Tax Inversion: Keeping American Companies in the U.S.

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WASHINGTON, D.C.—Many U.S.-based companies are in the process of reincorporating their headquarters to countries with lower corporate tax rates. This is commonly known as “inversions” or “expatriations” and takes place when a company merges or acquires a foreign company with the nearly exclusive purpose of paying lower corporate taxes.

Due to the increasing use of inversions among large American companies in recent years, Congress and President Obama each have announced proposals aimed at disincentivizing the use of inversions.

Since 1982, about 45 companies have reincorporated abroad. (see Figure 1) The first wave of inversions took place in the late 1990s and early 2000s. Congress responded by passing the American Jobs Creation Act of 2004, which effectively reduced inversion for several years. The act denied the tax benefits of inversion for U.S. companies that owned more than 80 percent of the new firm.

The strategy of inversion to reduce costs associated with taxes, however, is becoming a popular
strategy once again. Fourteen companies have reincorporated since 2012, with eight more companies in the process of reincorporating abroad (See figure 2).

The incentives for reincorporating generally follow two lines of reasoning. First, the U.S. corporate tax rate of 35 percent is the highest rate among the developed world. Countries such as Bermuda and the Cayman Islands have no corporate income tax and are primary locations for inversion. Second, the U.S. is one of the few developed countries that taxes foreign-sourced income, meaning it has a worldwide tax system as opposed to a territorial tax system. Thus, U.S. companies that generate foreign revenue cannot transfer that money to the U.S. without paying taxes on it. This issue seems to be the key factor driving companies to reincorporate today.

Tax inversion not only is stripping the federal government of taxable income, but also reduces state government revenue. Most states that tax corporate income take a portion of the federal corporate taxable income and apply that to the total in-state sales. Thus, tax inversion directly lowers the federal number that is applied to in-state sales, resulting in much lower revenues for states.
Republicans and Democrats in Congress have announced competing strategies to keep U.S. companies headquartered in America and lawmakers from both parties have expressed their support for lowering the corporate tax rate. Republicans, however, believe inversion is a problem stemming from a flawed tax system, so they generally support comprehensive tax reform. U.S. House Speaker John Boehner from Ohio recently announced to the press, “the sooner we have real tax reform on the corporate and personal level, the sooner that we’ll see this issue come to an end.” This could involve lowering the corporate tax rate or adopting a territorial tax system.

Congressional Democrats, on the other hand, generally have supported a more targeted approach aimed at disincentivizing tax inversion. Below are several of the bills that have been introduced.

- **H.R. 4679** [3] and **S.2360** [4] would treat all mergers as U.S. firms if management of the newly merged company remains in the U.S.;
- **H.R. 1554** [5], **H.R. 3666** [6], and **S.268** [7] would lower the tax benefits of inversions;
- **H.R. 694** [8] and **S.250** [9] would not only lower the tax benefits of inversions, but also would eliminate tax deferrals; and
The White House also has been active in trying to limit inversions. President Obama said at the U.S. Africa Leaders Summit [12] that a congressional solution is needed to solve this problem and that the White House “can’t solve the entire problem administratively.” In the meantime, the president said he would act on existing statutes that “at least discourage some of the folks who may be trying to take advantage” of inversions. The president also submitted to Congress a legislative plan [13] in his 2015 fiscal year budget aimed at reducing the incentives for companies to reincorporate abroad.

The U.S. Treasury Department and Internal Revenue Service also have acted on the inversion problem by issuing new regulations that make it more difficult for companies to reincorporate. The U.S. Treasury published a Fact Sheet [14] that details the specific actions that have been undertaken so far. In a September press release [15], Treasury Secretary Jack Lew said his department’s joint efforts with the IRS “make substantial progress in constraining the creative techniques used to avoid U.S. taxes, both in terms of meaningfully reducing the economic benefits of inversions after the fact, and when possible, stopping them altogether.”

Whether Congress will pass a bipartisan bill during the lame duck session is uncertain. Due to the differences in Republican and Democrat proposals, a bill that encompasses the interests of both parties appears difficult.

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