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Analyst: corporate tax reform needed in U.S.



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This summer of corporate governance reform, accounting scandals and anxiety about foreign terrorism might seem the wrong time for a U.S. business to reduce its taxes by moving overseas.

But **Veronique de Rugy** says it's happening with increasing frequency.

"Right now, for some reason, we seem to have this big attitude that businesses are evil," marveled de Rugy, a French-born fiscal policy analyst for the Washington, D.C. think tank, **The Cato Institute**. Flag-waving congressional proposals to stop U.S. companies at the border don't take into account executives' bottom-line rationale, de Rugy said.

"Corporate inversions" occur when a U.S.-based firm restructures itself under a new foreign parent company in a lower tax jurisdiction. Bermuda, the Cayman Islands and the Netherlands are popular destinations. The move generally has no effect on U.S. business operations.

But the tax impact can be substantial. Corporations pay U.S. taxes on their worldwide income. By moving offshore — often little more than a paper move —

the corporation avoids U.S. tax on its foreign income. And a May 2002 Treasury Department report on inversions noted corporations may use intercompany debt to leverage U.S. operations, or transfer intangibles to the foreign entity, to reduce U.S. taxable income on U.S. operations as well.

At 40% combined state and federal corporate income tax, the United States has the fourth highest rate among the 30-nation Organization for Economic Cooperation and Development; we'll be No. 2, de Rugy said, after Belgium and Germany enact planned rate reductions. That puts us at a disadvantage in the global marketplace.

What to do? De Rugy suggests a substantial cut in the corporate rate, to remove the incentive to look abroad for a tax cut. Adopting a territorial tax system that levies domestic corporate income only would remove the need for inversions, de Rugy said, and actually encourage foreign corporations to relocate here. De Rugy scoffs at the notion that U.S. multinationals are exploiting a loophole. Small companies with large foreign operations and startups, also can use the strategy.

"This is not a loophole. It's only that other countries have a better tax system than the U.S.," de Rugy said. "That's like saying I moved out of France because of a loophole. I left because France sucks."