

Testimony of

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Chairman Whitehouse, Ranking Member Grassley, Members of the Committee: Thank you for inviting me to share my views on corporate tax avoidance. Simple reforms to our business tax system can improve the system across multiple dimensions: generating more revenue, reducing offshoring incentives, enhancing competition and economic efficiency, and resulting in a fairer tax system. Given the importance of today's high levels of deficits and debt, it is particularly important to reform the tax system in a way that counters systematic sources of tax avoidance.

In my testimony today, I will discuss four crucial flaws in today's corporate tax system. First, current law contains large tax preferences for foreign income relative to domestic income, fueling offshoring and profit shifting. Second, as a consequence of current law incentives, we give up large revenues by failing to reform our tax system. Third, the current system favors a small number of large multinational companies, companies that often wield significant market power; these tax preferences inhibit the ability of smaller businesses to compete in free and fair markets. Finally, tax avoidance reduces the fairness of our tax system, benefiting corporate shareholders at the expense of middle-class taxpayers.

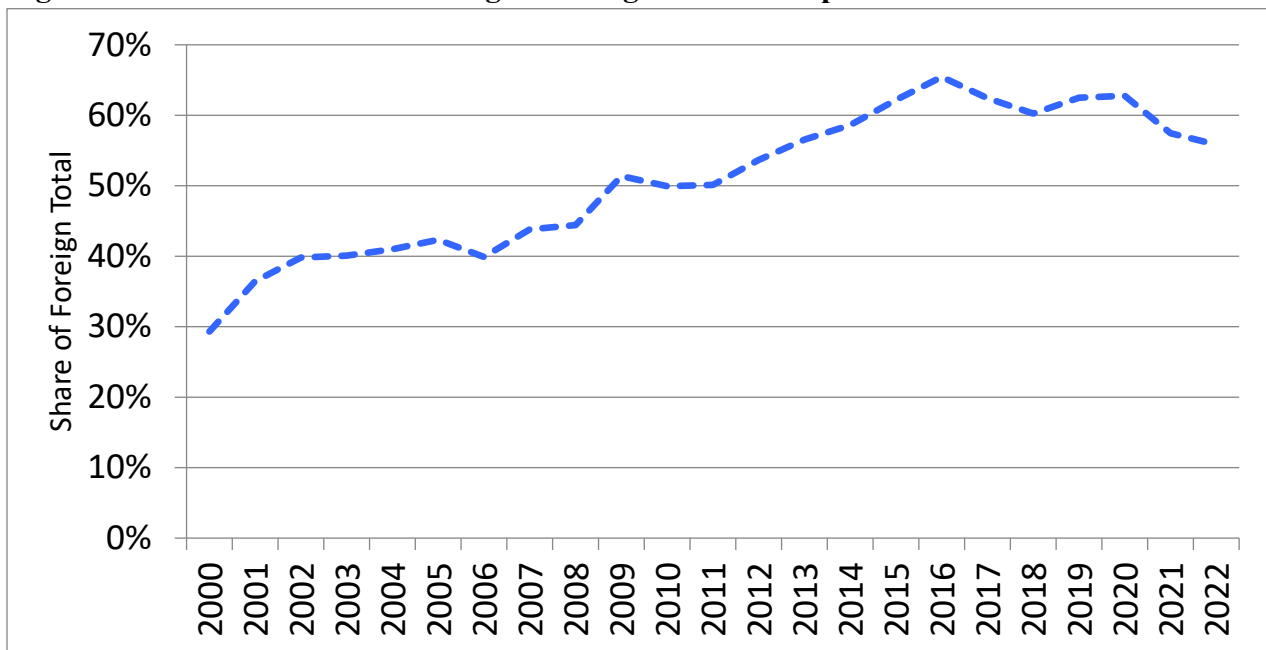
Fortunately, a few relatively simple reforms can address all of these problems; Senator Whitehouse's sponsored legislation shows one promising path forward.

## Four Key Flaws of the Current System

### 1. Current Law Generates Large Offshoring Incentives

Current U.S. tax law provides perverse incentives to earn income offshore; indeed, I have often referred to this system as “America-last” tax policy. U.S. income is taxed at a 21 percent rate from the first dollar of taxable income earned. In contrast, compare the U.S. tax treatment of foreign income reported in a zero-tax jurisdiction. The first ten percent return on foreign tangible assets is tax free, and subsequent income beyond that ten percent return is taxed at a 50 percent discount relative to domestic income. These rules provide strong incentives to move tangible assets offshore (to increase the tax-free return) and to book income offshore (to benefit from the 50 percent deduction). Consequently, it is hardly surprising that U.S. multinational companies report large profits in many jurisdictions with rock-bottom tax rates. Figure 1 shows the share of U.S. multinational company income in seven important low-tax rate jurisdictions. Despite changes in U.S. tax law, and some changes in tax laws abroad, that share has remained very high. In the five years prior to TCJA (2013-2017), the low-tax share averaged 61 percent; the present low-tax share is 56 percent.

**Figure 1: Share of U.S. MNC Foreign Earnings in Seven Important Low-Tax Jurisdictions**

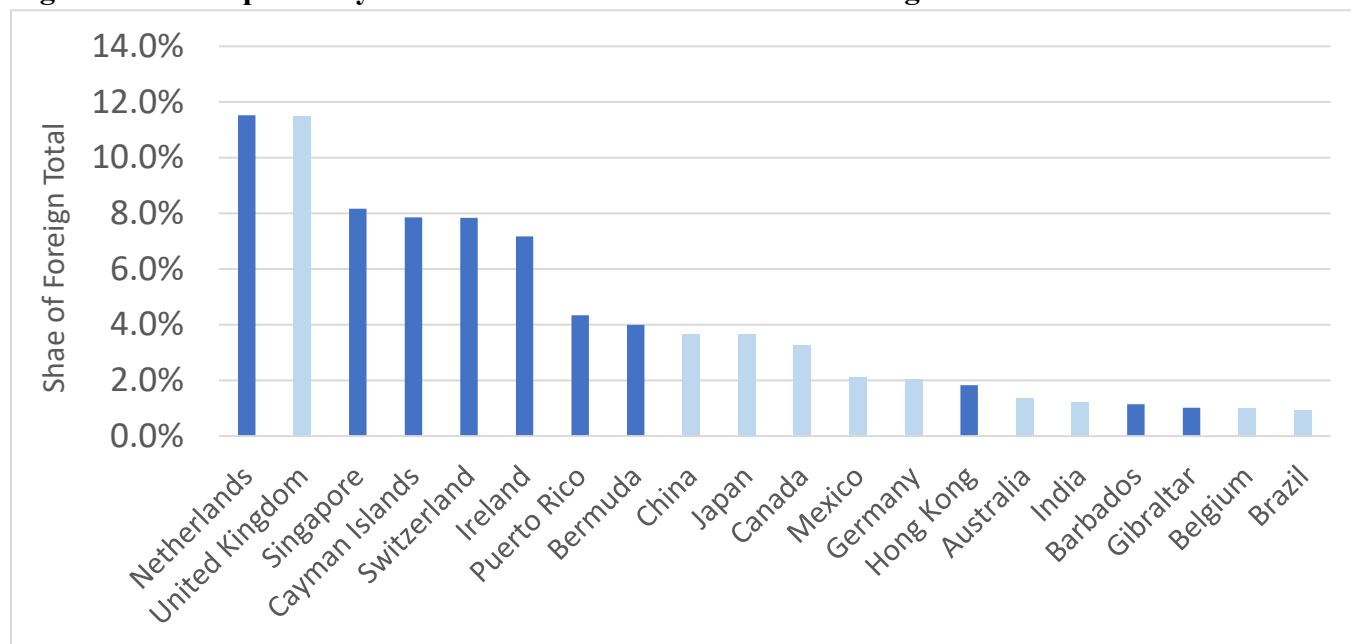


Source: U.S. BEA Foreign Direct Investment Earnings Data are available [here](#). The seven jurisdictions are Bermuda, Cayman Islands, Ireland, Luxembourg, the Netherlands, Singapore, and Switzerland.

Of note, the current U.S. tax system also favors the earning of income in *high-tax* countries abroad, relative to that in the United States; this is the “America-last” feature of the current U.S. tax system. Under the GILTI (for global intangible low-taxed income), foreign income is taxed on a globally blended basis. Income reported in France or Japan (both countries with rates above the U.S. rate) generates tax credits that offset tax due on low-taxed income, lowering the tax burden

on both sources of foreign income to about half the U.S. rate.<sup>1</sup> The GILTI tax also maintains the incentive for foreign countries to offer rock-bottom tax rates, since any GILTI tax due can be offset by tax credits from higher-tax foreign countries. Figure 2 shows the jurisdictions with the highest shares of U.S. multinational income in 2019. The jurisdictions with darker bars are all locations with historically very low corporate effective tax rates.

**Figure 2: The Top Twenty Locations for U.S. Multinational Foreign Profit in 2019**



Source: IRS SOI Form 8975 data. The foreign total excludes income classified as stateless.

The foreign-derived intangible income (FDII) deduction does not rectify these incentives; instead, it has perverse consequences of its own. For instance, as companies’ domestic tangible assets increase, they receive *lower* FDII deductions, enhancing their incentive to undertake tangible asset investments abroad (which also generates tax-exempt foreign income under GILTI). Further, the FDII deduction provides a tax break for excess profits, tilting the tax playing field in favor of large companies with market power. Finally, the FDII also favors export income, a policy preference that has no policy rationale and that is inconsistent with WTO rules.<sup>2</sup>

## 2. Current Law Facilitates Corporate Tax Base Erosion

These large tax preferences for foreign income relative to U.S. income erode the U.S. corporate tax base, such that relatively modest reforms to the U.S. GILTI tax have large revenue potential. For instance, ten-year revenue estimates for a country-by-country reform of the U.S. GILTI tax (which taxes the foreign income of U.S.-based multinational companies) from four different

<sup>1</sup> These incentives are explained in more detail in my paper: “Profit Shifting Before and After the Tax Cuts and Jobs Act.” 2020. *National Tax Journal*.73(4). 1233-1266.

<sup>2</sup> These WTO rules benefit the United States and the world trading system by discouraging export subsidies.

independent sources range from \$442 billion to \$692 billion; this reform would also raise the GILTI rate and reduce the amount of exempt income.<sup>3</sup>

### 3. *Current Law Distorts Market Competition*

Under current law, U.S. multinational companies pay much lower average tax rates than smaller domestic companies. The U.S. Joint Committee on Taxation calculated that U.S. MNCs paid an average tax rate of only 7.8 percent on their worldwide income in 2018. These tax rates are far lower than those paid by domestic companies, and indeed far lower than tax rates faced by MNCs abroad.<sup>4</sup>

Recent decades have been characterized by rising market power of large businesses, and a great degree of concentration is evident in the U.S. corporate tax base. For example, 2019 data from the IRS indicate that less than 2,000 companies (under one-half of 1 percent of 500,000 U.S. corporations) account for 87 percent of the U.S. corporate tax base, with about 350 of these companies accounting for 69 percent of the tax base.<sup>5</sup> Numerous scholars provide evidence of rising market power in the United States, and Figure 3 indicates that corporate profits are very high in recent decades when compared to prior decades.<sup>6</sup>

A tax system that benefits larger, multinational companies relative to smaller firms will tax economic rents – or profits above the “normal” return to capital – more lightly than regular returns. In contrast, economic theory suggests that taxing rents is less distortionary than taxing the normal return to capital, since rents taxation will not alter optimal decisions regarding capital investment, employment, or economic activity. The strong case for taxing economic rents has been emphasized by many scholars, but absent international tax reform, the international mobility

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<sup>3</sup> The GILTI rate would be 21 percent and the exemption for the first ten percent return on foreign tangible assets would be eliminated. Treasury scored the 2021 Biden reform [here](#) and a similar 2023 reform [here](#). JCT scored a similar proposal [here](#). Both the Tax Policy Center ([here](#)) and the American Enterprise Institute ([here](#)) scored the (very similar) Biden campaign proposal; the Tax Policy Center score covers only a nine-year window. These estimates are in line with my own empirical work in Clausing, Kimberly A. and Saez, Emmanuel and Zucman, Gabriel, Ending Corporate Tax Avoidance and Tax Competition: A Plan to Collect the Tax Deficit of Multinationals (January 20, 2021 Working Paper) and “Five Lessons on Profit Shifting from the US Country by Country Data.” 2020. *Tax Notes Federal*. 169(6). November. 925-940. My prior work in Clausing, Kimberly, “Profit Shifting Before and After the Tax Cuts and Jobs Act.” 2020. *National Tax Journal*. 73(4), 1233-1266, also documents large revenue losses from profit shifting, using a range of data sources and methods (see Table 1).

<sup>4</sup> JCT will likely update this number, but they have not released new estimates. For the analysis of the 2018 data, see table 3 on page 58 [here](#). JCT finds that our top ten trading partners levied an average tax rate of 18.1 percent. A recent [Reuters study](#) found that US multinational companies pay *effective* tax rates that are 8 percentage points lower than those of multinational companies in other countries.

<sup>5</sup> See the 2019 IRS SOI Publication 16, the “Corporation Income Tax Returns Complete Report.”

<sup>6</sup> For an overview of the literature in this area, see my recent working paper “Capital Taxation and Market Power”. Note that Figure 3 includes both C corporations and other corporations; unfortunately, the National Income and Product Accounts (NIPA) data don’t allow a separate breakdown of C corporation profits, and public IRS data are incomplete. Fortune 500 data on top US corporations also indicate strong increases in corporate profits for the Fortune 500. For example, real profits (adjusted for inflation) rose 67 percent over the prior decade’s lists, 2013-2022, in part due to a spike in profits in the final year of the list.

of the tax base makes it difficult to tax rents.<sup>7</sup>

**Figure 3: Corporate Profits Before and After Tax, 1980-2022, as a share of GDP**



Source: FRED data on Corporate Profits with adjustments for inventory valuation and capital consumption.

Stemming international tax avoidance is therefore an important part of ensuring healthy competition between smaller domestic companies and large multinational companies. As recognized since at least Adam Smith, market outcomes work best under competition, whereas market power can generate adverse consequences for workers, consumers, and the economy. At present, our tax system provides systematic tax preferences for the largest, most powerful multinational companies.

#### **4. Current Law Inhibits Tax Fairness**

Light taxation of corporate profits inhibits our efforts to build fair tax systems. The vast majority of capital income goes untaxed at the individual level by the U.S. government,<sup>8</sup> and capital income is far more concentrated at the top of the income distribution than labor income.<sup>9</sup>

<sup>7</sup> See Clausing, Kimberly. “Capital Taxation and Market Power.” 2023 Working Paper; Avi-Yonah, Reuven S. 2020. “A New Corporate Tax.” *Tax Notes Federal*, July, 653–60; Fox, Edward G., and Zachary D. Liscow. 2020. “A Case for Higher Corporate Tax Rates.” *Tax Notes Federal* 167 (12): 2021–38; Furman, Jason. 2020. “How to Increase Growth While Raising Revenue: Reforming the Corporate Tax Code.” In *Tackling the Tax Code: Efficient and Equitable Ways to Raise Revenue*. Washington DC: Hamilton Project; Furman, Jason, and Peter Orszag. 2018. “A Firm-Level Perspective on the Role of Rents in the Rise in Inequality.” In *Toward a Just Society*, edited by Martin Guzman, 19–47. Columbia University Press.

<sup>8</sup> In particular, more than 70 percent of capital income goes entirely untaxed by the US government at the individual level since it is held by untaxable entities or in untaxed accounts. Rethinking such tax preferences may be desirable, but it would be exceedingly politically difficult. See, e.g., Burman, Leonard E., Kimberly A. Clausing, and Lydia Austin. 2017. “Is U.S. Corporate Income Double-Taxed?” *National Tax Journal* 70 (3): 675–706; Rosenthal, Steven M., and Theo Burke. 2020. “Who’s Left to Tax? US Taxation of Corporations and Their Shareholders” and analysis linked [here](#). Even for taxable US accounts, taxation is often deferred indefinitely (until the capital gain is realized) or eliminated entirely (in the case of step up in basis at death).

<sup>9</sup> For example, the top 1 percent of the US income distribution receives 12 percent of all labor income, but 52 percent of positive capital income. See US Treasury analysis [here](#).

In recent decades, governments have shifted tax burdens away from capital income and toward labor income or consumption, making the tax system less progressive.<sup>10</sup> At the same time, before-tax economic inequality has increased, making a stronger case for a progressive tax system.

Business taxation has an important role to play in tax progressivity, since the corporate tax is a very progressive tax. All conventional models of corporate tax incidence assign the vast majority of the burden of the corporate tax to capital or shareholders, including models used by the Joint Committee on Taxation, the Congressional Budget Office, the U.S. Treasury, and the nonpartisan Tax Policy Center.<sup>11</sup> The persistent advocacy by the business community for low corporate tax rates is consistent with their economic interests; corporate shareholders and top executives frequently benefit from corporate tax cuts.

### **Promising Business Tax Reform Solutions**

Senator Whitehouse has shown leadership on international tax reform, sponsoring legislation that would address these concerns in the “No Tax Breaks for Outsourcing Act.” This legislation would completely level the tax playing field for U.S. multinational corporations, by fully taxing foreign income at the U.S. rate on a country-by-country basis and eliminating the tax-free return on foreign tangible assets. The legislation would also eliminate the foreign-derived income deduction, ending the perverse incentives associated with that provision. These changes would improve the competitive environment for smaller businesses in the United States, by requiring large multinational companies to face global tax burdens that are identical to the domestic tax burden, removing the large tax advantage that multinational companies presently enjoy.

The Biden proposals are a bit more modest than these, in that they merely reduce the tax preference for foreign income from 50 percent to 25 percent, but they were proposed in a similar spirit, working to lower the incentive to offshore, and building a tax system that reduces the advantages of large multinational companies relative to smaller businesses.

In both cases, by collecting more tax revenue on mobile capital income, international tax reforms would help build a fairer tax system. Asking multinational companies and their shareholders to pay a 21 percent tax rate on their income, regardless of where it is earned, is a very reasonable tax burden in light of the tax burdens faced by middle-class Americans. Workers face a 15 percent payroll tax rate on their earnings from the very first dollar earned (including employer contributions, which lower wages accordingly), and marginal federal income tax rates of 22 percent apply to earnings above about \$44,000, rising at higher income levels.

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<sup>10</sup> In the United States, the federal government has implemented 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.

<sup>11</sup> For JCT, see [here](#). For CBO, see [here](#). For Treasury, see [here](#). (This source is again available on the Treasury web site, after being removed in 2017.) For the Tax Policy Center, see [here](#).

Finally, this is a particularly good time for international tax reform, as many other countries are currently implementing country-by-country minimum taxes, so U.S. reform would better align our tax system with what the rest of the world is doing, without disadvantaging U.S. companies.<sup>12</sup>

### **The Importance of Tackling Tax Avoidance in Today's Fiscal Environment**

At present, the United States is facing a very challenging fiscal situation. The Congressional Budget Office projects deficit to GDP ratios of more than 5 percent for the entirety of the coming decade, and projected deficits rise in the second half of the decade.<sup>13</sup> Total stocks of debt relative to GDP rise from a level about equal to the size of the U.S. economy at present (97 percent) to 118 percent by the decade's end. While these projections account for CBO's best guess of the economic environment in the years ahead, they do not incorporate possible risks associated with unknown events such as recessions, public health emergencies, or international security risks.

This budget outlook makes new sources of revenue very important. It is simply not possible to tackle deficits and debt by relying on spending cuts alone. For example, a recent CBO analysis found that, if the Tax Cuts and Jobs Act provisions are extended past 2025, it is mathematically impossible to balance the budget in ten years without either tax increases or spending cuts in Social Security, Medicare, defense, or veterans' programs.<sup>14</sup> Even if the Tax Cuts and Jobs Act provisions are not extended, budget balance would require draconian (86 percent) cuts in every other program, should Social Security, Medicare, defense, and veterans' programs be left untouched.

Of course, budget sustainability need not require budget balance, and spending cuts to some of the protected categories might be justified, but budget stability will be very difficult to achieve absent efforts to collect additional tax revenue. Beyond international tax reform, there are many good ideas to augment tax revenue, including Biden Administration budget proposals as well as some of the CBO revenue options.<sup>15</sup> A few other proposals are also particularly worthy of mention.

- Senator Whitehouse has shown great leadership on climate, alongside several of his peers on the committee. Congress took important action on the climate through the clean energy transition subsidies that are in the Inflation Reduction Act; these policies are an important step forward for climate change mitigation. These policies would be even more effective if they were accompanied by legislative measures that ended current tax subsidies that favor fossil

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<sup>12</sup> For more details on the agreement, see my recent [policy brief](#) from [PIIE](#) on "The International Tax Agreement of 2021: Why it's Needed, What it Does, and What Comes Next?".

<sup>13</sup> See February 2023 CBO forecasts [here](#).

<sup>14</sup> See [here](#).

<sup>15</sup> The FY2024 Biden proposals are [here](#) and the CBO budget options are [here](#).

fuels. Congress should also charge a fee for carbon emissions; this policy could be designed to protect consumers from energy price increases by exempting retail gasoline. Such a fee would be an enormously effective tool to combat carbon emissions, and it would raise much needed revenue at the same time. It would also better align the United States with policies that the rest of the world is implementing to address climate change. We are the only G7 country that does not price carbon, and excluding the United States, more than half of OECD country emissions are covered by some form of carbon price.

- Congress took important action to fund the Internal Revenue Service more adequately as part of the Inflation Reduction Act, yet projections indicate that there will still be an enormous tax gap in the years ahead. IRS funding should be protected, and it would ideally be complemented by legislative measures that enhance third-party reporting and counter abusive tax practices.

In the years ahead, Congress will have difficult decisions to make regarding the future of tax policy. In 2025, most of the Tax Cuts and Jobs Act tax cuts will expire; the only exceptions are the corporate tax law changes, the changed inflation measure, and a measure that reduced spending on low-income health insurance. This provides Congress with risks and opportunities. Simply extending these tax cuts would be very expensive, totaling over \$3 trillion over ten years; restricting those extensions to just those below \$400,000 would also be expensive, totaling about \$1.8 trillion over ten years.<sup>16</sup> Given the path of deficits and debt described above, these blanket extensions are simply unaffordable, especially if other sources of revenue are off the table.

At the same time, it is important for the U.S. government to focus on making key public investments that will enhance the competitiveness of our economic fundamentals: building solid infrastructure, educating workers, and investing in communities that have been left behind. As we take on these public investments, which can be expensive, we need to focus on ensuring that our investments are cost-effective. For example, permitting and other reforms that make it easier to build energy transition projects and infrastructure will help these investments yield more bang for the buck. In addition, while national security is an ever-salient motivation, the United States can work with other nations to address these concerns while also promoting an open and vibrant exchange of goods, services, talent, and ideas. Openness to international markets will help spread the benefits from U.S. technological innovation abroad and improve the efficiency of the energy transition. Finally, immigration reform has a particularly important role to play in addressing our economic challenges.<sup>17</sup>

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<sup>16</sup> See Table 5.2 of the CBO May 2022 budget outlook, available [here](#), which calculates a \$2.1 trillion dollar cost for just part of the ten-year window, focusing on 2023-2032. (The tax provisions do not expire until 2026.) The Tax Policy Center calculates the 10-year cost from 2027 to 2036 as over \$3 trillion, excluding additional interest payments due to greater borrowing; see [here](#). About 40% of the benefits would go to those in the top 5 percent of the distribution, who they note “will make about \$400,000 or more” in 2026.

<sup>17</sup> Reversing recent declines in immigration, and providing more and better legal pathways for new Americans, would help address many key economic priorities in a cost-effective manner: reducing long-term fiscal imbalances (that are tightly linked to demographic factors), working to build or maintain our technological leads in semiconductor



## Appendix: Responses to Common Concerns Regarding International Tax Reform

*Does the new international tax agreement impede U.S. tax sovereignty?*

The United States retains autonomy in international tax matters, and the proposed international tax reforms are a good idea regardless of the policy choices of other countries. However, it is harder for the United States to plug the holes in our tax system when other countries provide zero tax rate environments. In that light, the international agreement is actually *restoring* countries' tax sovereignty, by enabling countries to set the tax policies that suit their economy, without a fear that other jurisdictions will lure activity away with zero-tax rate environments.

*Won't these reforms to our international tax system hurt the competitiveness of U.S. multinational firms?*

There are multiple types of competitiveness and international tax reform could *improve* the U.S. competitive position along several dimensions. First, countries compete on fundamental economic strengths, based on the abilities of their workers, the soundness of their institutions and infrastructure, and their ability to foster innovation and entrepreneurship. Putting the U.S. fiscal system on sounder footing is a key part of focusing on fundamentals. Second, the U.S. location is an attractive place to locate activity and profit, but U.S. companies often decide to locate activities and profits in part based on tax incentives. These proposals would reduce or eliminate the tax advantage of foreign income relative to domestic income. Third, U.S. companies compete with foreign companies, often through global merger and acquisition bids. At present, the agreement on international taxation will ensure that foreign multinational companies pay at least 15% on their foreign income, bringing the tax treatment of U.S. companies, even at a 21% GILTI rate, much closer to that of the tax treatment faced by foreign companies.

*Didn't the Tax Cuts and Jobs Act Grow the Economy?*

The TCJA did not alter underlying trends in either wage growth or investment, as confirmed by multiple sources.<sup>18</sup> There was also no evidence that the TCJA made a noticeable difference in the path of U.S. economic growth; a report from the International Monetary Fund (IMF) found that increased corporate cash balances were largely directed toward stock buybacks (which reached

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production and other high technology fields, and preserving our entrepreneurial culture. For a detailed discussion of the importance of immigration for the US economy, see chapter 8 of my book *Open: The Progressive Case for Free Trade, Immigration, and Global Capital* (Harvard University Press, 2019).

<sup>18</sup> See detailed evidence within: Furman, Jason. "Prepared Testimony for the Hearing "The Disappearing Corporate Income Tax." Committee on Ways and Means. 11 February 2020; Gravelle, Jane, and Donald Marples. "The Economic Effects of the 2017 Tax Revision: Preliminary Observations." *Congressional Research Service*. 22 May 2019; Clausing, Kimberly. 2020. "Fixing the Five Flaws of the Tax Cuts and Jobs Act." *Columbia Journal of Tax Law*. 11(2). 31-75.

record levels in the wake of the legislation) and dividend payouts.<sup>19</sup> The international tax provisions had a small effect in reducing profit shifting, and some companies moved intellectual property income back to the United States, but the overall scale of the effect was largely unchanged, as seen in Figure 1.

*With tough U.S. laws, won't companies invert or move their headquarters overseas? Didn't TCJA finally put an end to that practice? Shouldn't we think twice before reigniting inversions?*

Many countries are implementing the international tax agreement, so once those laws are in place, the advantage of foreign locations will be limited. In addition, simple anti-inversion measures, such as those suggested by Senator Whitehouse in his proposed legislation, can be quite effective in stemming the incentive to invert. Further, regulatory measures can be helpful here, as shown by the U.S. experience after the anti-inversion (and anti-income stripping) regulations of the late Obama years, which brought inversions to a halt.

*Won't raising taxes on corporations hurt the economy and jobs, especially during a time of macroeconomic uncertainty?*

Unlike the 2017 tax law—which created new incentives to shift profits and jobs overseas—this reform ends these incentives, increasing the incentive for economic activity in the United States. In addition, the revenue from these reforms will enable more fiscal stability, allowing possible fiscal space for investments that would boost the long-term competitiveness of the U.S. economy.

Further, it is important to remember that the corporate income tax is a profits tax, and as such, it is strongly countercyclical. Companies only pay corporate tax when they are profitable, and companies earning losses (or carrying them forward from prior years) pay no corporate tax. In contrast, other sources of tax revenue fall more heavily on typical American workers and families, regardless of economic conditions.

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<sup>19</sup> See Kopp, Emanuel, Daniel Leigh, Suzanna Mursula, and Suchanan Tambunlertchai. “US Investment since the Tax Cuts and Jobs Act of 2017.” International Monetary Fund. 31 May 2019. For evidence on record buybacks, see Yardeni, Edward, Joe Abbott, and Mali Quintana. 2019. “Stock Market Indicators: S&P 500 Buybacks and Dividends.”, available [here](#).