This week, Mercatus Center senior research fellow Veronique de Rugy examines the need for corporate tax reform to include the adoption of a territorial type of tax system. As shown in the chart below, the United States has the highest corporate rate, based on the combined (central and sub-central government) statutory corporate tax rate of OECD-member countries with worldwide tax systems in 2011.

Most major countries don’t tax foreign business income. Under a territorial system, corporate profits are only taxed by the country in which the income is earned. In fact, more than three quarters of OECD nations have territorial systems that tax firms only on their domestic income.

By contrast, under a worldwide tax system, a country’s domestic companies are subject to taxation on all income regardless of where it is earned (domestically or internationally). Profits of an American-owned computer plant, for example, are subject to U.S. taxes whether the plant is located in Texas or Ireland.

The data show that the average corporate income tax rate of the seven non-territorial countries is 21 percent, much lower than the 39 percent tax rate the U.S. imposes. American corporate profits earned abroad and at home are taxed at a higher rate than in most other countries. As a result, many companies are not bringing their profits back to America.

The combination of high rates, the worldwide tax system, and a competitive global marketplace makes the U.S. corporate tax system more punishing than it seems at first glance.

Veronique de Rugy discusses tax reform at NRO’s The Corner.

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