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Public Policy Group Analyzes U.S. Corporate Inversions

Summary by taxanalysts

The Institute for Policy Innovation on July 31 published an article positing that tax reform, rather than imposition of penalties and capital controls, is key to reducing corporate inversions among U.S. companies.

Full Text Published by taxanalysts

Inverting the Inversion Discussion

July 31, 2014

by Tom Giovanetti

There's nothing new about fleeing high tax rates. In the 1970s many popular rock stars fled their native countries to avoid sky-high marginal tax rates -- as high as 95 percent in England, which produced the line "There's one for you nineteen for me" in the Beatle's song "Taxman." David Bowie moved to Switzerland, Cat Stevens moved to Brazil, Rod Stewart moved to California, Sting moved to Ireland, and the Rolling Stones moved to France (hence "Exile on Main Street"). "We left, and they lost out. No taxes at all," Keith Richards told The New Yorker. "We had to leave England to acquire enough money to pay the [back] taxes," Mick Jagger told CNN.

More recently, when France's incoming socialist President Hollande carried through on his threat to impose a 75 percent tax rate on high-income earners, actors, entrepreneurs and high-profile business leaders left France. Today the French are finding out that, to paraphrase Margaret Thatcher, socialism only works until other people flee with their money.

Tax flight is a symptom of a larger problem: Tax rates that are out-of-line with other equally adequate locations. A wealthy individual might not consider Bangladesh to be a suitable substitute location, but Canada or Ireland or, today, England, which has learned its lesson and significantly lowered its individual and corporate tax rates, certainly is.

Free societies have to tolerate tax competition and tax flight; otherwise, they are no longer free societies. The alternatives are controls on the freedom of movement of people and capital, which characterizes totalitarian rather than free societies. Indeed, the freedom of people to leave a place that they no longer consider to be suitable is part of the beneficial feedback loop that keeps free societies responsive to their citizens.

It's within this context that we should understand the recent uproar over corporate inversions where, as part of an otherwise savvy international merger, a U.S. company reincorporates in the lower tax jurisdiction. A lower tax rate isn't the reason for such inversions -- these are global companies, after all, doing more business globally than they do in the U.S. But when choosing where the new company should be domiciled, the rational business decision is to choose the lower tax jurisdiction.

Inversions are the symptom: The problem is our high corporate tax rate that is out of line with our global competitors. We can impose penalties and capital controls on those who would flee our exorbitant business taxes, but that would require turning America's tradition of freedom on its ear, rewriting the words of our national hymns and chiseling over the wording on our national monuments.

Or our policymakers can do what is painfully obvious and reform our tax code in recognition of a globally competitive economy.

It's time to invert the discussion about inversions: It's about a bad tax code, not bad companies.

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