Debate

Smart Business or Unpatriotic?

Issue: Is it ethical for businesses to engage in tax inversions to lower their tax rates?

An inversion occurs when a U.S. firm moves its tax address to a tax-friendlier country. This often occurs when an American company merges with a foreign firm. Although there is legislation in place to limit inversions, loopholes have allowed major companies to relocate their headquarters to foreign countries with a lower tax rate. Since 1983 approximately 76 U.S. corporations have moved their tax domiciles out of the United States. This rate has significantly picked up in recent years; since 2011, there have been 22 tax inversions.

Many of these tax inversions involve well-known companies, such as Eaton, Medtronic, Chiquita, and Abbvie. More recently, Burger King, a brand highly associated with America, announced it was acquiring the Canadian doughnut chain Tim Hortons. As part of this acquisition, Burger King has announced it is moving its headquarters to Ontario. Conversely, Walgreens announced it was acquiring the remaining stake in British pharmacy chain Alliance Boots. Although it had the opportunity to relocate its tax domicile to the United Kingdom, which has one of the lowest corporate tax rates of developed countries, it chose to listen to public opinion and made the decision to stay in the United States.

Are tax inversions that are done simply to avoid taxes ethical? Stakeholders are split on the issue. There is no argument that tax inversions lead to lost revenues for the United States. If the rate of tax inversions continues, the United States could lose $20 billion in taxes over the next decade. Critics of tax inversions point out that these American companies made their fortune in the United States, so it is unethical to relocate somewhere else solely for the purpose of saving money. The Obama administration has called these moves "unpatriotic" and legislators are working to pass legislation to severely limit these inversions. About 59 percent of registered voters are in favor of Congress taking action to discourage tax inversions. Taxes lost through inversions have the potential to significantly impact the economy and the U.S. tax base.

Other stakeholders argue that as public corporations, the primary responsibility of these organizations is to their investors or shareholders. Therefore, they have a duty to do what it takes legally to lower costs and increase profits. It is notable that after Walgreens announced it was not taking advantage of a tax inversion, its share price decreased by 12 percent in mid-morning trading, suggesting that investors were punishing the company for not pursuing what they believed was in Walgreens best interests. Additionally, some businesses claim they have legitimate reasons for moving their tax domiciles that go beyond lower taxes. Tim Hortons, for instance, has a bigger market in Canada than Burger King in the United States. It is also notable that the United States has the highest corporate tax rate of developed countries at 35-40 percent. In contrast, the corporate tax rate is 21 percent in the United Kingdom, 12.5 percent in Ireland, and 18 percent in Switzerland. Approximately 32 percent of registered voters in a poll are supportive of tax inversions if it helps the company achieve its duty to shareholders in the form of lower costs and higher growth.

There are two sides to every issue:

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1. American companies have a duty to their citizens and should not seek inversions because it harms the American tax system.

2. American companies have a duty to their investors and should pursue tax inversions if it is in the best interest of the firm's owners.

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