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When corporations go abroad, blame tax policy

By Steve Stanek
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American companies that reincorporate abroad are not doing so to avoid paying taxes on U.S. earnings, despite the often misleading impressions left by the rantings of Sens. Carl Levin, Dick Durbin, Elizabeth Warren, and others to the contrary. They are doing it to avoid paying U.S. taxes on earnings in *other countries*.

The United States is the only industrialized nation that uses a “worldwide” tax system, in which a U.S.-based corporation must pay taxes to our government regardless of where the corporation earns its money. Most of the rest of the world uses a “territorial” tax system, in which a corporation pays taxes only where it earns income.

For instance, Volkswagen and BMW pay taxes to the federal and state governments on income earned in the United States. If they bring that money back to Germany, where they are headquartered, Germany taxes none of it, because the United States has already taxed it.

On the other hand, if a U.S.-based company earns income in Germany and wants to bring some of it back into this country, the company must pay federal tax even though the money has already been taxed in Germany.

This is a huge disadvantage to multinational corporations based in the United States and a big reason for corporate “inversions,” the word used to describe U.S. companies reincorporating in foreign countries.

Compounding the disadvantage is this: The United States has the highest corporate tax rate in the industrialized world. The federal rate is 35 percent, and most states levy their own corporate tax on top of that.

The Tax Foundation earlier this year noted the combined (state and federal) average corporate tax rate in the United States is 39.1 percent, while the average rate is 25 percent among the 33 other nations in the Organization for Economic Cooperation and Development. OECD nations include Australia, Canada (this nation's largest trading partner), France, Germany, Japan, Korea, Mexico, Sweden, and the United Kingdom.

In a recent interview with Budget & Tax News, Chris Edwards, director of tax policy at the Cato Institute, noted Canada has a net corporate tax rate of 15 percent — less than half the U.S. federal rate — and receives as much corporate tax revenue as a percentage of its gross domestic product as the United States receives.

"We don't find companies trying to invert out of Canada or Ireland these days, because they have reasonable corporate tax policies," Edwards said.

Pete Sepp, executive vice president of the National Taxpayers Union, also noted, "PricewaterhouseCoopers' annual 'Paying Taxes' study shows that for a hypothetical medium-sized firm, the time and cost spent just on tax paperwork puts the U.S. 61st out of 189 countries. Somehow the chant of 'We're 61!' doesn't seem to have much appeal to a beleaguered business."

The Obama administration has now made changes to tax policy to make it more difficult for companies to benefit from inverting, but the president is calling for further action from Congress.

Sen. Carl Levin has introduced a bill that would virtually end the ability of American companies to do inversions.

So has Durbin, who has seen the news that Illinois-based companies have been mulling overseas mergers to do inversions.

In response he has introduced the "Patriot Employer Tax Credit Act," a bill his press statement says "would provide a tax credit to companies that provide fair wages and good benefits to workers while closing a tax loophole that incentivizes corporations to send jobs overseas."

Lack of patriotism and "tax loopholes" are not the problem. The problem is a nation with the highest corporate tax rate in the industrialized world, a government that taxes income earned anywhere in the world, and an outrageously time-consuming and costly system just to pay taxes.