



Insight

# Recalling Inversions

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## Executive Summary

- The U.S. tax code became increasingly uncompetitive from the late 1980s onward, resulting in a series of corporate expatriations, or inversions, whereby firms would reorganize abroad to escape the U.S. tax system.
- This phenomenon largely ceased following the enactment of the Tax Cuts and Jobs Act (TCJA) in 2017; since the TCJA's passage, not a single major inversion has been reported.
- The Biden Administration is proposing to return the United States to its former uncompetitive tax system, replete with higher corporate rates and an outmoded international tax regime, that saw inversions occur with some regularity.

## Introduction

The United States was slow to recognize the significance that corporate tax policies can have on the international competitiveness of its firms. While the United States has been home to the world's most innovative enterprises, that innovation often came despite a tax code that became singularly disadvantageous to the nation's businesses. Over time, this disadvantage widened to the point that U.S. firms were induced to pull up stakes and move to host nations with more competitive tax environments. Known as inversions, these conspicuous casualties of obsolete tax policies have bedeviled policymakers, who tried through regulatory fiat to stem the flow of inversions. Despite these efforts, the trend persisted until the United States substantially reformed its tax code through the Tax Cuts and Jobs Act (TCJA) in 2017. Since the TCJA's passage, no major inversions appear to have been completed, while at least one major inversion has been reversed. The Biden Administration is proposing tax policies that would move the United States closer to the tax system, characterized by high corporate rates and an outmoded international tax regime, it had when inversions were occurring with some regularity.

## Corporate Tax Policy and Inversions

In 1986, the United States enacted the Tax Reform Act, a bipartisan, revenue-neutral, comprehensive reform of the tax code. Prior to 1986, the United States imposed a 46 percent corporate tax rate, which at the time was above the average of the United States' major trading partners. The Act brought the U.S. corporate rate to an eventual 34 percent, which brought the United States below the prevailing average. The United States' major trading partners followed suit, and over the next decade and beyond, reduced rates such that the United States was again an international outlier with respect to corporate taxation. Over that period, while other nations were reducing their rates, the United States was the only nation in the Organisation for Economic Co-operation and Development (OECD) to *increase* its corporate tax rate.<sup>[1]</sup> The result was that the United States was again in a comparatively uncompetitive tax posture.

The 1990s and early 2000s saw a series of corporate "expatriations," whereby U.S. firms re-domiciled abroad to reduce their tax burden. This phenomenon, also known as a corporate "inversion," was the subject of

congressional hearings and attention from the Bush Treasury Department.<sup>[2]</sup> The American Job Creation Act of 2004 (AJCA) included important anti-inversion measures that remain in force today. The AJCA sought to limit tax benefits as a result of inversion transactions unless the transaction met certain criteria – the goal being to limit the benefits of purely tax-driven expatriations without undue infringement on business activity. This policy somewhat stanching “naked” inversions, whereby firms simply reorganized in a lower-tax jurisdiction but otherwise did not change ownership or operations. Of note, this 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.

## **The Evolution of Corporate Inversions**

While the United States continued to impose an increasingly burdensome corporate tax, U.S. competitors pursued innovations in the taxation of foreign income. In addition to substantially improving the competitiveness of the rate of corporate taxation, major foreign competitors increasingly adopted forms of territorial tax systems. Under a territorial system, in general, active foreign-source income is untaxed, but for the tax imposed by the source jurisdiction. Thus, for a given foreign investment, no *additional* tax is imposed, and thus, the foreign investment is taxed at the same rate as an investment made under the domestic tax laws of the foreign nation. In short, a territorial tax system ensures an even-playing field for foreign investment.

By 2017, 29 of 35 OECD nations had some form of this tax system.<sup>[3]</sup> The United States clung to an outmoded system whereby corporation income tax applied to the worldwide earnings of U.S. headquartered firms. U.S. companies owed U.S. income taxes on income earned both domestically and abroad, although the United States allows a foreign tax credit up to the U.S. tax liability for taxes paid to foreign governments. Active income earned in foreign countries was generally only subject to U.S. income tax once it was repatriated, giving an incentive for companies to reinvest earnings anywhere but the United States. This system distorted the international behavior of U.S. firms and essentially trapped foreign earnings that might otherwise be repatriated back to the United States.

The U.S. tax system was fundamentally uncompetitive and was chasing U.S. firms offshore. Notwithstanding the enactment of the AJCA in 2004, cross-border mergers continued. A 2012 *Wall Street Journal* article described an accelerating pace of inversions after a period of relative inactivity. Between 2009 and 2012, at least 10 companies expatriated.<sup>[4]</sup> A spate of announced or proposed cross-border mergers involving recognized brands such as Sara Lee, Pfizer, Chiquita, and Medtronic, among others, invited attention from lawmakers and regulators.<sup>[5]</sup> The Treasury Department issued guidance and [regulations](#) over 2014-2016 that did thwart at least one major inversion, but in the absence of tax reform, the incentive to invert persisted. At least five major firms continued to structure inversions to avoid the strictures of Treasury’s regulations.<sup>[6]</sup>

## **Inversions and the TCJA**

In December of 2017, Congress passed the most sweeping set of changes to the federal tax code since 1986. The TCJA broadly reformed three major elements of the federal tax code: the individual income tax, the corporation income tax, and the tax treatment of international income. The latter two elements saw the United States substantially improve its international tax competitiveness by reducing its corporate tax rate to 21 percent and join most of its trading partners by adopting a territorial tax system. These key reforms substantially mitigated the incentives for firms to invert. Additional reforms also reduced the tax benefits of inverting. Taken together, the Joint Committee on Taxation estimated that the TCJA would result in increased investment in the United States.<sup>[7]</sup> This finding is consistent with other research that the United States’ uncompetitive tax code resulted in the loss of assets to foreign acquirers. According to one estimate, had the United States adopted a corporate

tax code similar to that created by the TCJA, it would have retained 4,700 companies over the period 2004-2016. [8] Data from 2018 and 2019 suggest that U.S. acquisitions of foreign companies increased by 50 percent, while acquisitions of U.S. firms declined by 25 percent, compared to the prior two-year period.[9]

Since the enactment of the TCJA, there have been no major reported inversions. Indeed, the most striking example of the post-TCJA inversion landscape is Assurant, Inc. Prior to the enactment of the TCJA, the corporation had announced its intention to expatriate. Following the enactment of the TCJA, however, the corporation restructured the transaction to keep its headquartered in the United States.[10]

The Biden Administration has proposed a number of tax policies that would increase the corporate tax rate, move the United States closer to an outmoded worldwide tax system, and impose new restrictions on cross-border transactions. Those restrictions have been previously estimated as risking upwards of 40,000 high-quality jobs alone.[11] The evidence over the decades suggests that as long as the United States pursues a tax regime that is substantially out of step with the rest of the world, the incentive to invert will persist.

## Conclusion

Inversions have largely been banished from the business pages. Where major companies once announced their intentions to move abroad, they are now staying put. Other formerly U.S.-headquartered firms are reportedly looking to return, now that the United States has a tax policy that is not conspicuously disadvantageous to U.S.-based firms. This is a policy success in the wake of decades of half-measures. Some policymakers can't accept this success and are seeking to upend the current tax system and return the United States to a comparatively uncompetitive tax system. If those efforts succeed, observers should not be surprised to see a return of inversions.

[1] <https://www.americanactionforum.org/research/economic-and-budgetary-consequences-of-pro-growth-tax-modernization/>

[2] <http://waysandmeans.house.gov/legacy/fullcomm/107cong/6-6-02/107-73final.htm>;  
<http://faculty.law.wayne.edu/tad/Documents/Country/Treasury%20inversion%20report%205%2017%2002.pdf>

[3] <https://taxfoundation.org/territorial-tax-system-oecd-review/>

[4] <https://www.wsj.com/articles/SB10000872396390444230504577615232602107536#:~:text=Despite%20'04%20Law%20>

[5] Chiquita and Pfizer

[6] <https://fas.org/sgp/crs/misc/R43568.pdf>

[7] <https://www.jct.gov/publications/2017/jcx-69-17/>

[8] <https://www.businessroundtable.org/buying-selling-cross-border-mergers-and-acquisitions-and-the-us-corporate-income-tax>; note that these companies can be relatively small transactions.

[9] 3 Andrew Lyon, “Insights on Trends in U.S. Cross-Border Mergers and Acquisitions After the Tax Cuts and Jobs Act,” Tax Notes, October 2, 2020, pp.497-507

[10] <https://www.businesswire.com/news/home/20180109005906/en/Assurant-and-The-Warranty-Group-Amend-Deal-Structure>

[11] <https://www.americanactionforum.org/research/economic-risks-proposed-anti-inversion-policy-update/>