

### Hooray for Trump's Proposal to End Deferral

To the Editor:

In his tax proposals released on September 28, 2015,<sup>1</sup> Donald Trump proposes, *inter alia*, to (1) tax business income at a 15 percent rate, (2) tax at a one-time 10 percent rate the accumulated deferred foreign income in foreign subsidiaries that are owned by U.S. corporations, and (3) eliminate on a going-forward basis the deferral of U.S. tax on foreign earnings of foreign subsidiaries of U.S. corporations. On the elimination of deferral, the Trump plan says:

*An end to the deferral of taxes on corporate income earned abroad. Corporations will no longer be allowed to defer taxes on income earned abroad, but the foreign tax credit will remain in place because no company should face double taxation.*

This apparently means that Trump supports an imputation system for taxing foreign income on a going-forward basis. Under an imputation system, the income (and loss) of foreign subs would be imputed up to the U.S. parent corporation. Then, the income would be subject to tax at the U.S. corporate rate, which under Mr. Trump's plan would be 15 percent, but the U.S. tax liability would be reduced by any foreign tax credit.

Assuming I am reading his plan correctly on this issue, I say: "Hooray for Trump's proposal to end deferral!" To my knowledge, Trump is the first and only presidential candidate or sitting president since John F. Kennedy in 1962 to propose the elimination of deferral. While I am a liberal Democrat, I have criticized President Obama's international tax proposals for being "*too timid*"<sup>2</sup> in not proposing an imputation system like that proposed by Trump. I am delighted to support Trump on this very sensible and logical proposal, which runs completely counter to Republican orthodoxy, and which supports, without apparent dissent, a move

to a territorial system. Such a system would not subject foreign business earnings of U.S. firms and their foreign subsidiaries to any U.S. tax, either at the time of earning or at the time of repatriation of the earnings to the United States.

The adoption of an imputation system would have many salutary effects, including the following, which I discuss in greater detail in my three *Tax Notes* articles<sup>3</sup> on this topic. One of the major benefits of an imputation system is that it would eliminate the incentive for foreign investment over domestic investment; an imputation system would level the tax playing field for foreign and domestic investment. On the other hand, a territorial system would exaggerate the incentive for foreign over domestic investment that is in our current deferral system because under a territorial system, foreign business income earned by foreign subsidiaries of U.S. corporations would be subject to tax only in the foreign jurisdiction. Why would we want to adopt a tax policy that would encourage investment in China over investment in the United States, which a territorial system could do?

Another benefit of an imputation system is that it would preserve the U.S. tax base by eliminating the inappropriate shifting of domestic earnings to foreign subsidiaries. Specifically, by enacting an imputation system, U.S. multinational corporations would no longer have an incentive to abuse the transfer pricing rules by deflecting income to foreign subsidiaries or to enter into abusive transactions to deflect expenses of foreign subs to U.S. parents. Those abuses are significant in the current deferral system and would be even greater with a territorial system.

This is because with a territorial system, every penny that can be diverted to a foreign low or no tax jurisdiction will be subject to tax only in that jurisdiction and then can be repatriated to the United States without tax. While Congress would attempt to erect barriers against this type of tax-free round-tripping with a territorial system, clever tax professionals will come up with schemes designed to penetrate the barriers.

<sup>1</sup>Trump, *Tax Reform That Will Make America Great Again*, available at <https://www.donaldjtrump.com/positions/tax-reform>.

<sup>2</sup>Samuel C. Thompson Jr., "Obama's International Tax Proposal Is Too Timid," *Tax Notes*, May 11, 2009, p. 738.

<sup>3</sup>Thompson, "Logic Says No to Options Y, Z, and C, but Yes to Imputation," *Tax Notes*, May 5, 2014, p. 579; Thompson, "An Imputation System for Taxing Foreign-Source Income," and *Tax Notes*, Jan. 31, 2011, p. 567; and Thompson, *supra* note 2.

With an imputation system, the lockout of trapped foreign income would be eliminated because there would be no tax detriment to repatriation of foreign income, as is the case with the current deferral system. While a territorial system would reduce the lockout effect, it would not eliminate it, because there would still be a major tax incentive for investing and reinvesting abroad in jurisdictions with tax rates that are lower than the U.S. rate.

Under the current deferral system, the United States loses billions of dollars in tax revenue; however, an imputation system would eliminate that revenue loss and permit a significant reduction in the corporate tax rate on a revenue-neutral basis. A reduction in the corporate tax rate would lead to an increase in both domestic-controlled and foreign-controlled investment inside the United States. That is, foreign corporations, like Mercedes-Benz, would be taxed on their U.S. operations at the same lower U.S. tax rate that would apply to GM.

While I doubt that on a revenue neutral basis, the corporate tax rate could be reduced to 15 percent as proposed in Trump's plan, I have no doubt that on a revenue neutral basis, the elimination of deferral and the adoption of an imputation system would result in significant revenues that could be used to significantly reduce the corporate tax rate.

Samuel C. Thompson Jr.  
Professor and Director,  
Center for the Study of  
Mergers and Acquisitions  
Penn State's Dickinson  
School of Law,  
State College, Pa.  
Sept. 28, 2015

*It's important to be able to count  
on someone's expertise.*

*(Especially when someone else  
is counting on yours.)*

Experts know they can rely on us for the answers their clients need. In fact, tax professionals at the top 25 international law firms, 96 of the top 100 U.S. law firms, and the majority of the *Fortune* 100 turn to us for tax news, analysis, and commentary.

To see why we've earned their trust,  
please visit [taxanalysts.com](http://taxanalysts.com).

**taxanalysts®**

Tax Notes Today® ▲ State Tax Today® ▲ Worldwide Tax Daily®