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Taming the Corporate Tax

By **JIM MCTAGUE**

Both parties think that changes should be made in the way companies are taxed, The president thinks so, too. But getting anything done over the next year won't be easy.

President Obama's call for corporate tax reform may be overly vague. But prudent investors shouldn't dismiss his recent rhetoric solely as a political ploy aimed at wooing back the corporate donors whom he alienated during the fractious midterm election. Momentum is building for a rewrite of the overly complex corporate code because both parties believe it is costing the U.S. jobs. Though change is unlikely before the 2012 general election, it's not premature to begin strategizing to reap the maximum benefit from an overhaul of the tax.

One big reason for the momentum here is that other countries are planning to aggressively cut their rates -- England, Japan, and Canada among them -- and luring away our businesses. If the merger of NYSE Euronext and Deutsche Börse goes through, the new entity will incorporate in the Netherlands, which has a top corporate rate of 25%. The U.S. has a combined federal-state corporate rate around 39%.

"Although NYSE will remain a U.S. corporation, even after its acquisition by a Netherlands corporation, and therefore subject to U.S. taxes on its worldwide income, the NYSE and its new Netherlands parent can, after the merger, engage in income-stripping transactions-- intercompany loans, intercompany license agreements, and/or intercompany management arrangements -- in which income is shifted from the U.S. to the Netherlands," says accounting guru Robert Willens, who runs a tax and accounting service in New York.

ADVANCED COUNTRIES in the Organization for Economic Co-operation and Development had an average top rate of slightly over 25% in 2010, according to Andrew Lyon, a principal in PricewaterhouseCoopers' Washington National Tax Service. So Congress would have to reduce the U.S. rate by about 14 percentage points (it can't reduce the state rates) just to match that OECD average.



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Elwood Smith for Barron's

How low Obama would like our current top 35% federal corporate tax rate to go is a mystery. In both his State of the Union Address and in a recent make-amends speech delivered to the U.S. Chamber of Commerce, the president suggested lowering the rate and paying for the change by eliminating certain loopholes that distort investment decisions, but he provided no details.

The President's reluctance to provide a blueprint might simply indicate that he doesn't have an actual plan yet. He and Treasury Secretary Timothy Geithner have begun a long round of discussions with business leaders about the best way to revising the tax without adding to the budget deficit. Since each industry has its own favorite tax break, a considerable amount of horse trading is likely.

Even if Obama wanted change tomorrow, he'd be unable to get the divided Congress to quickly go along. Republicans who control the House would have to compromise with him on other tax measures, says Rob Shapiro, a former Clinton advisor who now is chairman of Sonecon, an economic consulting firm in Washington, D.C. And "Democrats would have to buy off on trade-offs as well."

Another obstacle: Obama doesn't have a mandate from the electorate for corporate tax reform, says Caroline Harris, the chamber of commerce's chief tax counsel. Even so, the case for corporate tax reform is strong.

"THERE'S MUCH MORE INTEREST now in shifting to a territorial tax than at any time since I've been in Washington," says Shapiro. Such a levy would tax income earned in the U.S., but not money earned abroad, letting corporations repatriate the latter without a tax penalty. Many companies now are keeping huge amounts of cash overseas to avoid paying tax on it. (Related story, "[Time for a Change in Techland](#)".)

At the same time, the current tax system is so complex that some multinational corporations legally can lower their effective tax rates well below 35%. In 2009, [Citrix Systems](#), (ticker: CTXS) a multinational tech company with executive offices in Ft. Lauderdale, Fla., used foreign tax deductions and other credits to reduce its effective rate to 1.5%, according to Jack T. Ciesielski, a certified public accountant at R.G. Associates in Baltimore.

Foreign Allure

Tax breaks are among the factors that lead many U.S. companies to locate new production facilities abroad and focus on selling there

Foreign Sales as % of Total

Ciesielski's "The Analyst's Accounting Observer" investment newsletter reports that 19 U.S. multinationals had an effective rate below 26% in 2009. The rate was 12% at [Amgen](#) (AMGN), 16% at [Marsh & McLennan](#) (MMC) and 23% at [Xerox](#)

Information Technology	51%	(XRX). Not every company can take advantage
Materials	48	of all the breaks, however, creating a skewed
Health Care	46	playing field.
Industrials	39	
Consumer Staples	38	Often, companies locate facilities overseas
Energy	37	because that's where the growth is. But the
Consumer Discretionary	30	current system also provides unintended
Financials	29	incentives to shift production abroad because
Telecom	14	royalties and fees are taxed at a lower rate for
Utilities	11	goods made offshore, notes Gary Clyde
		Hufbauer of the Peterson Institute for

Source: *The Tax Foundation*

International Economics.

Ciesielski says that if the U.S. were to get its corporate taxes more in line with the rest of the world's, it would reduce the advantages enjoyed by the high overseas earners, especially technology and pharmaceutical concerns. Those enjoying fast growth in countries that maximize their tax advantages under the current system would have the most to lose. Corporations that produce products in the U.S., on the other hand, would benefit.

Under a territorial approach, Hufbauer says a tech outfit like Apple would have greater incentive to locate manufacturing facilities in the U.S.

Obama recently told business leaders: "I get it." We'll know in a year if he really does.

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