Obama's tax plans raises high-tech hackles

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(AP) -- President Barack Obama's plan to impose U.S. taxes on corporate America's overseas profits threatens to open a big crater in the financial statements of technology companies.

While additional taxes are rarely popular, Obama's decision to go after corporate earnings outside the United States is a particularly prickly subject for technology executives because the industry has been steadily boosting its overseas sales amid rising demand for its gadgetry and services.

If Obama's proposal becomes law, the hard-hit companies would include tech bellwethers like Hewlett-Packard Co., IBM Corp., Cisco Systems Inc., Microsoft Corp. and Google Inc. Each of those companies realized a benefit of more than $1 billion from lower foreign tax rates in their most recent fiscal years - an advantage that could lost if Obama is able to change the rules.

"It would be like an earthquake for high tech," said Carl Guardino, chief executive of Silicon Valley Leadership Group, an industry trade association. "On a Richter scale of 1 to 10, this would be a 12."

Collectively, HP, IBM, Cisco, Microsoft and Google lowered their tax bills by a combined $7.4 billion in their last fiscal years by taking advantage of lower tax rates outside the United States, according to an analysis by The Associated Press.

Through the years, these five tax companies have avoided U.S. income taxes and foreign withholding taxes on a combined $72 billion in undistributed earnings from their foreign operations.

While Obama's proposal might not tax all the money U.S. companies keep overseas, it apparently would target a big chunk. Obama estimated his plan would raise a total of $210 billion, or an average of about $21 billion annually, over a 10-year period.

By reinvesting their earnings overseas, U.S. companies insulate themselves from much higher tax rates had the money been made in their home country.

Google, for instance, would have been hit with an effective tax rate of 45.2 percent instead of 27.8 percent last year if it hadn't been able to capitalize on lower rates overseas, according to the Mountain View-based company's annual report. Without the lower foreign rates, Google's 2008 tax bill would have been $1.02 billion higher. Google's income before taxes totaled $5.85 billion last year.

Obama has been strongly supported so far by Google CEO Eric Schmidt, who campaigned for the president last year and has subsequently served as a technology adviser.

Google spokesman Adam Kovacevich said Monday it was too early to evaluate how Obama's tax proposal might affect the Internet search leader's operations because the idea is likely to be revised as it wends its way through Congress.

HP reaped a $1.77 billion benefit in its fiscal 2008 from lower foreign tax rates while Cisco and Microsoft each saw benefits of more than $1.6 billion, according to the companies' annual reports. IBM's foreign tax advantage last year totaled about $1.3 billion.

The high-tech industry isn't the only beneficiary from the current tax rules. General Electric Co., for instance, lowered its effective tax rate by nearly 27 percent last year by keeping profits outside the United States. That saved the company more than $5 billion in potential U.S. taxes.

And offshore earnings enabled drug maker Johnson & Johnson to lower its effective tax rate by 12.4 percentage points last year, saving about $2 billion.

Obama reasons that U.S. companies will create more jobs in the United States if there is less of an advantage to setting up operations overseas.

But Guardino disagrees, maintaining that high-tech firms and other U.S.companies are establishing more foreign offices to take advantage of their biggest growth opportunities. And as they bring in more revenue overseas, companies are also able to hire more workers in the United States as well as in other countries, Guardino said.

As it is, Google already generates more than half its revenue outside the United States and that percentage is expected to increase as more people around the world go online and gravitate to the company's services.

If they face higher taxes on their foreign earnings, high-tech companies will be at a competitive disadvantage that will discourage them from expanding their payrolls, Guardino said.

By coincidence, Guardino and about 50 Silicon Valley executives had already scheduled a trip to Washington this week. Guardino said the group plans to focus on meeting with lawmakers to explain why Obama's idea to tax overseas profits would do more harm than good.