



AMERICANS FOR TAX REFORM

# TAX POLICY BRIEF

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## The State of the Union for American Taxpayers

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### Making America Competitive in the 21<sup>st</sup> Century

January 30, 2006

In each of his first four years in office, President George W. Bush has signed a new tax cut into law. During this time, the Bush Administration has reduced taxes on individual income, slashed rates on both dividends and capital gains to 15 percent, and begun to phase out the death tax, which is just another layer of taxation on saved income that has already been taxed multiple times. Other tax cuts reduced the cost of capital for businesses by allowing companies to expense 50 percent of purchases and to repatriate foreign earnings at a lower tax rate. Unfortunately, these two latter tax cuts have expired, despite their unqualified success.

2005's tax cut will be enacted in the next few weeks as Congress was delayed in enacting critical extensions of capital gains and dividend tax cuts. Yet, despite passage in 2006, we would credit this tax cut to 2005 as the late passage is equivalent to handing in a term paper late but is no substitute for this year's homework.

Even with these pro-growth measures in place more needs to be done to keep America competitive in a rapidly changing global economy. Therefore, this year, and over the years to come, the challenge for policymakers is to ensure America remains competitive in the global economic arena. For all the talk about outsourcing and the loss of American jobs, very little has been done to remedy the problem, specifically changing America's antiquated tax code to ensure American companies and workers are not facing international competitive disadvantages.

When politicians rail about China and India taking jobs, they miss the point. America is not competing with these countries for jobs. America is competing with these countries for capital. And it is that capital which will create jobs. America's international tax law was designed at a time when America was the center of capital regardless of tax and regulatory policy. That has changed and the U.S. tax law needs to be updated to make America more competitive.

**Americans for Tax Reform urges the following six changes be made to ensure America is center of capital formation:**

**Reduce the Federal Corporate Tax Rate to 25%.** Nearly every industrialized country in the world has reduced their corporate income tax rate to lure new investment and spur economic growth. The United States has been sitting on the sidelines with a top corporate rate of 35 percent, giving the nation the second highest corporate tax rate in the world, with only stagnant Japan having a higher rate. The 25 countries in Europe now have an average 27 percent corporate tax rate while the 19 nations in Latin America and 18 Asia countries average 30 percent. As such, capital is now fleeing the United States for other countries. A 25 percent federal corporate tax rate will bring the U.S back into a competitive environment globally and will dramatically reduce the cost of capital, increase investment, jobs, and wages. This reform is essential for America to compete in today's global economy.

**Territorial Taxation.** Congress needs to immediately end the process of taxing profits earned overseas when those profits are reinvested back into American to create American jobs. Nearly every industrialized country in the world has a "territorial" system which allows foreign profits to be reinvested back into their country tax free. America, on the other hand, punishes companies with more taxes if those profits are reinvested back into America. This places American companies at a significant competitive disadvantage with foreign companies. If American companies want to reinvest their foreign profits to create American jobs they should be able to do it tax free.

**Full Business Expensing.** Making America competitive requires reducing the cost of capital for firms. Currently, long and onerous depreciation schedules for business investment raise the cost of capital and reduce the competitiveness of American businesses as most European countries already have this provision in place. Allowing companies the ability to expense their purchases in the first year will dramatically reduce the cost of capital, increase investment, and bolster job creation.

**Lifetime and Retirement Savings Accounts.** Countries around the globe continue to reduce, if not eliminate, the double taxation of savings and investment. America should follow this example by enacting Lifetime and Retirement Savings Accounts (LSAs/RSAs). These accounts allow everyone to save up to \$5,000 per account, tax free, with no limitations based on age or income status, while dramatically simplifying the current hodgepodge of savings programs. Enactment of this policy will eliminate capital gains, dividend, and interest taxation for nearly every American shareholder, thus increasing investors after tax return and boosting shareholder wealth significantly, thereby attracting more capital for job creation and wage growth.

**Health Savings Account Expansion.** Health Savings Accounts (HSAs) are on the cutting edge of providing better and more valuable health care for all Americans. The number of HSAs tripled to 3 million in 2005, and is growing exponentially. We need to build on this early success by 1) Removing the dollar cap limitation on HSA contributions, and allowing all HSA holders to contribute up to the out-of-pocket maximum every year; 2) Allow the health insurance premiums associated with HSAs to be deductible for all taxpayers, not just the self-employed and employees covered by an HSA plan at work; and 3) Kick-start HSAs for lower-income Americans by letting them take advantage of HSA tax credits, and by encouraging the states to allow Medicaid recipients to get their coverage using HSA-style funds.

**Portable Pensions.** The one area where America leads the world is portable pensions but more needs to be done. Already two thirds of all retirement funds are held in defined contribution plans controlled by workers themselves. Yet, that means one-third is still controlled by employers, unions, or state/local government at the peril of the worker. Anyone who wishes to have a defined contribution 401k style plan should be given that option so the worker no longer needs to worry that their sponsor is misusing and abusing their retirement savings.