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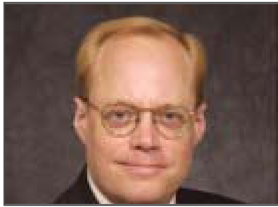

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U.S. Tax Rates? Not Competitive, But California's Are Worse

Is the U.S. tax system competitive? Many global companies say it isn't. Companies like Apple say they have to jump through hoops to stay competitive. In September 2012, the Senate Permanent Investigations Subcommittee's report on Apple painted a grim picture.

Senators Levin and McCain claimed that Apple skirted U.S. taxes on $44 billion over four years. Still, when CEO Tim Cook testified, he put the burden back on legislators, putting the tax code and the need for reform on display. The Senate Permanent Investigations Subcommittee looked at Microsoft and Hewlett-Packard too.

Many of their tax strategies are about off-shoring. Companies with IP often consider where it should be located. The Netherlands, Belgium, France, the U.K., Ireland, Switzerland, Spain and even China can be appropriate jurisdictions for patent entities. The owner may derive income from licensing the IP, selling products or providing services using it. Licenses and sales may be to related parties, unrelated parties or both. IP off-shoring can significantly reduce a company's effective tax rate.

By comparison, individual Americans pay tax at up to 39.6% on their worldwide income. Individuals complain too, noting that they're getting a raw deal. U.S. citizens and permanent residents must report their worldwide income, landing many in hot water. And even our capital gain rates in the

U.S. are problematic. Added to state taxes, our capital gain rates far exceed most in the industrialized world. So says the Tax Foundation's new report.

Our average top capital gain rate ranks sixth in the OECD, at 28.7%. And that doesn't even include the 3.8% Obamacare tax. Our rate on capital gains is over 10 percentage points *higher* than the OECD average of 18.2%.

The flag of California (Photo credit: Wikipedia)

It's even worse in the Golden State. California's top marginal tax rate of 33% is the third-highest tax rate in the industrialized world, behind only Denmark and France. That creates a bias against savings, slows economic growth, and harms U.S. competitiveness. See The High Burden of State and Federal Capital Gains Tax Rates.

The lack of an adjustment for inflation makes it doubly painful. Your *effective* capital gains rate could be even higher. After all, much of the increase in the value of the asset might be due to inflation, not to *real* gains. If you *really* want to be impressed, check out California's capital gain rate.

There isn't one–it's taxed as ordinary income. In California, those earning $254,250 to $305,100 a year now pay 10.3%. For $1 million-plus-earners, California's rate is 13.3%. At the federal level, the capital gain rate remains

15% for some, but rose to 20% for higher income taxpayers. Add the 3.8% investment tax under Obamacare, and you have 23.8% for many.

California taxes capital gains just like income, as high as 13.3%. You pay up to a 33% combined federal and state tax on capital gains in California. That means you're paying more than virtually anyone else in the world. Experts say the impact isn't just digging deeper at tax time.

In fact, such a high tax rate has long-term negative implications for the economy. People save less and invest less. Take a look at how we stack up:

Long-term Capital Gains Rate		
Rank	Country/State	Capital Gains Rate
1	Denmark	42.0%
2	California	33.0%
3	France	32.5%
4	Finland	32.0%
5	New York	31.4%
6	Oregon	31.0%
7	Delaware	30.4%
8	New Jersey	30.4%
9	Vermont	30.4%
10	Maryland	30.3%

11	Maine	30.1%
12	Ireland	30.0%
13	Sweden	30.0%
14	Idaho	29.7%
15	Minnesota	29.7%
16	North Carolina	29.7%
17	Iowa	29.6%
18	Hawaii	29.4%
19	District of Columbia	29.1%
20	Nebraska	29.1%
21	Connecticut	29.0%
22	West Virginia	28.9%
23	Ohio	28.7%
24	Georgia	28.6%
25	Kentucky	28.6%

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.