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Just One Way to Stop Corporate Inversions: Cut Taxes

By Chris Edwards

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The corporate inversion trend tells us that global tax competition is intense and that U.S. tax reform is long overdue. Our combined federal-state corporate tax rate of 40 percent is far higher than the rates of our trading partners. Inversions are a bid by companies to create self-help tax reform while Congress sits on its hands.

U.S. companies compete in foreign markets against firms based in countries that have lower tax rates and that exempt foreign business income from tax. Thus, a U.S. firm competing in China against a firm based in Britain (which has a 21 percent tax rate) will be at a disadvantage, and may lose market share as a result. Since the domestic jobs of U.S. companies partly depend on sales in such foreign markets, our uncompetitive tax system ends up hurting U.S. workers.

Inversions help U.S. firms compete by shaving off our extra layer of tax on foreign operations. Some inversions have merged U.S. companies into companies based in Europe, which has an average corporate tax rate of just 20 percent. Other U.S. companies have merged into corporations based in Canada.

Why Canada? Because it slashed its federal corporate tax rate from 28 percent in the 1990s to just 15 percent today. Businesses have responded by shifting more reported profits into Canada and boosting investment. That response has meant that Canada collects more in corporate tax revenues today (1.9 percent of gross domestic product) than it did in the 1990s (1.7 percent) when it had a higher tax rate. The government and businesses both gained from the reform.

Meanwhile, our federal corporate tax will raise only 1.8 percent of G.D.P. in revenue this year — about the same as Canada — even though our federal tax rate is far higher at 35 percent. Our high tax rate is scaring away investment and reported profits.

The solution to the inversion problem is the same as for our economic growth problem: cut the corporate tax rate. The good news for policymakers — as Canada has shown — is that federal coffers won't be drained with such a reform, and may even gain from it.

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