Joint Economic Committee
Representative Pat Tiberi, Chairman | Senator Mike Lee, Vice-Chairman

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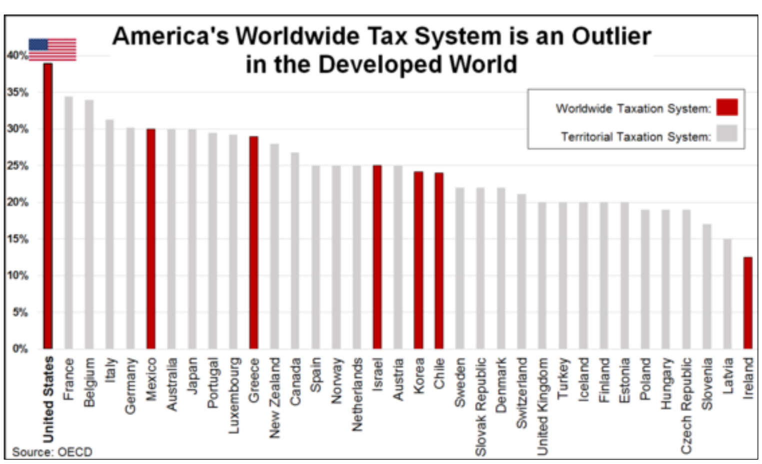
CBO Provides Another Reason Tax Reform is Urgent: Corporate Inversions

What CBO examined. The Congressional Budget Office (CBO) recently analyzed "corporate inversions," transactions in which a U.S. company that does business in other nations merges with a foreign company and switches its country of incorporation to one with lower tax rates.[1] To a lesser extent, CBO also looked at other profit-shifting transactions in which companies move income from the highly taxed U.S. tax system to a lower-tax country.

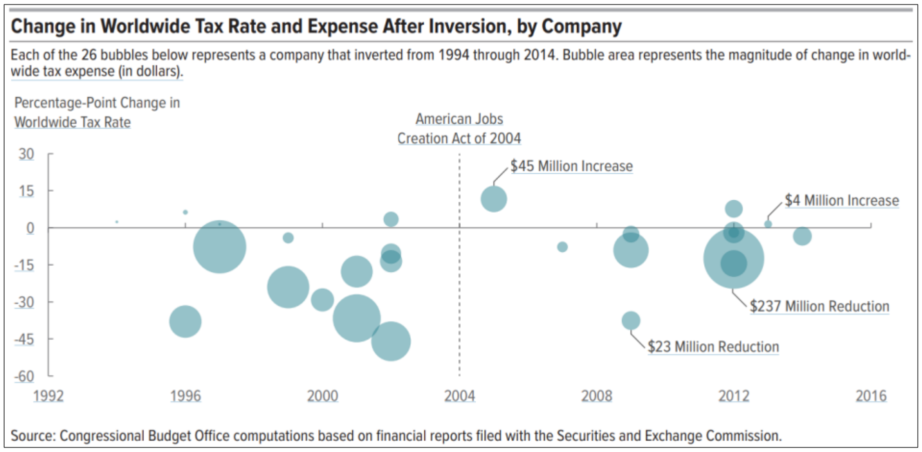
And it wasn't even the whole story. CBO did not attempt to quantify the effect of inversions on American workers, their families, or the economy as a whole as more production activities shift outside the United States.[2] CBO also didn't consider the "excess burden" on the economy as the government and private sector waste resources on these transactions.[3]

What CBO found:

1. **America's high corporate rate and worldwide taxation provide an incentive to invert and shift income overseas.** Most nations have much lower corporate tax rates and generally do not tax their companies on profits earned overseas (territorial taxation).[4] In contrast, America has the highest corporate rate in the developed world and taxes domestic companies on overseas earnings when they bring them back to the United States. The high tax rate puts U.S. companies at a competitive disadvantage, and imposing this rate on worldwide earnings effectively traps the profit of American companies offshore, increasing the incentive to invert.



2. **Companies significantly reduce their total tax burden when they shift headquarters out of America but incur other wasteful costs.** CBO examined inversions of companies with positive earnings from 1994 to 2014 and found that on average, inverted companies lowered their total tax expense the year after inversion from 29 percent of earnings to 18 percent, or an average of $47 million in tax savings.[5] However, in the process a company wastes considerable time and resources that could be better spent growing the business and its leaders risk losing control over the future direction of the company.[6]



3. **U.S. pain is greater than company gain.** The net tax savings of inverted companies translate into an even greater loss for the U.S. treasury, as more tax payments go to the low-taxing foreign jurisdiction and significantly less go to the U.S. Though the average tax savings of inverted companies was $47 million, payments to the U.S. were on average $65 million—or 46 percent—lower than they would have been without the inversion.[7]

4. **Unless the U.S. changes tax course, inversions and other profit shifting to lower-taxing countries will increase.** CBO estimates that unless America changes policy direction, inversions and other profit shifting will grow over the decade, reducing the income the U.S. treasury receives from corporate income taxes by $12 billion more in 2027 than if profit-shifting activity remained constant at current levels.[8]

5. **Treating the symptoms doesn't work.** Congress tightened the rules around inversions in 2004, but while this slowed some activity it also made other inversion transactions larger and increased their impact on company operations.[9] The previous and current administrations have also examined regulatory ways to stem inversions, but CBO notes that these are partial and temporary fixes at best as companies search for new ways to shift income to lower-taxing countries.[10] It follows that the best and only solution to prevent American companies and jobs from leaving our shores for tax reasons is to solve the root problem by *reforming America's outdated, uncompetitive tax code*.

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[1] Congressional Budget Office (CBO), "An Analysis of Corporate Inversions," September 2017, p. 1, https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/53093-inversions.pdf.
[2] CBO, p. 2.
[3] See "excess burden" discussion at https://www.jec.senate.gov/public/_cache/files/3db451d0-56ee-4f01-95ea-10b0d0908df4/weekly-economic-update-091817.pdf.
[4] CBO, p. 4.
[5] CBO, p. 11.
[6] CBO, p. 5.
[7] CBO, p. 14.
[8] CBO, p. 15.
[9] CBO, p. 3. The American Jobs Creation Act added section 7874 to the U.S. tax code and required a significant change of ownership after the inversion.
[10] CBO, p. 15.