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Keep Companies in America by Reforming Corporate Tax

By Andy Puzder

House Ways and Means Committee Chairman Kevin Brady (R-Texas) hosted a hearing last month exploring how to reform the U.S. corporate tax system. The country's tax rate of 35 percent, the highest in the developed world, and its unique application to foreign profits put U.S. companies at a competitive disadvantage with their foreign competitors.

On the international playing field, the company with the lowest costs (including taxes) is in a competitively superior position as it can charge less for its products while dedicating more to research and development or other capital projects. In an attempt to level the playing field, U.S. companies are increasingly pursuing tax inversions, where they merge with foreign competitors and headquarter abroad, saving them hundreds of millions of dollars in taxes that can be spent on expansion, jobs, and research.

In recent months, major American companies like Johnson Controls, Pfizer, and Baxalta have pursued tax inversions with Irish companies and plan to headquarter in Ireland, where the corporate tax rate is 12.5 percent. Over the past 16 months, 13 inversions have occurred.

The committee hearing highlighted that this recent spate of tax inversions indicates that there is an "immediate need" to reform the corporate tax system to encourage American companies to stay at home. The expert panelists agreed that international corporate tax competition is real, and America is losing. The tax code is "severely" out of line with international norms, negatively impacting the American economy, jobs, and quality of life.

The hearing also highlighted another overlooked negative aspect of the current tax system: It makes U.S. companies vulnerable to foreign takeovers. Because of the high taxes they pay, American companies can be artificially undervalued in the global marketplace. This can make them ripe targets for foreign corporations looking to profit from a hostile takeover and relocation to a more hospitable tax climate. This is how Irish competitor Shire was able to take over Baxalta, a US based rare drugs manufacturer.

To stop inversions and protect American companies from takeovers, Congress must reform the U.S. corporate tax code to bring it in line with international norms. That means significantly lowering the tax rate to be competitive with countries like Ireland and ending double taxation, which forces U.S. companies to pay tax twice, once abroad and again at home.

Double taxation gives foreign companies an unfair advantage because they are able to invest their foreign earnings in the U.S. tax free; whereas, American companies must pay tax to the U.S. government on their foreign earnings (plus various state corporate income taxes) before they can invest at home. This disadvantages US based companies when it comes to efficiently allocating resources in an increasingly global economy.

Consider the rivalry between tech giants Samsung and Apple. At the moment, foreign companies like Samsung can invest their non-U.S. earnings in the U.S. – the largest global market -- without first paying tax to the U.S. government. On the other hand, American companies like Apple must pay American corporate tax on their foreign earnings before they can invest at home, handicapping them from the start.

Some commentators and policymakers argue that companies that

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invert are "corporate deserters" and that the best way to prevent additional inversions is by increasing regulations to forbid them. But why use the heavy fist of government to put U.S. based companies at a competitive disadvantage? In reality, U.S. companies often pursue inversions to put themselves in a better competitive position to invest in the U.S. They still pay U.S. tax on their domestic earnings, but can use their foreign profits to expand their U.S. operations, hire more Americans, and increase payouts to shareholders, many of whom are American pensioners and retirees.

What about the assertion that inverting companies simply want to free ride on the U.S. legal system, infrastructure, and patent law? This claim fails on two counts. First, as mentioned, even when companies are headquartered abroad, they still need to pay taxes on U.S.-generated income. Second, foreign companies that do business in the U.S. are also granted the benefits and protections of doing business in the U.S. without being subject to double taxation.

One of many unintended consequences of the current tax system is that U.S. companies are currently holding $2.1 trillion of foreign profits overseas to avoid the double taxation that would occur if they were brought home. That's more than double the amount of President Obama's "stimulus" spending that could be invested in the US without any increase in our national debt. Perversely, under our current laws, American companies are incentivized to invest these funds and create jobs abroad rather than at home.

Commonsense corporate tax reform that brings the rate in line with international norms and eliminates double taxation would stop inversions, protect American companies, grow the economy, and maybe even encourage foreign companies to move to the U.S. Last month's hearing highlighting the need for immediate reform was a good start. Now it's time for Congress to do its part.

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