

Nothing Unpatriotic About Doughnuts to Dollars

By Diana Furchtgott-Roth



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Diana Furchtgott-Roth, former chief economist at the Labor Department, directs Economics21 at the Manhattan Institute for Policy Research.

In this article, Furchtgott-Roth suggests that inversions are patriotic and that they benefit the U.S. economy because the earnings can be repatriated tax free. Thus, all those earnings can be used for investment or job creation. Despite threats from President Obama, inversions will not vanish until corporate tax rates are lower and the United States moves to a territorial tax system.

President Obama is threatening to use his powers of executive order to stem the flood of inversions that is gripping the U.S. multinational corporate scene. Since 2012 about 15 inversions have occurred, with another half-dozen deals in progress. Treasury Secretary Jacob Lew on September 8 called for tax legislation banning inversions retroactive to May 2014.¹ Some have suggested that Obama will issue a retroactive executive order on the grounds that he threatened to end inversions in May, so companies would know not to do them.

A retroactive executive order that would stop inversions is even less credible than Obama's September 10 threats against Syria, Russia, and the Islamic State of Iraq and Syria. At least with foreign policy, the president has the power to act unilaterally if he wants to. Tax bills must originate in the House, be voted out of Congress, and then sent to the president's desk for signature.

As previously reported in these pages, Burger King Worldwide Inc. announced its intention to merge with Canadian doughnut chain Tim Hortons

Inc.² Inversions are not limited to pharmaceuticals and medical device companies. Any U.S. company with operations abroad has an incentive to invert, especially if it wants to bring capital back to the United States. Now that Burger King announced its intention to invert, other fast-food chains might be tempted to follow suit.

The best option, proposed by people as different as Boston University professor Laurence J. Kotlikoff³ and former *Washington Post* columnist Ezra Klein,⁴ would be to get rid of the corporate tax altogether and raise taxes on corporate distributions such as dividends and capital gains, which now receive preferential treatment because they are already taxed once at the corporate level.

The United States raised \$274 billion from the corporate tax in 2013, according to the Congressional Budget Office. That is just 10 percent of all U.S. revenue, and the tax costs millions of dollars to administer.⁵ Most importantly, the tax effectively discourages investment in the United States.

Obama has the power to ban foreign companies from being federal contractors, but that might violate WTO regulations.

Inversions are happening because the U.S. tax code is out of line with foreign tax codes. Until that changes, inversions will continue.

Although Republicans, Democrats, and Obama call for a lower corporate tax rate, it has yet to be voted out of Congress and signed by the president. One reason for that may be that tax bills have to be revenue neutral to pass under what are generally static "pay as you go" rules. That means if the corporate tax rate decreases, another tax should go up to pay for the missing revenue.

But Congress often ignores the pay-go rules in the context of spending. It increases spending in some programs without lowering spending elsewhere. That is in part why federal spending has increased by more than \$500 billion over the past 10

²Andrew Velarde, "Burger King to Buy Tim Hortons and Invert to Canada," *Tax Notes*, Sept. 1, 2014, p. 1003.

³Kotlikoff, "Abolish the Corporate Income Tax," *The New York Times*, Jan. 5, 2014.

⁴Klein, "Let's Get Rid of Corporate Taxes Altogether," *The Washington Post*, May 23, 2013.

⁵CBO, "The Budget and Economic Outlook: 2014 to 2024" (Feb. 2014).

¹Lew, "Remarks of Secretary Lew at the Urban Institute," Treasury (Sept. 8, 2014).

years, after adjusting for inflation.⁶ It is not that Congress is fastidious about spending.

A company can finance capital expenditures in a variety of ways. Those include using net income or retained earnings from prior years, borrowing, and raising new equity. For U.S. corporations with international subsidiaries with substantial earnings accumulated abroad, there is a temptation to repatriate that capital and use it to expand. But that would trigger the 35 percent tax.

One common technique to finance capital expenditures is to borrow from a financial institution or even from an affiliate. If borrowing costs are high and likely to increase as interest rates rise over the next few years as expected, repatriating funds becomes more appealing. Inverting can save companies millions of dollars.

Inversions have been gaining traction for three reasons. First, countries have lowered their tax rates while the United States has kept its rates constant. Second, U.S. corporations have had more international activity over the past few decades, and now about \$2 trillion in retained earnings is held abroad.⁷ Third, imitation is the sincerest form of flattery: Once one company has inverted, boards of directors of that company's competitors discuss it.

Obama has called inversions "unpatriotic," and last month said, "You shouldn't get to call yourself an American company only when you want a handout from American taxpayers."

But inversions have benefits for the U.S. economy. They make it easier for companies to invest in the United States. They raise profits and reduce tax liability for them and for their U.S. shareholders. Then the companies can channel more funds back to the United States. Companies that relocate overseas should be praised for making the right decision, not scolded for being un-American. What is more American than doing what is best for your company?

Consider a U.S.-based multinational that wants to bring back foreign earnings for the purpose of expanding. Under the current system, that multinational would pay a tax of 35 percent on the amount it brings back. If it brought back \$200 million, it would pay a tax of about \$70 million, depending on other foreign taxes paid. Using simple math, only \$130 million would be available for investment.

Inversions are lucrative because U.S.-based multinationals face a federal corporate tax rate of 35

percent, one of the highest in the world, on worldwide income, not just territorial income. That does not include state taxes. The United States is one of only seven OECD countries that taxes companies on their worldwide income, and the others have significantly lower corporate tax rates.⁸

If Burger King were headquartered in Canada and it wanted to bring back \$200 million to invest throughout the United States, all of that \$200 million could be invested. None would go to Treasury. U.S. residents would be better off, and the shareholders of the company would be better off. The United States would grow because companies generally spend money more effectively than does the government.

Since inverting to Panama in 1982, McDermott International Inc. has created U.S. jobs by constructing pipelines and oil platforms in the Gulf of Mexico and across the country. Panama's lower corporate income tax rate, 25 percent, leaves McDermott with more funds to hire the workers to complete those projects.⁹

Inversions can result in a greater flow of income into the United States. A company such as Medtronic Inc. that has recently inverted can expand its U.S. operations at a lower cost than can its competitors.

That means that once one company inverts, others in the same industry will have to do the same, or risk losing their competitive advantage. Just as we saw many pharmaceutical device companies inverting, Burger King could be followed by other fast-food chains.

As *Tax Notes* columnist Martin A. Sullivan has astutely observed, none of the corporate tax reform plans under discussion would end the advantage that foreign companies have in investing in the United States.¹⁰ All of the current tax reform plans would impose some kind of minimum tax on repatriated U.S. earnings. So a foreign company investing in the United States would still have an advantage, and inversions would continue.

Punishing inverted companies will not solve the fundamental problem that our tax system is out of line with the tax systems of other countries.

Last month Sen. Robert P. Casey Jr., a Democrat from Pennsylvania, wrote to Lew complaining about inversions. Casey said, "As a member of the Senate Finance Committee, I am committed to enacting long-term reforms to our tax code that will

⁶Office of Management and Budget, "Historical Tables — Table 1.1 Summary of Receipts, Outlays, and Surpluses or Deficits," the White House (Mar. 2014).

⁷Don Whalen and Chris McCoy, "Foreign Indefinitely Reinvested Earnings: Balances Held by the Russell 1000: A 6-Year Snapshot," Audit Analytics, Mar. 31, 2014.

⁸Philip Dittmer, "A Global Perspective on Territorial Taxation," Tax Foundation, Aug. 10, 2012.

⁹KPMG LLP, "Corporate Tax Rates Table" (2014).

¹⁰Sullivan, "Will Tax Reform Stop Inversions?" *Tax Notes*, Aug. 4, 2014, p. 530.

encourage domestic investment. However, given the rapidly increasing number of inversion deals, I am considering the merits of short-term solutions."¹¹

But there is little that Casey or Lew can do. It is impossible to levy higher taxes than other countries and prevent companies from inverting. Moves to punish U.S. companies from inverting will only cause them to break down the doors and invert more rapidly.

Some say that the United States can sustain higher tax rates because having a U.S. headquarters benefits corporations. Taxing U.S. corporations' global profits simply asks them to pay for that benefit. But the advantage of having a U.S. headquarters is disappearing. Markets are expanding and headquarters can be located closer to a firm's client base. Other countries now have stable legal and financial systems, making them ideal headquarters for multinationals. The Chicago insurance company Aon PLC, which relocated to London in 2012 for tax reasons, found Britain's legal system adequate.

Obama can threaten corporations ad infinitum, but he can only stop inversions by encouraging Congress to reform the code so that U.S. multinationals have the same tax and investment advantages as foreign ones. By inverting, corporations are only acting in their best interests and in the interests of their shareholders, and they should be praised for doing that.

¹¹Casey, "Casey Presses for Action on Inversions, Loophole That Allows Companies to Reincorporate Abroad to Avoid Paying Fair Share of Taxes" (Aug. 1, 2014).



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