multinationals, the plan would bestow a tax cut on more than 99 percent of U.S. companies, Kerry advisers say. Kerry would also try to lure an estimated $639 billion in untaxed foreign earnings back home with a "tax holiday" that would lower the rate on repatriated earnings to 10 percent for one year.

"In any proposed change to corporate tax law, there will be some companies that will do less well than others," said Roger C. Altman, a senior Treasury official in the Clinton administration and a top Kerry economic adviser. "But the preponderance of companies will do better" under Kerry's proposal.

Eliminating loopholes and lowering overall tax rates is standard, orthodox tax theory, said Joel B. Slemrod, a tax economist at the University of Michigan. On balance, he said, Kerry's plan would probably benefit the U.S. economy.

Given their long-standing support for "tax holidays" on foreign earnings and lower corporate rates, some businesses said they were willing to suspend judgment until they see more details of the proposal. Spokesmen for Merck and Intel said their expansions abroad are not driven by tax factors. Merck spokesman Tony Plohoros noted that the company just opened a research facility in Seattle and is building a multimillion-dollar research lab in Boston.

Chuck Mulloy, an Intel spokesman, said Intel's growth abroad is fueled by a simple fact: 70 percent of the company's sales are international. But he did not dismiss Kerry's plan out of hand.

"It certainly deserves serious consideration," Mulloy said.

But even philosophical supporters of the plan see major problems. Leonard E. Burman, a former assistant Treasury secretary for tax analysis, said he understands why Kerry wanted to exempt income earned in local foreign markets. But, he said, separating out such income would be difficult, and could open an abused system to still more abuse. "It's great news for accountants and lawyers," he said.

More fundamentally, critics said, the plan would only hasten the movement of companies abroad. Some countries, such as France, tax only income earned within their borders. Many Republican tax economists say the U.S. system already taxes companies more heavily than other countries and has pushed companies to reincorporate abroad.

Under Kerry's proposal, "What's to prevent them all from going overseas?" said Terry Holt, a spokesman for President Bush's reelection campaign.

Altman, who is now a Wall Street investment banker, scoffed at that prospect. "If a corporation has a successful foreign investment, I don't think they're going to divest it for reason of changes in the tax law," he said.

But Shackelford, who supports Kerry's plan, suggested that Hufbauer has a point. At least, he said, it would create incentives for corporate mergers that wind up headquartered overseas, just as Chrysler Corp. and Daimler-Benz AG produced Germany-based DaimlerChrysler AG.

"If deferral is eliminated, there's going to be some hurt there, I don't think there's any question," Shackelford said.

Kerry advisers conceded that they wrestled with many of those objections before deciding to push ahead. "This is a tough issue, but I kind of think we came out in the right place," Sperling said.

He said objections to the fine print should not distract from the point Kerry is trying to make: The U.S. tax code is actually encouraging the movement of jobs overseas.

"This is a big deal," agreed Robert S. McIntyre of Citizens for Tax Justice, who has inveighed against foreign tax deferral for years. As a company, he said, "you may go to India or China or Ireland for the wage differentials -- there's nothing we can do about that. But we don't have to pay you to go there."

Source: The Washington Post
http://www.law.wayne.edu/McIntyre/text/in_the_news/Deferral%20CTJ%20WPost%20April%202%202004.pdf