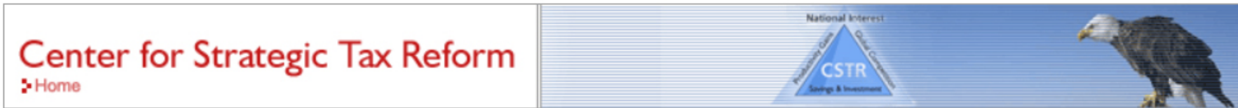

Why Foreign Buyers Are Snapping Up U.S. Companies
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By James Carter and Ernest S. Christian

No matter who is elected president in November, fixing America's broken tax code should be a high priority. Laying the groundwork for tax reform, the House Ways and Means Committee recently held a hearing inviting "proposals for improvements to the U.S. tax system." Here's one that should head the list: Bring U.S. corporate taxes in line with the rest of the developed world.

America's 35% federal corporate-tax rate—the highest in the developed world—and outdated world-wide tax collection system, under which profits earned abroad face U.S. taxation when brought home, puts U.S. businesses at an enormous disadvantage to foreign competitors. The great majority of developed countries now have a territorial tax system, which taxes business income only once, in the country where it was earned.

This has led to an increase in so-called corporate tax inversions—that is, acquisitions by U.S. companies of smaller foreign firms, with the tax home of the new merged corporation transferred abroad, where rates are lower and a territorial system is employed. The Obama administration has vehemently targeted inversions and on April 4 the Treasury Department introduced its third set of rules to discourage the practice.

But inversions are simply a logical reaction to the way businesses based in the U.S. are taxed. We are among the 18 former Treasury officials, including Secretary George Shultz, who wrote last month in a letter to Treasury Secretary Jacob Lew: "Inversions are a symptom. The disease is America's anomalous international tax code."

On average, the marginal corporate tax in the 34 Organization for Economic Cooperation and Development countries is 14 points lower than in the U.S. That can mean up to $140 million in savings for a company earning $1 billion—funds that can be reinvested in more jobs for Americans, in higher wages, in research and development, in new factories or higher dividends.

America's punitive corporate tax rate has also led to a rapid increase in takeovers of U.S. companies by foreign firms. Through the first week of May this year, foreign businesses have paid roughly $137 billion to buy U.S. companies—an increase of 39% over the same period last year, according to the research firm Mergermarket. That's the highest figure for the period since the firm started keeping records in 2001.

In a statement announcing its latest anti-inversion rule, Treasury said, "Genuine cross-border mergers make the U.S. economy stronger by enabling U.S. companies to invest overseas and encouraging foreign investment to flow into the U.S."

Yet our tax code encourages the opposite. In 1986, 218 of the world's 500 largest corporations, as measured by revenue, were based in the U.S. Thirty years later the figure has dwindled to 128.

The result, in many cases, is the loss of U.S. jobs—as headquarters, research and development, marketing and even manufacturing move to the home country of the acquiring company. Inversions, on the other hand, increase U.S. jobs by allowing profits stranded overseas to return to the U.S. for domestic investment.

While U.S. companies are taking over foreign firms as well, the difference in volume is striking. A report released in March 2015 by Ernst & Young for the Business Roundtable found that America's "outdated tax code led to a $179 billion net loss of American companies and business assets to foreign buyers from 2003-2013." The report also found that a 25% U.S. corporate tax rate, more in line with rates in other developed countries, "would have prevented foreign purchases of 1,300 [U.S.] companies."

On the surface, the fact that foreigners are net buyers of American firms looks puzzling. After all, the U.S., the world's richest country, is home to the largest and most profitable corporations. But foreign businesses have become more competitive through lower tax rates, and, by purchasing a U.S. company they can immediately increase the after-tax profits of their new acquisition.

Inversions and acquisitions of U.S. companies by foreign firms are propelled by the same forces: the high U.S. corporate tax and our unusual system of taxing profits wherever in the world they are earned, rather than only in the jurisdiction where they are earned. In other words, foreign-source income is worth more in foreign hands, so it's no surprise that more and more of this income will find its way there.

America's competitors are benefiting. As Mieko Nakabayashi, a member of Japan's parliament at the time, said in April 2012: "With most of the world—Japan included—cutting corporate tax rates and employing territorial tax systems to remain competitive, the U.S. must surely know that its hesitancy to do these things is handing the advantage to its international competitors."

Rob Portman, a member of the Senate Finance Committee, put it best when he said in a hearing last July: "Our tax code makes it hard to be an American company, and puts U.S. workers at a disadvantage." Congress should deliver, and the president should sign, legislation that ends this "disadvantage" as soon as possible.

Messrs. Carter and Christian are both former U.S. Treasury Department officials. Mr. Carter served as deputy assistant secretary for economic policy from 2002-06, Mr. Christian as deputy assistant secretary for tax policy from 1974-75.