US multinationals awarded huge tax break on foreign earnings

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Under the guise of a provision to create jobs, the US Congress passed a revision to the tax code allowing an 85 percent reduction in taxes on foreign earnings of many of the country's largest corporations. The reduction applies to profits made and held by overseas subsidiaries. Instead of requiring the companies to pay the standard 35 percent top corporate tax rate on these earnings, the rate on such earnings "repatriated" to the US parent will go down to a mere 5.25 percent for one year.

The *Wall Street Journal* estimates that as much as $750 billion in profits may be subject to the lower rate.

A provision of the law is supposed to prohibit companies from using the tax bonanza to boost dividends, buy back stock or raise executives' compensation. Nothing, however, prevents the companies from using the money to pay down debt, for capital spending that may already have been budgeted, or for research and development costs. Money saved on such purposes could easily be reallocated for the technically prohibited uses.

Under the "domestic reinvestment" plans required under the act, consumer giant Procter & Gamble, for instance, is expected to use the extra cash to help finance its planned $57 billion acquisition of Gillette. Cereal maker Kellogg, Inc., likewise announced it would use the money to purchase competitors.

While the law is titled the "American Jobs Creation Act," it could more accurately be described as the "American Corporate Tax Boondoggle Act." It passed the US House by 280 to 141 and the Senate by 69 to 17. President Bush signed it into law last October, but its impact is only now coming to light as corporations project earnings for the coming year based on the tax breaks.

The list of companies that stand to benefit reads like a Who's Who of American business. Exxon, General Electric and IBM have profits subject to the favorable tax treatment of about $20 billion each. Pharmaceutical manufacturers stand to reap exceptional rewards. Pfizer heads the list at $38 billion of eligible overseas earnings, followed by Merck at $18 billion, Johnson & Johnson at $14.8 billion and Eli Lilly at $9.5 billion. Drug makers Bristol-Myers Squibb and Schering-Plough are also sitting on many billions of "unrepatriated" earnings.

The excuse provided to lawmakers for signing on to such a blatant corporate tax giveaway is that pumping dollars into corporate America will stimulate the economy, resulting in the creation of new jobs. The package does not, however, require that a single job be created. Computer maker Hewlett-Packard, which lobbied heavily for the bill and is sitting on some $14 billion in accumulated foreign profits, announced recently that it would continue to cut jobs this year, on top of the 25,000 it has eliminated over the past three.

By allowing companies to use the tax windfall for corporate buyouts, the result is all but certain to mean fewer jobs as production is "rationalized." Analysts expect software maker Oracle Corp. to use some of its $3 billion in foreign earnings to help pay off its recent acquisition of PeopleSoft. The company plans to consolidate the two companies at a cost of 5,000 jobs.

Ostensibly, the tax break is required to compensate US exporters for the loss of a government subsidy that helped offset tariffs imposed by other countries. The World Trade Organization ruled the subsidy a violation of fair trade. The European Union (EU) recently imposed sanctions, which were due to increase in successive months.

Upon elimination of the tax subsidy, known as foreign sales corporation/extraterritorial income (FSC-

ETI), the EU agreed to lift the sanctions. At the same time, the move opened the door to a major revision of the corporate tax code. Companies will reap the benefit of the revisions, even if they never benefited from the now repealed FSC-ETI subsidy.

Apart from the reduction in tax on foreign profits, all companies designated as “manufacturers” will see their standard rates go down from 35 percent to 32 percent. The rate will slide even further to 29 percent in 2007.

Not only will traditional manufacturing benefit, but the term is defined so broadly as to include such far-flung fields as construction, engineering, energy production, computer software, film and videotape, and any processing of agricultural products. A national retail coffeehouse chain will be allowed to call its coffee-roasting “manufacturing.”

In addition to throwing agricultural processing into the manufacturing category, more than 20 other tax breaks have been given to agricultural concerns. The largest of these is a $10 billion fund for tobacco farmers. Lawmakers voted down a requirement to bring tobacco under Food and Drug Administration (FDA) regulation as a condition of setting up the fund.

The list continues. Other specific “incentives” were incorporated for wholesale distributors of distilled liquors, NASCAR car owners and farmers’ cooperatives. An ethanol subsidy targeted for farm states has been extended.

The bill also extends government largesse to high-income individuals. It provides concessions totaling $4 billion on the treatment of the Alternative Minimum Tax (AMT), which Congress passed in 1969 after negative publicity about wealthy individuals who used loopholes to reduce their tax burden to zero. Owners of small aircraft will receive a 50 percent bonus depreciation credit. In addition, broad-based stock options have been excluded from payroll taxes.

In a letter to congressional leaders on the eve of the vote, even US Treasury Secretary John Snow noted that the bill was filled with provisions for “special interests.” At the same time, he signaled the intention of President Bush to sign the bill.

The bill was touted as “revenue-neutral” for the government, meaning that the lost revenue from the tax breaks would be counteracted by the elimination of the $50 billion FSC-ETI subsidy and other increases in revenue. Such claims are deceptive.

The legislation as it passed mandates that the tax credits, such as the main one on foreign profits, shall expire in a year. However, if Bush, abetted by Congress, seeks next year to make these cuts permanent, the cost to the treasury could run $500 billion or more, according to CCH Tax and Accounting, a leading tax-consulting firm.

This is exactly the approach the administration has taken with its first-term income tax cuts for the wealthy. In that case, it low-balled the amount of the tax cut by maintaining it would expire in a few years. Now, additional billions are being sought from tax revenue to make those cuts permanent.

The so-called American Jobs Creation Act constitutes yet another step in the concentration of wealth in the hands of the few. The business tax breaks just enacted would more than cover the cost of the cuts in social programs proposed in this year’s budget. Programs to help the working class and the poor, such as Medicaid, housing and student loans, are given short shrift, however, by a Congress bent on lowering the tax burden on their sponsors among the wealthy elite.