THIRD WAY

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The U.S. Corporate Tax Code is Bananas

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A much-too-high corporate tax is causing companies to flee for Europe.

If any U.S. company seems ripe for moving to an island tax haven, it's Chiquita. Based in Charlotte, the company's sale of bananas, grown largely in Central America, accounts for two-thirds of its profits. But Chiquita isn't bound for the tropics. It's headed to Ireland, where the climate may be hostile to banana trees, but the cool 12.5 percent corporate tax rate feels just right.

Later this year, Chiquita will merge with Fyffes, an Irish fruit distributor half its size. Usually the larger company buys the smaller one, but not anymore. Entirely because of taxes, a newly formed Irish company will control the merged companies. Chiquita will remain listed in the U.S., but its headquarters will move to Dublin, unlocking access to the favorable Irish tax code.

Chiquita's move, called corporate "inversion," isn't new. It's an old strategy that U.S. companies have rediscovered. Everyone in Washington — Democrats and Republicans — should be concerned. Though completely legal, new inversions this decade will costs the Treasury nearly $2 billion a year, and they move high-paying corporate jobs overseas, albeit in limited numbers. Inversion happens because our bloated corporate tax code is bad public policy, severely handicapping U.S. businesses relative to their foreign competitors.

Inversion first became popular in the late 1990s when companies like Ingersoll-Rand and Fruit of the Loom reincorporated in Bermuda and the Cayman Islands. Then Washington started playing whack-a-mole, but not doing it very well. IRS rules targeting inversion didn't work, so in

2004 Congress passed a law making moves to offshore havens more difficult.

The law now requires an American company looking to move its headquarters overseas to use a merger or acquisition with a foreign company at least one-fifth its size. This mostly took the Caymans out of the picture, because only shell companies locate there. But Europe is a more attractive corporate destination than it was 15 years ago. Countries like Ireland, the Netherlands and the UK noticed that in today's globalized world, a competitive corporate tax code matters more than ever. So they lowered their corporate tax rates and eased taxation of foreign-earned income.

Meanwhile, the U.S. tax code sat rotting on the shelf. Our 35 percent statutory rate is highest among the world's developed economies. While few companies pay an average rate that high, numerous tax preferences raise compliance costs and skew incentives.

One example is the "lockout effect." Because some corporate profits are taxed only when returned to the U.S., many U.S.-based multinationals keep piles of cash on the books of their overseas subsidiaries. If it's not coming home, that cash may be deployed to purchase a foreign company. When the selling company is big enough, the U.S. buyer can invert and avoid even more taxes.

If inversion were limited to bananas, maybe we wouldn't care. But oil and gas companies, drug companies and others have exported their U.S. headquarters in recent years. Altogether, since 2012, at least 14 U.S. companies have completed or considered inversion deals. This month's on-again, off-again takeover talk between Pfizer and AstraZeneca is one example. U.S. companies look to inversion not because CEOs wake up one day and feel the pull of the old country, but because they are seeking to maximize profit in the face of foreign competition. The pace is likely to accelerate, because as much as we may decry it, inversion currently makes financial sense.

In response, President Obama proposed in his 2015 budget that Congress raise the inversion foreign ownership threshold to 50 percent. This month, Senator Ron Wyden, D-Ore., and Sen. Carl Levin, D-Mich., are crafting legislation modeled after Obama's proposal.

These efforts show Congress is taking inversion seriously. But let's also realize that our uncompetitive code is the root of the problem. Only when Washington fully reforms the corporate tax code will the pressure for companies to leave the U.S. tax system subside.

First, the 35 percent corporate tax rate must come down, at least to President Obama's proposal of 28 percent and preferably further. The cut can be financed in part by eliminating some outdated tax breaks, but savings elsewhere may also be necessary. Second, the lockout effect has to end. Some foreign-earned income, particularly passive income, should be taxed currently no matter where it's earned. And income from real business activity abroad should be lured home with a tax rate competitive with those of other developed countries. Third, the tax code needs to be simplified.

A simpler, more competitive corporate code shouldn't be confused for a giveaway to corporations or the wealthy. Research suggests that if Chiquita were to spend less preparing and paying corporate taxes, its shareholders and its workers share the benefit. Most importantly, so would the broader U.S. economy, which would attract and retain more business and more jobs. It's bananas for the U.S. to sit back and do nothing as good American companies decamp for Europe

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