Inverted Thinking on Corporate Taxes

Instead of trying to bar U.S. companies from going overseas, why not make America more hospitable?

By

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Treasury Secretary Jack Lew must have loved the children's classic " Hans Brinker, or the Silver Skates"—and perhaps even believed it, especially the story of a Dutch boy who saves his nation by putting his finger in a leaking dike. That appears to be the Obama administration's approach to tax policy.

In a letter to Congress on Tuesday, Mr. Lew called on lawmakers to stop U.S. corporations from merging with foreign corporations and locating the parent company abroad to reduce their taxes. He also asked Congress to make the new law to combat such "inversions" retroactive to May. That was the month when Pfizer's attempt to merge with AstraZeneca in the U.K. produced front-page headlines. Mr. Lew's letter was apparently provoked by the similarly high-profile news in recent days that AbbVie, a U.S. biopharmaceutical company, is seeking to buy the Irish drug manufacturer Shire—and to make Ireland the parent company's tax home. Financial analysts have estimated that the move might save AbbVie $1.3 billion in taxes over the next several years.

The AbbVie news came almost in tandem with reports that the U.S.-based generic drug maker Mylan is buying the generic-drugs business of Abbot Laboratories in a $5.3 billion deal, with a plan to organize in the Netherlands and cut its tax bill.

In real life, the finger-in-the-dike approach doesn't work. With corporate inversions, there are simply too many companies that have very large incentives for poking more holes. Many more inversions are on the way. Investment bankers have warmed to the potential for this kind of merger business and are competing to be matchmakers for a flood of such deals.

Inversions by U.S. companies to take advantage of more favorable corporate tax laws abroad are nothing new. Of the more than 25 U.S. companies that inverted between 1982 and 2002, more than 20 made Bermuda or the Cayman Islands their home. Others chose Panama. One moved to the Netherlands, another to Canada.

Treasury Secretary Jack Lew in Washington, D.C., June 26. Win McNamee/Getty Images

The first effort to stop this tide was a 1996 Treasury regulation in response to the cosmetic company Helen of Troy's move to Bermuda. That regulation didn't work. So, in 2004, Congress enacted new anti-inversion legislation. That obviously hasn't worked either. Estimates by congressional staff show that inversions will cost the U.S. Treasury $20 billion in the next decade. Now, despite two decades of failed efforts in this realm, Mr. Lew and many senators and representatives want to tighten the 2004 law. The Treasury secretary calls also for companies to demonstrate "a new sense of economic patriotism."

Make no mistake: Such proposals would do nothing to make the U.S. a more favorable place to locate multinational headquarters or investments. If they succeed—which is unlikely, given the creativity of tax planners and the potential large tax savings at stake—the most likely outcome will be more foreign takeovers of U.S. companies. No anti-inversion legislation will block this route for garnering the large tax savings that U.S. companies are now seeking.

To ask, "How do we stop American companies from leaving for more favorable tax jurisdictions?" is asking the wrong question. The right question is "How do we make the United States a more favorable location for investments, jobs, headquarters, and research and development activities?" That will require genuine tax reform.

Ireland, Canada and the U.K. now have emerged as favored places to locate corporate headquarters. Their treasury officials are thrilled that U.S. companies want to relocate there. These countries have more in common than the English language and well-educated, motivated workers. They have all recently reformed their business income taxes to lower rates. At 35%, we now have the highest statutory corporate rate in the Organization for Economic Cooperation and Development, which has 34 developed countries as members. And, unlike the U.S., the vast majority of OECD countries do not impose taxes when their companies reinvest their foreign earnings at home. When U.K. or Irish treasury officials talk about their low-rate business-tax systems, they don't speak about patriotism; they talk about being "open for business."

The U.S. is the only OECD country that doesn't have a national tax on consumption. Relying, as we do, so heavily on individual and corporate income taxes to pay for federal expenditures hobbles us in today's global economy. Political leaders from both parties should demonstrate their own "economic patriotism." They need to stop just talking about tax reform. The time has come for them to sit down together and enact a tax system that is fair, simple for the vast majority of Americans, and much more conducive to economic growth.

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