New Tax Rules Are Met With Protest

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A day after the Obama administration limited the ability of U.S. companies to do international deals to lighten their tax burdens, Pfizer and Allergan terminated their planned $150 billion merger and other companies around the globe raced to assess the impact of the new rules.

The new Treasury Department rules -- the third such attempt to rein in a spate of so-called tax-inversion deals -- drew swift condemnation from Allergan Chief Executive Brent Saunders, who criticized them as "un-American" and "capricious."

"The rules are focused on the wrong thing: Our government should be focused on making America competitive on a global stage, not building a wall locking companies into an uncompetitive tax situation," Mr. Saunders said in an interview.

In an Op-Ed written for The Wall Street Journal appearing in Thursday's newspaper, Pfizer CEO Ian Read wrote that U.S. pharmaceutical companies "compete in a global marketplace at a real disadvantage" to rivals with lower tax burdens. "While the Treasury's proposal is a shot at Pfizer and Allergan, this unilateral action will hurt other companies as well," he wrote.

The White House and the Treasury Department pushed back against the criticism. They argued that they were shutting down unfair loopholes that shift the tax burden to everyone else.

"We tailored our earnings stripping rules to focus on abusive practices, not genuine investment in our country," said Rachel McCleery, a Treasury spokeswoman. "Businesses that are investing in American workers and infrastructure will not be penalized by these regulations."

The rules are aimed at making it more difficult for companies to move their tax addresses out of the U.S. and its 35% corporate tax rate and then shift profits to low-tax companies using a maneuver known as earnings stripping.

The action drew howls of protest from corporate boardrooms and conservative critics.

Some foreign companies with ordinary U.S. businesses worried they would be swept up by the rules. Nancy McLernon, president of the Organization for International Investment, a nonprofit that represents the U.S. operations of foreign-based companies, said the proposal would put at risk the jobs of 12 million American workers.

"This is a misguided approach that could have a freezing effect on attracting global employers and will damage U.S. competitiveness," she said.

A spokesman for Swiss food giant Nestlé SA delivered a similar message, though he said the draft regulations wouldn't affect Nestlé's current investment and employment in the U.S. "As a major investor and employer in the U.S.A., we are concerned that those new regulations intended to curb 'inversions' by U.S. companies could have substantial impact on good-faith foreign-based groups' creation of jobs and investments in the U.S.," the spokesman said.

U.S.-based companies with large global operations like General Electric Co. and Honeywell International Inc. don't appear to be affected by the proposed rules. Still, the rules raised concerns among analysts about tougher tax treatment of foreign earnings.

Industrial companies with "persistently low tax rates and a low mix of U.S. federal taxes will be viewed as potentially vulnerable to these Treasury proposals," Morgan Stanley analyst Nigel Coe said in a note to investors. GE is among industrial companies at the low end of that range, Morgan Stanley said.

GE and Honeywell declined to comment.

Merck & Co. Chief Executive Kenneth Frazier said in an interview Wednesday the new Treasury rules will make tax inversions less attractive for companies to pursue. But he predicts "you'll still see iconic American companies moving their headquarters overseas or being acquired by foreign companies" because the Treasury changes don't address the underlying reason that companies pursue inversions: a U.S. tax structure that he says puts American companies at a competitive disadvantage to rivals like Switzerland's Novartis AG that have lower effective tax rates.

The U.S. political response to the issue has been fraught. Both parties are distressed by the fact that U.S. companies benefit by having their tax addresses outside the U.S., and lawmakers on both sides agree the U.S. corporate tax code is broken and in desperate need of an overhaul. Neither side expects change any time soon.

The Obama administration and congressional Republicans actually agree -- and have for years now -- that the U.S. should cut its corporate-tax rate, make it harder to push profits out of the U.S. and remove the incentives to stockpile profits abroad.

The agreement ends there, and there are few signs that the parade of companies attempting to flee the U.S. tax net or the administration's increasingly ambitious regulatory attempts to stop them will prompt Congress to act. Major legislation looks especially unlikely in an election year when both sides think they might get more of what they want in 2017.

"The further you drill down, the more difficult it becomes to keep everyone on the same page," said Dorothy Coleman, vice president of domestic economic policy at the National Association of Manufacturers. "People recognize that we have a dysfunctional tax system and something needs to be done about it."

While both sides are pushing "tax reform," they don't mean the same thing. President Barack Obama wants to focus on business taxes only, and he would address U.S. companies' foreign income by making them pay a 14% one-time tax on their stockpiled offshore profits and a 19% minimum tax on future foreign profits. The corporate tax rate on U.S. income would drop to 28%. Under his approach, tax changes would neither be a net tax cut nor a tax increase.

Republicans want to address individual and business taxes together, because the two systems are so closely linked. They want lighter taxes on U.S. companies' foreign income. Rep. Kevin Brady (R., Texas), the chairman of the House Ways and Means Committee, has said he'd like to take the corporate tax rate below 20%.

"This is a competitive disadvantage that we have" compared with other major countries, said Sen. David Perdue (R., Ga.), a former chief executive of Reebok and Dollar General Corp. "These aren't companies that are led by mean, greedy CEOs. These are people making good decisions based on our current tax law."

Republicans are also much more open to cutting taxes on net. The presidential candidates have proposed steep tax cuts that would amount to trillions of dollars over a decade. In 2014, Republicans cast aside a revenue-neutral plan released by then-Rep. Dave Camp (R., Mich.), in part because of the politically difficult trade-offs that crop up when some taxpayers pay more and others pay less.

"Policy makers could reach complete unanimity on how to deal with inversions," said Warren Payne, who was policy director for Mr. Camp and now advises companies at Mayer Brown LLP. "But there are other international tax issues that they need to agree on, plus they have to agree on a host of other issues."

Perhaps U.S. lawmakers should just stop trying for "tax reform," the idea that the system can be fixed in one fell swoop in a repeat of the bipartisan magic of 1986, said Jared Bernstein, a former economic adviser to Vice President Joe Biden. Instead, he said, Congress should try to identify discrete problems, such as inversions, and solve them one at a time.

"Tax reform is an elusive muddled concept that yields nothing but animosity and confusion at this point," Mr. Bernstein said. "Stop chasing the tax reform unicorn, which leads nowhere."

--Saabira Chaudhuri, Ted Mann and Peter Loftus contributed to this article.

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