The Daily Dish

# November 25th Edition

DOUGLAS HOLTZ-EAKIN | NOVEMBER 25, 2015

Either today or next Monday, the EPA is expected to come out with their new biofuel standards. According to Reuters, “The EPA is broadly expected to raise the mandates for quantity of biofuels that fuel companies must blend into motor fuels some 400 million to 500 million gallons for 2016, bringing the total renewable fuels required to nearly 18 billion gallons…”

Iran expects the deal struck with the U.S. and other nations will go into effect by January. This is the very same deal the opens $140 billion for Iran in sanctions relief, including $3.1 billion that would go directly towards terror financing.

For some countries, the cost to produce a barrel of oil is actually above the current trading price of $42. The costs are becoming prohibitive for both Brazil and the United Kingdom to drill for more oil, costing $49 and $52.50 respectively. In the United States it still costs $36 to extract a barrel, under the trading price. This has all led to cutbacks in production by companies.

***Eakinomics: Shooting the Messenger***

The U.S. corporation income tax is broken. It has achieved an unholy trifecta by being anti-competitive, burdensome, and ineffective as a revenue-raising policy. One manifestation of its flaws is the decades-long phenomenon of “inversions.” A tax inversion occurs when a U.S.-headquartered firm acquires or merges with a smaller global firm, and relocates for tax purposes in the acquired firm’s country.

The latest piece of evidence is the acquisition by Pfizer of Allergan — the largest inversion deal of all time. The deal — like all inversions — begins as a valuable strategic purchase, not an unpatriotic (“Benedict Arnold firms”) act by tax evaders. Add to this the fact that the U.S. corporation income tax rate is 35 percent, the highest in the developed world. Stir in the reality that only the U.S. among its developed-country competitors persists in taxing the worldwide earnings of its companies. What is the result?

When a U.S. firm competes with a German firm in Brazil, the German firm pays the Brazilian tax and is done. The U.S. firm pays the Brazilian tax and then a second U.S. layer of tax up to the U.S. rate of 35 percent. Thus, from the outset, the U.S. firm is at a disadvantage. In an effort to alleviate this tax-based disadvantage, the U.S. defers collecting the second layer of tax until the funds are brought back to the United States. That is, the firm can engineer a level tax playing field if it cedes access to its offshore earnings! The ramifications are obvious. First, the repatriation tax leads to trillions of U.S. dollars locked offshore and unavailable for hiring, R&D, expansion, or innovation in the U.S. Second, the U.S. is at a disadvantage in decisions over the location of headquarters. Given the opportunity to improve its core business, compete on a level global playing field, have access to all its earnings, and obligations to shareholders, inversions are born.

Those facts don’t match the heated rhetoric from candidate Hillary Clinton yesterday who is “accusing Pfizer of using legal loopholes to avoid its ‘fair share' of taxes in a deal that she said 'will leave U.S. taxpayers holding the bag.’” The latter is simply untrue. Under the current system, firms simply don’t bring the funds back to the

U.S., so no tax is collected to begin with. And, both before and after the inversion Pfizer will pay U.S. tax on its U.S. earnings. She compounded the errors in logic by arguing “We cannot delay in cracking down on inversions that erode our tax base.” Sorry, the tax base has already eroded and it is the current tax code that is at fault.

No amount of Treasury rule making or political huffing and puffing will fix the problem. The U.S. continues to need a 21st century corporate code that permits it to compete in a global economy.

***Fact of the Day***

EPA’s proposed methane standards for landfills and fracking sites would cost $460 million, as methane emissions continue to decline in the U.S.