First Trust
Monday Morning OUTLOOK
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Tax Reform: The Real Anti-Inversion Solution

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Inversions – a financial deal where a large US company merges with a smaller foreign one and then reorganizes so the US wing of the new firm is the subsidiary and the entity pays a lower foreign corporate tax rate – are the rage these days.

Well, sort of. A few companies have done them, and, according to one lawmaker, maybe 25 more are in the works. The rage is coming from politicians. They argue that inversions are unpatriotic and want to stop them.

There might be some law that could stop inversions, but if politicians are serious, they will push real tax reform. The US has the highest corporate tax rates in the world and it applies that rate to income from anywhere in the world.

A company cares about its customers, employees and shareholders, not the tax collector. Inversions offer US companies a "three-fer." First, they cut taxes owed on income from foreign operations. Second, the company gets access to foreign profits without repatriating them and paying high US taxes. Third, the new company can, in theory, use the US-wing to borrow money for global operations and deduct the interest it pays from any US income it makes.

Despite the hysteria about inversions, federal corporate tax receipts were $303 billion in the past twelve months, an increase of 11.4% versus a year ago. Taxes on profits have risen faster than profits themselves. So, inversions haven't crimped anything yet. Moreover, profits get taxed again when they are distributed to shareholders as dividends. So, $1 of corporate profits first gets chopped to 65 cents (from the 35% corporate tax rate), then to 52 cents when it is paid as a dividend and taxed at 20%. This is an effective federal tax rate of 48%.

Any ability to avoid those taxes means lower prices for customers, higher salaries for employees, and greater returns for shareholders. And because the US doesn't have a territorial system, if a US company makes money anywhere around the world, the IRS wants a share, even if the activity had nothing to do with the US. No wonder companies want to move abroad.

Rather than demagoguing, lawmakers ought to reform the corporate tax code, cutting tax rates on capital and limiting the reach of the IRS to activity that happens here. That would encourage more capital investment and keep US companies from moving abroad for tax purposes. In turn, more investment means higher productivity and higher wages.

Don't hold your breath, though. That kind of reform will have to wait until at least 2017.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-29 / 9:00 am	Consumer Confidence – Jul	85.5	**86.1**		85.2
7-30 / 7:30 am	Q2 GDP Advance Report	3.0%	**2.7%**		-2.9%
7:30 am	Q2 GDP Chain Price Index	1.8%	**2.3%**		1.3%
7-31 / 7:30 am	Initial Claims - Jul 27	302K	**302K**		284K
8:45 am	Chicago PMI	63.0	**64.0**		62.6
8-1 / 7:30 am	Non-Farm Payrolls – Jul	231K	**218K**		288K
7:30 am	Private Payrolls – Jul	228K	**216K**		262K
7:30 am	Manufacturing Payrolls – Jul	14K	**11K**		16K
7:30 am	Unemployment Rate – Jul	6.1%	**6.0%**		6.1%
7:30 am	Average Hourly Earnings – Jul	+0.2%	**+0.2%**		+0.2%
7:30 am	Average Weekly Hours – Jul	34.5	**34.5**		34.5
7:30 am	Personal Income – Jun	+0.4%	**+0.3%**		+0.4%
7:30 am	Personal Spending – Jun	+0.4%	**+0.4%**		+0.2%
8:55 am	U. Mich Consumer Sentiment- Jul	81.5	**83.0**		81.3
9:00 am	ISM Index – Jul	56.0	**55.4**		55.3
9:00 am	Construction Spending – Jun	+0.5%	**+0.3%**		+0.1%
afternoon	Total Car/Truck Sales – Jul	16.7 Mil	**16.7 Mil**		16.9 Mil
afternoon	Domestic Car/Truck Sales – Jul	13.2 Mil	**13.2 Mil**		13.2 Mil