The Daily Dish

Inversions and the Global Minimum Tax

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In the early 2010s, it seemed there was a parade of major firms announcing their intention to escape a U.S. tax code that had gotten substantially out of step with the rest of the world. These cross-border mergers were an evolution of a long-standing phenomenon known as "expatriations," or "inversions." Indeed, policymakers were well aware of this trend. The 1990s and early 2000s saw a series of corporate inversions, whereby U.S. firms re-domiciled abroad to reduce their tax burden. This phenomenon was the subject of congressional hearings, and Congress passed legislation in 2004 to limit tax benefits resulting from inversion transactions.

This policy somewhat staunched "naked" inversions, whereby firms simply reorganized in a lower-tax jurisdiction but otherwise did not change ownership or operations. But the reform did not fundamentally reduce the relative disadvantage placed on U.S.-headquartered firms. The result was that cross-border mergers and acquisitions took the place of the naked inversion as the means of achieving corporate expatriations and continued through the last decade.

Previous administrations tried and failed to arrest this corporate flight through regulation. Though there is some evidence that regulation did reduce some of these incentives, the yawning gap between the U.S. tax system and that of other major trading partners was simply too great to fully address the problem. The Tax Cuts and Jobs Act (TCJA) did just that in 2017, bringing the U.S. corporate rate down to a more competitive rate. Today, the United States imposes a combined rate of 25.75 percent, which is the 12th highest in the Organisation for Economic Co-operation and Development (OECD), and a bit above the 22.85 percent average among the 37 OECD nations. The TCJA also moved the tax treatment of foreign-sourced income to a territorial system consistent with the overwhelming majority of major U.S. partners.

The evidence of this policy change's success is perhaps best understood by what we are not seeing: corporate inversions. Indeed, one company that had announced its intention to merge with an overseas partner restructured the transaction to remain in the United States after the TCJA became law.

But the Biden Administration has proposed moving the tax code back to the 1990s by raising the corporate rate to 28 percent and reverting to an outmoded style of taxing foreign income. The rate hike would restore the United States to its prior status as having the highest corporate tax among major world economies. Recall that the nonpartisan Joint Committee on Tax found that the TCJA would result in greater investment in the United States. The Biden Administration's tax policies would reverse those incentives and make the United States less attractive to investment.

None of this is particularly new – indeed successive administrations presided over a broken tax code that induced major companies to relocate abroad. It was just the cost of a tax code no one could fix. But the major push by the Biden Administration to convince the rest of the world to impose a minimum corporate tax is a novel development. It is also a tacit acknowledgement of the risks the corporate tax proposals otherwise pose to U.S. firms. The effect of the minimum tax is to shrink the gap between high-tax and low-tax countries, which animates where corporations choose to invest.

The outlook on the Biden Administration's tax plans and agreement on a global minimum tax remains unclear. What is clear is that some policymakers have learned the lesson that inversions make for bad economics and bad press. Unfortunately, they continue to fail to know how to avoid them.