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Economic Patriotism or Free Market Pragmatism

The Obama administration is becoming quite critical of US corporations acquiring foreign firms in order to relocate their tax domicile to a country with a more favorable regime. Last week, US Treasury Secretary Jack Lew suggested American companies that have done so or are thinking about doing this lack a sense of economic patriotism. In his opinion, American corporations should not take advantage of the benefits of doing business in the United States and utilize loopholes in the US system in order to write down their tax liabilities. The President joined the chorus this week suggesting “some people are calling these companies corporate deserters.”

They’re both wrong.

US corporations are abiding by the current tax legislation that is in place. It’s simplistic and absurd to suggest they have a patriotic responsibility towards the United States. In fact, management of these corporations do have a responsibility, and that is after considering their stakeholders like their employees, suppliers, and customers, they are responsible to their shareholders. Thus, one would imagine US lawmakers would need to ensure that the United States is a competitive nation in terms of offering a favorable corporate tax rate that provides US business with the right incentives, but not put the onus on them to do ‘what’s right for America.’

For this, there is no question broad based corporate tax reform is desperately needed. It is evident from the fact that an additional 25 major US companies are considering relocating overseas by the end of this year in order to take advantage of a smaller tax bill. Senate Democrats have proposed raising the foreign ownership threshold required of a US company to re-domicile their tax base from 20 per cent to 50 per cent. Despite being backed by the current administration, this is not the solution. It is simply a Band-Aid fix, and one might even suggest that if such a significant tax advantage still exists, US corporations would flee more capital from the United States to acquire larger shares of foreign companies.

As The Economist points out, there are two major flaws with America’s tax code. First, on paper America’s corporate tax rate is 35%, which is the highest amongst the 34 member countries in the OECD, but their effective tax rate is less than the OECD average thanks to a laundry list of aimless loopholes. This alone illustrates the complexities and resulting inefficiencies in their tax code. The second is that the US taxes income regardless in which country it is earned, but doesn’t collect until funds are brought back to the US. This creates yet another disincentive to repatriate foreign profits and the consequence is less investment in the US.

If the US government wants better corporate participation at home, then it behooves them to rewrite the tax code. Ultimately, this is what will incentivize these same US companies that hold profits overseas to bring those profits home and lead to the positive contributions to the American domestic economy.