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Corporate Welfare Runs Amok

Earlier this month, Johnson & Johnson became one of the first major American corporations to sign on for a one-year "tax holiday" -- a government-sponsored opportunity for American multinationals to bring their foreign profits back to the United States at a puny tax rate of 5.25 percent, compared with the normal corporate rate of 35 percent. Johnson & Johnson intends to repatriate $11 billion. And that is just the beginning of what is shaping up to be an unprecedented government giveaway.

The drug giant Schering-Plough has announced a coming $9.4 billion repatriation, and Eli Lilly has announced one for $8 billion. Many other cash-rich companies, especially in pharmaceuticals and technology, are expected to follow suit. Pfizer is considering whether to repatriate $29 billion in untaxed foreign profits; Hewlett-Packard has $14.5 billion eligible for repatriation; Intel has $6 billion. By the end of 2005, an estimated $100 billion to $500 billion will have found its way home. Over the long run, Congress's Joint Committee on Taxation projects that the holiday will allow companies to avoid $3.3 billion in taxes, an estimate that many tax experts think is low.

The nation's corporate tax rules -- combined with spotty enforcement by an underfunded and outmuscled Internal Revenue Service -- provide strong incentives for American companies to shift their profits from the United States to low-tax havens, such as Ireland and Luxembourg. Once there, the profits are allowed to grow untaxed by the United States until they are repatriated. That tax deferral is a hugely munificent gesture -- as if the country's biggest businesses had been granted their own special I.R.A.'s.

But it wasn't enough for many companies that have piled up excess cash abroad. The Homeland Investment Coalition, a roster of dozens of America's largest corporations, lobbied vigorously -- and successfully -- for a tax holiday before deigning to repatriate their overseas profits.

Congress's ostensible purpose for allowing the holiday is to unleash a flood of money for job creation, hence the name of the law that includes the holiday -- the American Jobs Creation Act of 2004. But few of the approved uses for the repatriated funds -- such as debt redemption, advertising and a catchall category of "financial stabilization" -- will lead directly, if at all, to more jobs. One approved use -- the ability to spend the money to buy other companies -- would be more likely to create layoffs, as corporate acquisitions usually do.

Companies can also use the money to help pay legal liabilities, which could prove to be a big boon for companies like the drug maker Merck, which is sitting on some $15 billion in untaxed foreign profits and faces an estimated $18 billion in potential claims arising from the Vioxx debacle. Multinationals cannot use the repatriated profits to pay dividends to shareholders, buy back their own stock or pay executives. But because companies have a lot of flexibility in financing their activities, they will generally be able to use the money as they see fit while still meeting the letter of the law.

So the tax holiday blesses rather than curbs tax avoidance and is structured to encourage little if any new domestic economic activity. It establishes a horrible precedent by encouraging companies to leave profits abroad in anticipation of

future holidays. It makes fools of companies that have routinely repatriated foreign profits at the full corporate tax rate. And it disadvantages American companies that have no foreign presence and thus no opportunity to reap profits at a discounted tax rate.

All it will really do is what the drafters probably intended all along -- further erode the nation's corporate tax base and impugn the system's integrity, in that way building a case for eliminating corporate taxes altogether. That is a lousy way to make policy. Reforms to the corporate tax system must be debated on their merits, not under cover of some phony label like "job creation."

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