January 22, 2019

The Honorable Richard Neal
Chairman
Committee on Ways and Means
US House of Representatives
Washington, DC 20515

The Honorable Charles Grassley
Chairman
Committee on Finance
US Senate
Washington, DC 20510

The Honorable Kevin Brady
Ranking Member
Committee on Ways and Means
US House of Representatives
Washington, DC 20515

The Honorable Ron Wyden
Ranking Member Committee on Finance
US Senate
Washington, DC 20510

Re: Support for trade competitive tax reform: Destination-Based Sales Factor Apportionment and a Strategic US Goods and Services Tax

Dear Chairman Grassley and Ranking Member Wyden/Chairman Neal and Ranking Member Brady:

The Coalition for a Prosperous America (CPA) looks forward to your upcoming efforts to improve the US tax system. We ask that you consider both (1) a Destination-Based Sales Factor Apportionment tax and (2) a strategically implemented US Goods and Services Tax for future tax reform.

CPA is the only national organization that represents exclusively domestic producers. We represent manufacturing, agriculture, and labor. We support a simpler tax code that improves US trade performance, solidifies the tax base and eliminates multinational and foreign corporations' tax advantages.

Introduction

The Tax Cut and Jobs Act (TCJA) was an important tax reform effort. However, we are concerned that problems remain, including tax code complexity, profit shifting, and favoritism towards foreign producers.

CPA urges you to strongly consider a destination based system of taxing both profits and consumption. The US has the world's largest consumer market. Companies achieve profits by accessing our market. Domestic, multinational and foreign businesses should all be taxed based upon that access.

The current system of taxing multinational firms should shift to Destination-Based Sales Factor Apportionment. The US tax base for corporations should be calculated based on a fraction of their worldwide income. That fraction would simply be the share of their worldwide sales that are destined for customers in the United States.

The US should also institute a consumption tax, such as a Goods and Services Tax (GST), to improve our trade competitiveness. A GST should be implemented in a revenue and distribution neutral manner by reducing other domestic taxes or costs. American exports face foreign countries' value-added taxes, averaging 17% globally. Foreign imports to the US receive a value-added tax rebate from their home country. Therefore our exports are double taxed while foreign imports are not. A GST would neutralize their advantage.

Destination-Based Sales Factor Apportionment

CPA requests that Congress reform the tax code based upon a territorial corporate income tax called Destination-Based Sales Factor Apportionment (DBSFA). The corporate tax base would be solidified because DBSFA provides near immunity from base erosion. Multinationals would no longer gain a tax advantage by profit shifting to subsidiaries in low tax countries. Many US states have, for many years, used a sales-based formulary apportionment system to allocate national income for tax purposes. These states adopted SFA to solve the difficulty of assigning corporate profits across state borders. A sales-based taxation method recognizes that customers are the true source of profits and are far less mobile than the firm's assets or employees.

The previous and current tax system incentivizes offshoring, corporate inversions out of the US, profit shifting to foreign tax havens and other tax avoidance schemes. Multinational corporations (MNCs) can strategically allocate earnings to subsidiaries outside of the US while allocating costs to locations within the US. The TCJA did implement some complex, but limited, defensive rules against these strategies. However, the early evidence is showing these rules to be insufficient. The TCJA rules of GILTI, BEAT, and FDII can be avoided by moving assets and labor out of the US to avoid falling prey to arbitrary calculations.

The location of corporate headquarters should not matter, but it still does under the TCJA. MNCs have replaced their old deferral strategies with new strategies distinguishing their internal profit categories to avoid triggering GILTI and BEAT. By recategorizing what type of profit was made by the corporation, tax lawyers allocate profits into beneficial TCJA defined categories, MNCs continue to reduce how much profit is attributed to the US under TCJA. Domestic US companies, in contrast, can't afford the lawyers or the subsidiaries and thus pay more taxes on equivalent profits. Foreign domiciled corporations doing business in the US pay taxes on a fully territorial basis, and only and still have an advantage. In other words, they only pay taxes on profits they allocate here not on the profits earned by their sales here. The tax system rewards corporate firms for being "less of an American company."

DBSFA solves these problems. Corporations earn income from sales. Therefore income should be allocated based upon the destination of those sales. MNC income should no longer be allocated based upon the location of a subsidiary that allegedly earned it. The location of sales is much more difficult to manipulate than the "origin of income" under the current system. The US tax base for corporations would be calculated on the basis of a fraction of companies' worldwide income. This fraction would be the share of each company's combined (including subsidiaries within the company's legal and economic control) worldwide sales that are destined for customers in the United States.

Access to our consumer market from which all business, foreign or domestic, generate their revenue should determine the taxes owed to our country. A DBSFA system ignores the artificial legal distinctions among types of firms. Subsidiaries, branches and hybrid entities are all considered a unitary business for tax purposes - which, after all, is what they are. Whether a parent or a subsidiary is incorporated in the US or elsewhere makes no practical difference to production, sales or distribution. Hence it should make no difference to taxation.

A DBSFA system would improve America's trade competitiveness because it provides domestic producers a further incentive to export. Profits from overseas sales would not be subject to taxation. Foreign producers who sell goods and services here would pay taxes on profits arising from the privilege of accessing our market. No corporate tax benefit would result from moving a US plant overseas.

DBSFA should have bipartisan support because it would solidify the corporate tax base and raise more revenue under current lower rates. It would end favoritism towards foreign and multinational companies and de facto discrimination against domestic companies. Tax competition from low tax countries will have little effect on US tax revenue or corporate behavior because a location of sales based system makes profit shifting irrelevant. The tax code should not incentivize production to move from the US. It is for these reasons that we ask you to establish destination based sales factor apportionment as the basis for corporate income tax reform.

A Strategic US Goods and Services Tax

CPA requests that you consider strategically adopting a consumption tax known as a Goods and Services to improve the global trade competitiveness of US-based companies and workers, reduce the trade deficit and foster sustained job and economic growth. A GST can be and should be revenue and distribution neutral.

The US unilaterally disarmed, in the last 45 years, by reducing tariffs while over 150 countries replaced their tariffs with value-added taxes averaging 17%. American exporters, therefore, face nearly the same border taxes (tariffs plus consumption taxes) as they did in the 1970s.

When the US exports a $600 dishwasher to China, the price becomes $696 when the Chinese 16% VAT is added. When a Chinese company exports a $600 dishwasher to the US, the VAT rebate reduces the price by about $96 to $504.

Congress can neutralize this foreign trade advantage by adopting a GST and using the proceeds to reduce other domestic taxes and costs in a revenue and distribution neutral manner. For example, a 13% GST could raise $1.4 trillion in revenue which could fund a full offset of domestic payroll taxes, reduce personal income taxes and provide a credit for health care costs.

US companies would receive a 13% GST rebate when exporting, largely eliminating the double taxation penalty when paying the average 17% foreign VAT. Foreign companies would pay our 13% GST when shipping to the US. Imports are 15% of US GDP. By applying a GST on those imports, we can reduce the tax burden on US producers and taxpayers.

The result would foster greatly improved US trade performance, reduce offshoring and create good-paying American jobs. A strategically designed US GST is necessary to level the playing field between US companies and foreign competition.

Thank you for your consideration.

Sincerely,

Brian O'Shaughnessy
Vice Chairman of the Board
Coalition for a Prosperous America

Michael Stumo
Chief Executive Officer
Coalition for a Prosperous America

Cc: Members of the Senate Committee on Finance
Members of the House Committee on Ways and Means