Rehabilitating the U.S. Corporate Income Tax System in Light of Current Realities and 26 U.S.C. § 965

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Abstract

The U.S. corporate income tax system is outdated, overly prescriptive, and too complex and oppressive to respond efficiently and effectively to global business. As highlighted by 26 U.S.C.

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2. For a thorough analysis of the prescriptive nature of the U.S. corporate tax rules and the benefits of rewriting them to include principles-based rules, see generally Holmes, supra note 1.


4. See generally JEC, supra note 1 (describing the inefficiencies of the U.S. corporate tax system and its costs and burdens on U.S. multinationals); Michael C. Durst, International Tax Reform and a Corporate Rate Cut for Stimulus, Efficiency, and Fairness, 53 TAX NOTES INT’L 313, 314 (2009) (stating that the international provisions are among the most wasteful and inefficient elements of the U.S. tax system); Holmes, supra note 1, at 1 (stating that “[t]he U.S. corporate tax system is failing to keep pace with the evolving global economic landscape”); see also Ilan Benshalom, Sourcing the “Unsourceable”: The Cost Sharing Regulations and the Sourcing of Affiliated Intangible-Related Transactions, 26 VA. TAX REV. 631, 633-41 (2007) (explaining the global nature of business as related to the U.S. tax rules); Craig M. Boise, Breaking Open Offshore Piggybanks: Deferral and the Utility of Amnesty, 14 GEO. MASON L. REV. 667, 667-70 (2007) (discussing U.S. MNEs foreign-source
§ 965, the international provisions are especially stale. Yet, multinational enterprise (MNE) income dominates the business environment, and cross border transactions are on the rise.

I recommend placing global business concepts and the international tax code provisions at the center of restructured rules that include the following: new entity definitions and transaction/source rules that reflect evolving business realities; a strengthened worldwide system capable of encompassing border-defying income activity; principles-based standards to remain dynamic and relevant, as well as to simplify the Internal Revenue Code and Treasury Regulations and to clarify congressional intent; ending deferral for U.S. foreign-source income; reducing the overall corporate income tax rate; and integrating the corporate and individual income tax systems according to the Comprehensive Business Income Tax (CBIT) prototype put forth by the U.S. Treasury Department.

I. Introduction

The U.S. corporate income tax regime is a disaster. U.S. corporations seek to escape the home jurisdiction, primarily because, in staying, they are forced to deal with the U.S. corporate income tax system. The high U.S. tax rate is glaringly so, and the system in general is burdensome. This reality is felt internationally. Foreign and domestic investments in the United States are declining. At the same time, increased international income tax avoidance); see generally David S. Miller, Unintended Consequences: How U.S. Tax Law Encourages Investment in Offshore Tax Havens, in NEW YORK UNIVERSITY SCHOOL OF LAW colloquium on TAX POLICY AND PUBLIC FINANCE (2011), available at http://www.law.nyu.edu/ecm_dlv3/groups/public/@nyu_law_website_academics_colloquia_tax_policy/documents/documents/ecm_pro_067812.pdf (outlining the U.S. tax Code features that encourage U.S. multinationals to take advantage of international commerce to defer U.S. taxes offshore); Daniel Shaviro, The David R. Tillinghast Lecture, The Rising Tax-Electivity of U.S. Corporate Residence, 64 Tax L. Rev. 377, 377-80 (2011) (highlighting the tax disadvantages of incorporating in the United States).


8. A territorial system’s reach is limited to national boundaries and thus inappropriate for cross-border value creation. See id. at 80-81.


10. Shaviro, supra note 4, at 377-78.

11. Id.


13. See David Malpass & Stephen Moore, America’s Troubling Investment Gap, Wall St. J., July 5, 2011, at A15 (stating that the United States is losing growth capital). In spite of positive numbers put forth by the White House, overall foreign direct investment in the United States is declining. See id. Further, U.S. investment is leaving the United States at a faster rate than foreign investment is arriving. See id.
investment in tax-haven nations has become a global concern for Organisation for Economic Co-operation and Development (OECD) countries, including the United States.\textsuperscript{14} The U.S. income tax system is the number one incentive for multinational enterprises (MNEs) to elect foreign over U.S. incorporation.\textsuperscript{15} It is why U.S. multinationals are choosing to do business offshore rather than at home.\textsuperscript{16} What is more, U.S. taxes preclude U.S. MNEs from bringing their foreign income back to the United States (repatriating).\textsuperscript{17}

Because the United States does not tax the foreign income of foreign corporations, U.S. MNEs that incorporate and earn income overseas can defer, or put-off, U.S. taxation for as long as they keep their earnings abroad.\textsuperscript{18} Many U.S. MNEs continue deferral indefinitely.\textsuperscript{19} As such, the U.S. corporate tax system is essentially a barrier, preventing U.S. foreign income from supporting U.S. revenue\textsuperscript{20} or reaching the U.S. capital market.\textsuperscript{21}

The system is backfiring on itself. The U.S. tax base is eroding,\textsuperscript{22} the United States is losing its international standing as a desirable place to invest,\textsuperscript{23} and the U.S. market in general is losing its capital base.\textsuperscript{24} The Joint Committee on Taxation (JCT) has expressed great concern regarding the U.S. market effects of U.S. MNE taxation.\textsuperscript{25} Multinationals are “shifting . . . investment[s] to low-tax jurisdictions” and “structuring investments in high-tax jurisdictions to take advantage of low rates elsewhere . . . .”\textsuperscript{26} The committee noted that consequences of the current corporate tax rules include “uncertain implications for U.S. investment and employment; and incentives to incorporate a business [and earn income] outside the United States.”\textsuperscript{27}

To respond to the JCT, we must consider U.S. taxes within an international context. If the United States seeks to bring its corporate income home, it must think like its corporations do. It must aggressively capture value. It must also draw business back to the United States, enabling MNEs to earn their greatest returns onshore. The bottom line is that the United States must improve its corporate income tax system as a whole from the

\textsuperscript{15} See Miller, supra note 4, at 3-4; Shaviro, supra note 4, at 377-78.
\textsuperscript{16} Shaviro, supra note 4, at 377-78.
\textsuperscript{17} JCT, supra note 7, at 69-79; Miller, supra note 4, at 3-4.
\textsuperscript{18} Boise, supra note 4, at 667-68.
\textsuperscript{19} Id.
\textsuperscript{20} Holmes, supra note 1, at 10-15 (describing the system complexity that encourages entities to go to great lengths to exploit gaps and loopholes); see generally Miller, supra note 4, at 12-14 (explaining deferral and avoidance vehicles).
\textsuperscript{21} See JEC, supra note 3, at 6-7.
\textsuperscript{22} JCT, supra note 7, at 69-71.
\textsuperscript{23} See Matthew Saltmarsh, U.S. Slips to Fifth Place on Competitiveness List, N.Y. Times, Sep. 7, 2011, at B9 (reporting that the United States’ standing has declined for the third year in a row). The results were attributable to “some aspects of the United States’ institutional environment.” Id.
\textsuperscript{24} JCT, supra note 7, at 69-79.
\textsuperscript{25} Id.
\textsuperscript{26} Id. at 69.
\textsuperscript{27} Id.
inside out to meet everyone's best interests. I propose that this can be done, but only under a fully rehabilitated construct as recommended here.

Part II of this paper outlines the issues plaguing the U.S. corporate income tax system. It describes the system, how it fails to meet practical realities, and the effects of those failings. Part III presents the experiment of 26 U.S.C. § 965 and its results. Section 965 temporarily allowed repatriation of U.S. foreign subsidiary income at sharply reduced rates. This law drew MNE foreign-source income home, indicating a wealth of poorly addressed offshore U.S. resources. Part IV provides recommendations for restructuring the U.S. corporate income tax system. Part V concludes.

II. Issues Plaguing the U.S. Corporate Income Tax System

A. The U.S. Corporate Income Tax Structure Encourages Deferral

1. The Worldwide U.S. Income Tax System

The U.S. corporate income tax structure encourages deferral. It does this by leaving gaps in the rules that would capture income for revenue. Understanding these gaps begins with an understanding of the United States' worldwide income tax structure.

The United States operates a worldwide income tax system. This means that the United States taxes its residents on income generated anywhere in the world. To relieve U.S. residents of the burden of doubly paying U.S. and foreign taxes on the same income earned abroad, the United States offers credits to its residents against foreign taxes paid.

Many other nations exercise territorial systems, taxing their residents only on income generated within their home countries. Canada, France, Germany, and the Netherlands, for example, have all operated primarily territorial systems for years. In 2009, Great Britain and Japan also both transitioned from worldwide to territorial systems, leav-
ing the United States in the minority of OECD countries still operating worldwide systems. 38

Whether the United States should continue to operate a worldwide system or should move to a territorial regime is the subject of much debate. 39 A territorial system would exempt U.S. foreign-source income from U.S. taxation, making U.S. MNEs more competitive. 40 As territorial systems rule the day, corporations from worldwide systems are at a disadvantage, paying home-country taxes on all income while their territorial counterparts’ foreign income is earned free of home-country taxation. 41 The value of incorporating within a territorial system is undeniable. 42 Territorial systems can also be simpler to administer than worldwide systems, which must track corporate income around the globe. 43

But, in the long term, the United States would likely not benefit from limiting taxation to its physical borders. Per Desai and Hines, “the available evidence suggests that, both in magnitude and in character, foreign income, and its taxation by foreign countries and the United States, continue to grow in importance over time.” 44 This is precisely why the United States must strengthen its worldwide income tax structure. The United States must use all available data to re-design a system that will allow it to excel on its own terms, and not merely to compete by attempting to keep up with others’ policies, prevailing or not.

Distributive notions underlie the validity of the worldwide system. 45 The U.S. income tax system attempts to distribute the tax burden across all areas where income accrues, taxing earnings from capital and labor. 46 Capital income migrates more easily across borders than human labor. 47 Thus, a territorial system would exempt mobile capital income from taxation, leaving the primary tax burden on the less mobile national labor force. 48

39. See Benshalom, supra note 4, at 633-34 (discussing the issue as a “source of contention, embodying vehement academic and political debates . . . .”); Shaviro, supra note 4, at 378-79 (noting “[t]he long and frequently vociferous debate about whether the United States should seek to strengthen its worldwide taxation of resident companies, or instead follow the rest of the world by moving towards exemption . . . .”).
40. JEC, supra note 3, at 4.
41. Id.
42. See Shaviro, supra note 4, at 378 (noting the high cost of U.S. incorporation relative to territorial system business costs).
43. See JCT, supra note 7, at 20-21 (generally describing the domestic and foreign transactions of which the United States must keep track in taxing worldwide income); Avi-Yonah, supra note 6, at 1583-84 (describing difficulties in tracking worldwide income “[e]ven [for] sophisticated tax administrations like the IRS . . . .”).
44. Desai & Hines, supra note 1, at 939.
45. Avi-Yonah, supra note 6, at 1576-78. But see Shaviro, supra note 4, at 394-95 (explaining that the distributitional analysis of worldwide taxation is sensitive to whether taxation occurs at the entity or individual levels).
46. See Avi-Yonah, supra note 6, at 1576-78 (explaining the distributive underpinnings of developed nation income taxation).
47. See id.
48. See id. (explaining the chain of events that occurs when foreign income is taxed at a lower rate than domestic income, causing capital to flee the home jurisdiction and the tax base to shift toward labor; see also Durst, supra note 4, at 314 (stating that the burden of the corporate tax falls on labor and “middle-income earners, whose retirement and other savings plans own stock in the corporations that must pay the tax . . . .” This means that the tax dampens national investment and employment.).
The worldwide system attempts to capture income from capital that has grown and benefited from the home jurisdiction even when it elects to move overseas.\textsuperscript{49} An educated understanding of the worldwide versus territorial discussion requires a multi-step assessment of how income taxes work globally, including how nations tax foreign parties doing business within their borders and the rates at which nations tend to exchange foreign investors.\textsuperscript{50} This paper examines the reasoning behind choosing either system to ask specifically how it relates to the increasingly borderless corporate income environment. The simple answer to this question (in favor of a worldwide system as described in Part IV below) makes the rest of the debate moot.

The current U.S. system provides a worldwide context for U.S. taxation,\textsuperscript{51} but fails to effectively utilize its platform.\textsuperscript{52} The system's foundational provisions were conceived when domestic commerce prevailed.\textsuperscript{53} Income was associated with physical business presence isolated within national borders.\textsuperscript{54} As business evolves beyond these concepts, the outdated U.S. rules leave gaps in the intended worldwide net, failing to reach and capture all U.S. income streams.\textsuperscript{55}

2. Income Tax Gaps: The Legal Status of U.S. Corporations

The United States, of course, treats corporations as distinct legal persons\textsuperscript{56} and taxes corporations separately in conjunction with their separate juridical status.\textsuperscript{57} Corporations and their shareholders each pay separate taxes on income earned.\textsuperscript{58} One of the keys that helps to create a tax gap relative to separate corporate taxation is the meaning of income earned.\textsuperscript{59} U.S. taxes are only owed when they are realized\textsuperscript{60} by a U.S. resident or a person engaged in business or trade within the United States.\textsuperscript{61} When a U.S. parent company establishes a foreign subsidiary, it generally organizes a wholly foreign corporation for which it (the U.S. parent) is the primary shareholder.\textsuperscript{62} This allows the U.S. MNE to

\textsuperscript{49}. See JEC, supra note 3, at 1-6 (describing capital mobility and worldwide system taxation).
\textsuperscript{50}. See Shaviro, supra note 4, at 385-412 (analyzing issues related to worldwide taxation).
\textsuperscript{51}. See JCT, supra note 7, at 20-21.
\textsuperscript{52}. Desai & Hines, supra note 1, at 937-38.
\textsuperscript{53}. Id.
\textsuperscript{54}. Id.
\textsuperscript{55}. Id.; see generally Benshalom, supra note 4.
\textsuperscript{56}. See I.R.C. § 11 (imposing tax on corporations); see also BLACK'S LAW DICTIONARY 24 (9th ed. 2009) (defining a corporation as "[a]n entity (usu. a business) having authority under law to act as a single person distinct from the shareholders who own it" or "a group or succession of persons established in accordance with legal rules into a legal or juristic person that has a legal personality distinct from the natural persons who make it up . . . .").
\textsuperscript{58}. See I.R.C. § 61(a)(7) (defining dividends as separate income); see also INTEGRATION, supra note 9, at 1 (describing as classical the U.S. tax system's separate treatment of corporations and their investors and explaining that economic distortions result from this double tax).
\textsuperscript{59}. See id. § 1001.
\textsuperscript{60}. See 26 C.F.R. § 1.61-1 (stating that "[g]ross income includes income realized in any form . . . .").
\textsuperscript{61}. See JCT, supra note 7, at 20-21 (explaining the principles underlying taxation of U.S. residents' worldwide and foreign parties' U.S.-related income).
\textsuperscript{62}. See Boise, supra note 4, at 672-74 (introducing and explaining the "Principles Underlying Deferral").
establish a foreign subsidiary whose income is wholly separate from its U.S. parent's income, and can therefore escape U.S. tax.  

Under the rules, a U.S. corporation can establish a foreign subsidiary corporation that is a separate legal entity from its U.S. parent, is not a U.S. resident, and is not engaged in business or trade within the United States. If the subsidiary's income is foreign, and the parent realizes no income from exchanges with or distributions from the subsidiary, the United States cannot tax the subsidiary's earnings at all.  

This un-taxable foreign-source income is commonly known as "deferred" income. The term implies that potential U.S. income is temporarily delayed. If this income were returned to the United States, it would be taxed here. But this income may never be "repatriated." There is no legal requirement that corporations must repatriate their foreign-source earnings within a certain time-frame, or at all.


The landscape of international business now makes the Internal Revenue Code's (IRC or the Code) and Treasury Regulations' definitions and foundational concepts unhelpful in effectively raising revenue from capital. The provisions that relate entities and income to the United States are problematic. They encourage deferral. Put bluntly, the rules fail to link modern economic activity to taxation.

The Code defines a U.S. corporation simply as one that was legally organized in the United States. Related entities escape U.S. taxation by organizing elsewhere. In reality, however, foreign and U.S. corporations often generate value together, yet parse rights, responsibilities, and earnings in ways that defy historic U.S. tax notions.

63. See id. at 667-76.
64. BLACK'S LAW DICTIONARY, supra note 56, at 24.
65. See I.R.C. § 7701(a)(4)-(a)(5) (stating that a foreign corporation is one that is not created or organized in the United States).
66. See Boise, supra note 4, at 673 (explaining that corporations formed and earning income solely abroad are legally unrelated to and untaxable by the United States unless or until their income is realized at some point by U.S. residents). Because U.S. corporations and their shareholders are taxed separately and distinctly, this remains true when the persons (natural or juridical) organizing the foreign corporations are U.S. persons. Id. at 672-76 (explaining the "Principles Underlying Deferral").
67. See I.R.C. §§ 881-882 (imposing income tax only on foreign corporations receiving income from within the United States or engaged in trade or business within the United States).
68. See Boise, supra note 4, at 667.
69. See id. at 667-68.
70. See JCT, supra note 7, at 70 (noting the ability to retain earnings in a foreign subsidiary as the principal advantage of deferral); see also Boise, supra note 4, at 667-68 (stating that U.S. corporations may never repatriate foreign earnings). Boise describes U.S. foreign subsidiaries as "offshore piggybanks." Id. at 667.
71. See Benshalom, supra note 4, at 633-37.
72. See id.; see also Avi-Yonah, supra note 6, at 1575-77 (discussing problems related to taxing present-day capital income under current income tax structures).
73. See Avi-Yonah, supra note 6, at 1593; see also Miller, supra note 4, at 5 (indicating that deferral stems from the rules' failure to accurately reflect the nature of multinational corporate income).
74. See Benshalom, supra note 4, at 641.
75. See I.R.C. § 7701(a)(4).
76. See generally Miller, supra note 4 (detailing the many U.S. tax avoidance incentives for organizing foreign corporations).
77. See Benshalom, supra note 4, at 633-51 (outlining the ways MNEs generate value).
"The new actors are able to manipulate different sources of income flows to minimize tax liability, and thus to dismantle historic links between geographic borders and effective national fiscal jurisdiction."\(^78\) For MNEs as umbrella corporations, income is created when value increases.\(^79\) Several jurisdictions and units may be involved.\(^80\) Multinational income is no longer jurisdiction specific.\(^81\) Outdated geographical and legal partitions no longer reflect the MNE as an economic value generating, or income generating, unit.\(^82\)

Though long held, the United States' determination to tax its entities solely according to the site of their legal organization is arbitrary and can be altered.\(^83\) Entities could be defined for tax purposes by their sites of management and control,\(^84\) by their consumer markets,\(^85\) by the legal and market jurisdictions that enable their growth and development,\(^86\) by the resident status of the natural persons with whom they are ultimately affiliated, by some combination of these standards, or by standards yet to be devised.\(^87\)

The United States could tax U.S. and related foreign businesses according to the value they generate together as integrated entities.\(^88\) For example, U.S. foreign subsidiary income could be taxable to the United States, unless it could be proved that the subsidiary's income did not benefit from the parent jurisdiction. Considering the importance of the U.S. business development and consumer markets, this argument may be difficult for a U.S. foreign subsidiary to prove.\(^89\) Such a tax structure would require expanding histori-

\(^{78}\) See id. at 638-39.
\(^{79}\) See id. at 642.
\(^{80}\) See id.
\(^{81}\) See id. at 633-51.
\(^{82}\) See id. "Put differently, income is conceptualized as the change of value within a specific economic unit over a designated period of time. Integrated MNEs are economic units operating in several jurisdictions and through several corporate entities. Accordingly, trying to forge significance into geographical, legal, or national boundaries to divide the MNE's single economic unit for sourcing purposes thus seems antithetical to income's conceptual anchor." Id. at 634 n.45.
\(^{83}\) See id. The legal notion associating taxes with corporate organization grew logically. Corporate finance issues are inherently engaged when establishing a corporation because organizing is undertaken to protect shareholders from corporate liability. Isolating corporations for liability means protecting corporate and shareholder dollars. But taxation and liability are distinct legal concepts and can be unbraided. Furthermore, taxing solely according to the site of organization is no longer apropos. We can tax corporations and their shareholders, or corporations and their subsidiaries, in new ways while still holding corporations separate for liability purposes.

The United States has built other legal concepts upon the link between corporations' legal status and their finances. See generally Citizens United v. FEC, 130 S. Ct. 876 (2010) (holding that the government could not suppress political speech based on the speaker's identity as a corporation). Citizens United upholds corporate political spending based on corporations' separate legal person status, growing the concept of corporate person-ness to allow corporate financial participation in the political process. Unhitching taxation from corporate separate person status may or may not relate to how the United States applies legal person status in other contexts.

\(^{84}\) See Boise, supra note 4, at 676 (suggesting that the United States may alter the definition of a foreign corporation to reflect the corporation's place of management and control).
\(^{85}\) See Avi-Yonah, supra note 6, at 1586-87, 1670-74 (discussing taxing multinationals in their consumption, or demand, markets).
\(^{86}\) See id. at 1586-87 (discussing taxing income relative to its supply jurisdiction; Avi-Yonah's supply jurisdiction concept relates taxation to production). Here, I relate taxation to a product's development jurisdiction, which may precede and differ from the eventual production jurisdiction.
\(^{87}\) See id. at 1580.
\(^{88}\) See Benshalom, supra note 4, at 642 (highlighting MNE value generation).
\(^{89}\) See Avi-Yonah, supra note 6, at 1670-71 (discussing the importance of OECD consumer markets).
cal Code ideas that tie supposedly immobile income to geographic borders. Realistically, today’s income is often mobile and border-defying. The Code provisions that assess transactions and determine income sources must therefore grow to embrace evolving business.

U.S. and foreign MNEs no longer fall into the static tax concepts reflected in the U.S. rules and developed when income and production were grounded by a fixed physical business presence. Today’s entities can avoid and abuse U.S. taxes because they operate on a level that our outdated provisions do not reach. Modern entities absolutely take advantage of our inert standards to structure their subsidiaries, transactions, and income to defer, and indefinitely avoid, U.S. tax.

4. Deferral

Because deferral results in un-taxable income, the United States has long been trying to combat it. IRC Subpart F denies deferral for certain income. Subpart F is the part of the Code that outlines the U.S. income tax anti-deferral rules for income sources outside the United States defined as Controlled Foreign Corporations (CFCs). Among other things, Subpart F defines when a foreign corporation is controlled by U.S. shareholders for income tax purposes, and what qualifies as income under Subpart F. It is devoted to specifying when the U.S. parent of a CFC must claim foreign-source income on its U.S. tax return. The rules recognize that a parent corporation may structure its transactions and entities to unjustly defer U.S. income that would be taxable to the United States if not moved offshore.

Subpart F attempts to regulate deferral activity by exhausting a list of transactions from which income must be claimed for U.S. tax. MNEs, however, have grown increasingly skilled at finding ways to ensure that their foreign subsidiary income does not trigger the anti-deferral rules.

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90. See Ben-Shalom, supra note 4, at 638-39 (discussing historic notions of fiscal jurisdiction); Miller, supra note 4, at 5 (noting that the U.S. anti-deferral rules were intended to represent immobile income, but that intention is not reality).
91. Miller, supra note 4, at 5; Ben-Shalom, supra note 4, *passim*.
92. See Ben-Shalom, supra note 4, at 634-35 (discussing the inadequacies of current sourcing conventions).
93. Ben-Shalom, supra note 4, *passim*.
94. See id. (describing the problem of relating multinational income to taxation); Avi-Yonah, supra note 6, *passim* (describing legal issues related to taxing multinationals); Holmes, supra note 1, at 1-11, 21-53 (describing the failings of prescriptive rules).
95. *See generally* Miller, supra note 4.
97. I.R.C. §§ 951-965; see Deferral, supra note 31, at 2 (explaining the tax concepts at the core of Subpart F).
99. I.R.C. § 957 (stating that a corporation is a CFC if more than 50 percent of: “(1) the total combined voting power of all classes of stock entitled to vote, or (2) the total value of the stock of such a corporation, is owned . . . or is considered as owned . . . by United States shareholders . . .”).
100. See I.R.C. § 952 (defining as income the sum of several listed income sources).
101. See I.R.C. § 951 (defining when CFC income must be included in the gross income of U.S. shareholders).
102. CFCs Study, supra note 95, at 12-14.
Subpart F rules (does not resemble income on the list) and can therefore remain offshore, unclaimed and untaxed in the United States.104 "At present, U.S. multinationals have more than $10 trillion invested abroad, including at least $1 trillion of foreign earnings."105 Ending deferral could return $11 billion to $60 billion in annual U.S. tax revenue.106

As described, deferral is simply a consequence of gaps in the U.S. income tax structure.107 Moreover tax avoidance, or taking advantage of these gaps, is legal.108 It is allowable to position oneself to maximize income while minimizing taxes owed.109 Multinationals must avoid U.S. tax to compete in an increasingly global marketplace in which the U.S. tax rate is proportionately too high,110 and the complex U.S. rules require corporate contortions.111 Though Subpart F would direct MNEs through a patchwork of transactional provisions, MNEs can sometimes achieve more reasonable exchanges by avoiding U.S. tax and Subpart F.112 Where deferral is concerned, however, the line between avoidance and evasion can be difficult to discern.113

Deferral is the principal tax incentive to operate through a foreign subsidiary or to organize a foreign corporation in general.114 The benefits of operating through a foreign subsidiary and avoiding Subpart F income are maximized if the subsidiary can be located in a low-tax, or no-tax, jurisdiction.115 That way, if the MNE achieves deferral and avoids Subpart F, its subsidiary income will be minimally taxed, if it is taxed at all, resulting in maximum investment returns.116

The outdated rules encourage four main avenues for achieving deferral and avoiding Subpart F in global business.117 The rules also provide numerous other incentives to op-

104. See Miller, supra note 4, passim (delineating MNE activities designed to avoid the Subpart F rules).
105. Shaviro, supra note 4, at 380.
106. Miller, supra note 4, at 7.
107. Boise, supra note 4, at 668; CFCs Study, supra note 96, at 1-4.
108. See Boise, supra note 4, at 668 (distinguishing tax evasion from deferral). Tax avoidance is simply tax planning to minimize amounts owed. See Gregory v. Helvering, 293 U.S. 465, 469 (1935) (stating that, "[t]he legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted." Under U.S. case law, tax avoidance differs from tax evasion in that it is not criminal.). Under I.R.C. § 7201, however, "[a]ny person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony . . . ." I.R.C. § 7201.
109. Helvering, 293 U.S. at 469 (recognizing the legal right of taxpayers to decrease or avoid tax payments).
110. See Durst, supra note 4, at 314 (discussing the "uncompetitively high" U.S. tax rate); see also Carroll, supra note 12, at 5-6 (highlighting the U.S. corporate tax rate as "increasingly out-of-line internationally," and advocating that a reduced rate would alone, or with other restructuring changes, improve U.S. corporate tax).
111. Miller, supra note 4, at 3.
112. Id.
113. See generally JANE G. GRAVELLE, CONG. RESEARCH SERV., R40623, TAX HAVENS: INTERNATIONAL TAX AVOIDANCE AND EVASION passim (2009) (examining techniques used to evade and avoid U.S. income tax payments on foreign earnings). In Gravelle's report, the distinction between international tax avoidance and tax evasion is very thin, if at all clear. See id.
114. Miller, supra note 4, at 3-4.
115. Id. at 4.
116. Id. at 3-9.
117. Id. at 9-12.
erate through a foreign corporation. The main types of activities that achieve deferral are (1) transfer pricing; (2) allocating interest expenses; (3) contract manufacturing and similar agreements; and (4) the use of hybrid entities and instruments.

a. The Four Main Deferral Activities

i. Transfer Pricing

The largest MNEs own and profit from mobile information assets, such as intellectual property and other intangibles. Under the rules, these purely technological products are ideal for avoiding taxation within horizontally integrated international business models. MNEs operating such models can arrange cash flows by dividing rights and risks among their various international units. In such scenarios, shifts in ownership and control are available through mere mouse clicks, and tax sensitive transactions can migrate across borders to the greatest value-returning environments.

U.S. multinationals can develop intellectual property and intangibles in the United States, and then transfer ownership to subsidiaries in low-tax jurisdictions. The subsidiaries then license the properties back to the U.S. corporations. Alternatively, the subsidiaries can manufacture in the low-tax jurisdictions and then sell the properties back to the United States units for distribution. The entities in the low-tax jurisdictions pay minimal amounts to buy the products from the U.S. firms. The low-tax entities then own the products and claim most of the income related to their use.

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118. Id. at 19-48 (stating that these incentives include avoiding federal limitations on miscellaneous itemized deductions, avoiding alternative minimum tax limitations on deductibility, avoiding the "taxable mortgage pool" rules, and avoiding cancellation of indebtedness income).
119. Id. at 9-12.
120. Benshalom, supra note 4, at 645-48.
121. See id. passim (describing the problems associated with designing source and transaction definitions that properly embrace mobile technological assets).
122. Id.; see Jesse Drucker, IRS Auditing How Google Shifted Profits, BLOOMBERG, Oct. 13, 2011, http://www.bloomberg.com/news/print/2011-10-13/irs-auditing-how-google-shifted-profits-offshore-to-avoid-taxes.html (reporting that companies including Google, Cisco, Facebook Inc., Microsoft, and the pharmaceutical company Forest Laboratories have all been able to easily move profits from valuable patents and copyrights to tax haven nations. Often these assets are allocated to addresses with no employees or working offices).
123. Benshalom, supra note 4, at 648; Avi-Yonah, supra note 6, at 1587.
124. Miller, supra note 4, at 9.
125. Id.; see also Michael Avramovich, Intercompany Transfer Pricing Regulations Under Internal Revenue Code Section 482: The Noose Tightens on Multinational Corporations, 28 J. MARSHALL L. REV. 915, 927-29 (1995) (illustrating intercompany transfer pricing); JOINT COMM. ON TAXATION, JCX-37-10, PRESENT LAW AND BACKGROUND RELATED TO POSSIBLE INCOME SHIFTING AND TRANSFER PRICING 11-17 (2010) [hereinafter T-PRICING] (explaining business restructuring and transfer pricing); JCT, supra note 7, at 22 (describing transfer pricing); see also Drucker, supra note 122 (reporting that Google developed certain technology in the United States, and then transferred the technology to a subsidiary in Bermuda through an intra-company transaction. After the exchange, profits from the technology would be earned overseas rather than in the United States, where they would have otherwise been subject to the high U.S. tax rate. The IRS approved the transfer price associated with the transaction, but is looking into transfer prices that Google's subsidiaries paid to Google in the United States for other intangibles).
126. See T-PRICING, supra note 125, at 11-17 (outlining transfer pricing issues and techniques).
127. See id.; Avi-Yonah, supra note 6, at 1591; Avramovich, supra note 124, at 927-29; Benshalom, supra note 4, at 645-48; Drucker, supra note 122; Miller, supra note 4, at 9.
128. See T-PRICING, supra note 125, at 11-17; Avi-Yonah, supra note 6, at 1591; Avramovich, supra note 125, at 927-29; Benshalom, supra note 4, at 645-48; Drucker, supra note 122; Miller, supra note 4, at 9.
then lightly taxed or not taxed at all. The entities in the high tax jurisdictions pay use and licensing fees or purchase prices to the low-tax product owners. The high-tax entities earn little or no profit due to these payments. High incomes are achieved in the low-tax jurisdictions, and low incomes or losses are had in the high-tax jurisdictions. As an integrated entity, the MNE defies borders to maximize overall value while the high-tax jurisdiction may be losing out on revenue.

It can be difficult to assess suspect transactions for validity. The U.S. rules proscribe transfers that would unjustly avoid U.S. tax. But attempts to determine the true economic location and value of intangibles and other assets through established transfer pricing methods are often inappropriate, overly prescriptive, and easy to avoid. To determine whether MNEs' intangibles transactions are legitimate or are designed to skirt U.S. taxes, transactions are appraised according to an arm's length standard. This standard is intended to be indicative of what an unaffiliated party would pay to purchase the asset in a true market.

Unfortunately, the rules are disadvantageous because there often are no market comparables for such products. Further, the value of intangibles can be difficult to ascertain. It cannot be inferred from the costs incurred to create the products because they are "high risk" items, meaning that they may achieve high values disproportionate to their creation costs. Additionally, their values can vary over time and in different use environments.

As such, $60 billion in annual U.S. revenue is likely lost to transfer pricing schemes. One-third of the repatriations under § 965 (described in Part II below) were related to profits from intangibles within the pharmaceutical, and the computer and electronics industries. The current rules fail to reflect the dynamic aspects of mobile business trans-

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129. See T-PRICING, supra note 125, at 11-17; Avi-Yonah, supra note 6, at 1591; Avramovich, supra note 125, at 927-29; Benshalom, supra note 4, at 645-48; Drucker, supra note 122; Miller, supra note 4, at 9.
130. See T-PRICING, supra note 125, at 11-17; Avi-Yonah, supra note 6, at 1591; Avramovich, supra note 125, at 927-29; Benshalom, supra note 4, at 645-48; Drucker, supra note 122; Miller, supra note 4, at 9.
131. See T-PRICING, supra note 125, at 11-17; Avi-Yonah, supra note 6, at 1591; Avramovich, supra note 125, at 927-29; Benshalom, supra note 4, at 645-48; Drucker, supra note 122; Miller, supra note 4, at 9.
132. See T-PRICING, supra note 125, at 11-17; Avi-Yonah, supra note 6, at 1591; Avramovich, supra note 125, at 927-29; Benshalom, supra note 4, at 645-48; Drucker, supra note 122; Miller, supra note 4, at 9.
133. Benshalom, supra note 4, at 633-41.
134. Id.
135. See T-PRICING, supra note 125, at 18-50 (describing U.S. law related to transfer pricing).
137. Id. at 641-45. The IRS also allows other accounting methods for determining transfer price. Avramovich, supra note 125, at 931-35. These methods include the comparable uncontrolled prices method, the resale price method, the comparable profits method, the profit split method, and unspecified methods. Id. The regulations do not specify a hierarchy among methods. Id. Rather, they require entities to use the "most reliable" method. Id. (citing Treas. Reg. § 1.482-1(c) (1994)).
139. Benshalom, supra note 4, at 641-51.
140. Id.
141. Id.
142. Id.
143. Miller, supra note 4, at 9.
144. Id.
fers, the border defying economics required in valuing modern information assets, and the true economics of multinational integrated entities.\textsuperscript{145}

\textit{ii. Allocation of Interest Expense}

Because a U.S. parent and its CFC are distinct legal entities, the rules allow a U.S. parent to borrow funds, thus incurring debt to contribute equity to its foreign subsidiary.\textsuperscript{146} The U.S. parent can deduct the interest paid in servicing the debt against its domestic income taxes.\textsuperscript{147} The subsidiary's foreign income, including that generated by the borrowed funds, continues to benefit from deferral.\textsuperscript{148} This is allocation of interest expense between a U.S. parent and its CFC for U.S. tax purposes.\textsuperscript{149} These activities take advantage of outdated entity and sourcing rules that do not reflect the integrated nature of MNEs' earnings. Favorable MNE interest allocations likely account for the largest U.S. revenue losses after transfer pricing.\textsuperscript{150}

\textit{iii. Contract Manufacturing and Other Similar Arrangements}

Contract manufacturing and similar arrangements, such as commissionaire agreements in which a low-tax jurisdiction subsidiary earns commission for arranging sales of goods, maneuver to shift income to related low-tax entities without triggering the Subpart F anti-deferral rules.\textsuperscript{151} A CFC in a low-tax jurisdiction can enter into a contract manufacturing agreement with a high-tax jurisdiction manufacturer.\textsuperscript{152} The CFC can input "substantial contributions" to the manufacturing process without generating income that will trigger Subpart F.\textsuperscript{153} The CFC's contributions will trigger Subpart F if the CFC also has a branch in the high-tax jurisdiction.\textsuperscript{154} But substantial contributions, themselves, will not constitute having a branch.\textsuperscript{155} The CFC's non-Subpart F sales income resulting from these arrangements will continue to enjoy deferral.\textsuperscript{156}

These rules are rooted in outdated place-of-business concepts.\textsuperscript{157} They presume that non-Subpart F income, or income entitled to deferral, is immobile and related to a single jurisdiction.\textsuperscript{158} But in reality non-Subpart F income is readily movable and multi-jurisdictional.\textsuperscript{159} The rules are founded in ideas that relate singular physical presence and residency to national production, value creation, and income.\textsuperscript{160} But, as the link between taxpayer presence and economic activity erodes, attributing taxpayer income to a fiscal

\textsuperscript{145} See Benshalom, supra note 4, at 641-51 (highlighting the horizontally integrated operations of MNEs).
\textsuperscript{146} Miller, supra note 4, at 10.
\textsuperscript{147} Id.
\textsuperscript{148} Id.
\textsuperscript{149} Id.
\textsuperscript{150} Id.
\textsuperscript{151} Id.
\textsuperscript{152} Id. at 10-11.
\textsuperscript{153} Id. at 10.
\textsuperscript{154} Id.
\textsuperscript{155} Id.
\textsuperscript{156} Id.
\textsuperscript{157} Id. at 5.
\textsuperscript{158} Id.
\textsuperscript{159} Id.
\textsuperscript{160} See Benshalom, supra note 4, at 641-51.
jurisdiction under the current rules becomes less and less feasible. Moreover, “it is rather unclear that the current sourcing conventions are apt for determining the fiscal connection of many economic activities that have no clear physical presence . . . ” These rules do not account for global income.

iv. Hybrid Instruments and Check-the-Box Elections

Hybrid instruments and check-the-box elections were originally intended to designate whether a firm was a corporation or a partnership for tax purposes when a U.S. corporation was doing business overseas. They applied to foreign circumstances through the “disregarded entity” rules, under which an entity might have been recognized as a separate corporation in one nation but not in another. Corporations can now structure their transactions to take advantage of these rules to avoid Subpart F, under which the income would otherwise be taxable. As stated above, Subpart F is designed to deny the deferral of income structured to deprive the United States of revenue. Check-the-box and hybrid instruments allow a CFC to simply elect to be disregarded for U.S. federal income tax purposes while taking advantage of opposite entity treatment in foreign jurisdictions. Other hybrid instruments avoid U.S. taxes by electing debt treatment in one jurisdiction and equity treatment in another. Such elections blatantly conflict with Subpart F’s intentions.

In addition to maximizing deferral by avoiding Subpart F through the above activities, taxpayers may also take advantage of the highly prescriptive rules to structure their entities to avoid the CFC rules entirely.

B. The Prescriptive Rules are Complex and Outdated

The rules are outdated, highly prescriptive, and overly complex. The international provisions have not been seriously overhauled since Subpart F was enacted in 1962. The general corporate system has not been revisited since 1986.

161. See id.
162. Id. at 634-35.
163. GRAVELLE, supra note 113, at 10-11.
164. Id.
165. Miller, supra note 4, at 10-11.
166. I.R.C. §§ 951-65; CFCs STUDY, supra note 95, at xi-xv, 22.
168. Miller, supra note 4, at 11-12.
169. See GRAVELLE, supra note 113, at 7 (noting artificial profit shifting).
170. Miller, supra note 4, at 13. Taxpayers would also need to avoid the Passive Foreign Investment Company Rules, similarly enacted to deny deferral. Id.
171. Desai & Hines, supra note 1, at 937; Holmes, supra note 1, at 3.
172. Holmes, supra note 1, passim.
173. Id. at 10-15; JEC, supra note 3, passim.
174. Holmes, supra note 1, at 3.
175. Id.
As the business environment evolves and international business increases, taxpayer behaviors adapt.\textsuperscript{176} In reacting to taxpayers, legislators have added a staggering array of piecemeal changes to the rules on top of the old framework\textsuperscript{177} without modifying the underlying architecture or synthesizing the regime.\textsuperscript{178} The American Bar Association recognizes the “accretion of tax rules without periodic thorough reviews of the needs of the system”\textsuperscript{179} as a key reason for the system’s resulting complexity.\textsuperscript{179} The rules contain inconsistencies, work at cross-purposes, lack coherence, and make it difficult for the United States to achieve any ultimate policy goal.\textsuperscript{180}

Additions to the rules tend to be prescriptive, literally identifying behaviors, and qualifying and quantifying their results, but failing to “govern by principle”.\textsuperscript{181} Prescriptive rules issue precise instructions for specific factual situations without indicating why those instructions are required.\textsuperscript{182} Principles-based rules, on the other hand, expressly state the principles underlying the rules.\textsuperscript{183} For example, prescriptive rules issued in my home may state that removing items from the refrigerator or using dishes after 9:00 p.m. is disallowed. An individual in my home would be unable to discern the principle underlying these rules, which is that once mom has cleaned up and done the dishes for the evening, she does not want any messes in the kitchen. This example’s prescriptions leave no room for mom or others to respond reasonably to the underlying principle in adhering to or enforcing the rule. What if mom works late and cannot get into the kitchen to make dinner until after 9:00 p.m.? What if others in the household are willing and able to clean up after themselves in the evening? Stating on the face of the rules the principles sought to be applied can enable those whose activity is being regulated to respond appropriately in a variety of situations.\textsuperscript{184} Clarity can also engender greater respect for the rules themselves.\textsuperscript{185} Further, it allows regulators to enforce the rules consistently with their underlying principles even in unpredictable circumstances.\textsuperscript{186}

For established and habitual fact patterns, however, prescriptive rules may be ideal for bringing about consistently reasonable results.\textsuperscript{187} In regulating driving speeds, a prescriptive rule would simply provide a precise speed limit.\textsuperscript{188} A principles-based rule might state that driving speeds must be safe within existing traffic and weather conditions.\textsuperscript{189}

\begin{thebibliography}{100}
\bibitem{176} See Benshalom, \textit{supra} note 4, at 633-40 (describing taxpayer behaviors and the eroding link between fiscal jurisdiction and residency); Desai & Hines, \textit{supra} note 1, at 938 (describing today’s evolving markets and global economies); Holmes, \textit{supra} note 1, at 1, 3 (describing “highly elastic” multinational corporations).
\bibitem{177} Holmes, \textit{supra} note 1, at 8-11.
\bibitem{178} See id. at 11.
\bibitem{180} Holmes, \textit{supra} note 1, at 12 (citing Robert J. Peroni et al., \textit{Reform and Simplification of the U.S. Foreign Tax Credit Rules}, 31 \textit{TAX NOTES INT’L} 1177, 1181 (2003)).
\bibitem{181} Holmes, \textit{supra} note 1, at 6-7, 48-49, 48 n.161 (citing Kevin Dolan, \textit{Foreign Tax Credit Generator Regs: The Purple People Eater Returns}, 47 \textit{TAX NOTES INT’L} 251, 256 (2007)).
\bibitem{182} Holmes, \textit{supra} note 1, at 6.
\bibitem{183} Id.
\bibitem{184} Id. at 21-23.
\bibitem{185} See id. at 21.
\bibitem{186} Id. at 1-11, 21-53.
\bibitem{187} Id. at 21-22.
\bibitem{188} Id. at 22.
\bibitem{189} Id.
\end{thebibliography}
case, drivers would be left to determine for themselves which speeds were safe in what conditions.  

In corporate tax law, prescriptive rules are perfect for governing ordinary repeated activities. But the more sophisticated the transactions being regulated, the more dynamic must be the rules regulating them. Principles-based rules are dynamic. Prescriptive rules are not. They cannot reach evolving taxpayer behaviors or unknown situations. The more complex the behaviors being addressed, the more extensive, convoluted, and inadequate are the prescriptions that attempt to regulate them.

In resorting to prescriptive rules, the government fails to state its underlying intentions and the rules obscure congressional meaning. For example, to relieve taxpayers of dual-nation taxation, IRC § 901 and its associated regulations allow U.S. tax credit for foreign taxes paid or deemed paid when the foreign payment is “compulsory.” But the rules can be abused. Recognizing this, the regulations enunciate criteria describing abusive “structured passive investment arrangements” that constitute “noncompulsory” payments not eligible for U.S. tax credit. As is common in the rules, the regulations fail to state any underlying principle relative to disallowing excess foreign credits. They strictly apply if six requirements are met. In response to the prescriptive provisions, business entities are able to engage in transactions substantially identical to those proscribed without triggering the regulations, and transactions not designed to avoid U.S. tax, but that do meet the six criteria, are captured by and disallowed under the regulations.

In contrast, the passive-activity loss rules underwent just such a change when an exhaustively prescriptive version of these standards was re-written as simpler and more principles-based. The principles-based iteration of the rules more easily addresses varying taxpayer behaviors. IRC § 469 and its accompanying regulations outline the U.S. tax rules for income related to passive trade or business activities. In an effort to eliminate abusive passive activity loss transactions, the Internal Revenue Service (IRS) initially prescribed sixty pages of activities “tests” designed to cover every transactional scenario in

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190. Id.
191. See id. at 26-27, 36-37, 40, 53 (describing the benefits of prescriptive rules in the Code).
192. Id. at 21-53.
193. Id. at 21-23.
194. Id.
195. See id. at 21-53 (describing principles-based versus prescriptive rules).
196. Id. passim.
197. Id. at 48-49.
198. Id. at 47.
199. Id. at 46-49.
200. Id. at 48.
201. Id. at 46-49.
202. Id.
203. Id.
204. Id.
205. Id. at 24-25.
206. Id.
207. Id.
which a taxpayer could participate.\textsuperscript{208} The regulations were highly criticized as too long and complex,\textsuperscript{209} and were allowed to expire.\textsuperscript{210} In their place, the IRS put forth eight pages of more principles-based regulations applicable to both known and unknown situations.\textsuperscript{211} Though simpler, these regulations are more dynamic and have been increasingly successful at halting taxpayer abuse.\textsuperscript{212}

The U.S. corporate tax system under-utilizes principles-based standards.\textsuperscript{213} It is "dominated by a complex array of bright-line prescriptive rules."\textsuperscript{214} As our tax system has grown, its prescriptive nature has not.\textsuperscript{215} The attempts of the Code and its related regulations to address ever evolving international taxpayer behaviors and other sophisticated transactional dynamics with narrow static prescriptions result in a code that has grown from "complex to [ ] super-complex . . . ."\textsuperscript{216}

The U.S. rules span nearly 100,000 pages of the Code and regulations.\textsuperscript{217} They require over 1,000 different taxpayer forms.\textsuperscript{218} They attempt to limit abuses by proscribing specific transactions "without stating why [those] transaction[s] [are] bad,"\textsuperscript{219} They assign outcomes \textit{ex ante} to anticipated factual situations.\textsuperscript{220} They fail to embrace elastic commercial exchanges.\textsuperscript{221} Their static attempts to address real world activity are always one or more steps behind taxpayers.\textsuperscript{222} Without real-time business relevance or harmony within a unified system, the rules reflect a stale, unnecessarily complex, and "schizophrenic"\textsuperscript{223} regime that must nonetheless be followed by all who seek to do business within the United States.\textsuperscript{224}

The rules are also challenging and costly to administer and to enforce.\textsuperscript{225} "[I]t can be difficult, or nearly impossible, for the IRS to fully unravel the transactional web that is woven in order to accurately decipher the true economics and intentions of the taxpayer."\textsuperscript{226} The rules have become too complex "for the government to audit effectively."\textsuperscript{227}

\textsuperscript{208} Id.  
\textsuperscript{209} Id.  
\textsuperscript{210} Id.  
\textsuperscript{211} Id.  
\textsuperscript{212} Id.  
\textsuperscript{213} Id. \textit{passim}.  
\textsuperscript{214} Id. at 6-7.  
\textsuperscript{215} See id. \textit{passim} (describing the Code).  
\textsuperscript{216} Id. at 11.  
\textsuperscript{217} Id. at 10.  
\textsuperscript{218} Id.  
\textsuperscript{219} Id. at 48 n.161 (citing Dolan, \textit{supra} note 181, at 256).  
\textsuperscript{220} Id. at 6.  
\textsuperscript{221} Id. at 1-11, 21-53.  
\textsuperscript{222} Id. at 11.  
\textsuperscript{223} Id. at 12.  
\textsuperscript{224} See JCT, \textit{supra} note 7, at 20-21 (describing U.S. taxation); Holmes, \textit{mpra} note 1, at 1-15 (discussing the complex regime).  
\textsuperscript{225} Holmes, \textit{supra} note 1, at 13-14.  
\textsuperscript{226} Id. at 14.  
\textsuperscript{227} Id.  

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C. The Rules Fail to Reflect the Global Tax Market

The U.S. corporate income tax rules fail to acknowledge the world tax market. In today’s economy, international considerations are central to corporate planning and taxation. Not only has taxpayer behavior continued to evolve beyond the rules’ prescriptions, but taxes have grown from purely domestic concerns to global commodities. No single nation or pair of nations operating through a treaty can control the tax environment. Technological advances and relaxation of international exchange controls mean that businesses can increasingly elect to organize almost anywhere. As such, tax incentives and rates are subject to global competition. The U.S. system fails to respond to this reality.

As the U.S. corporate income tax rate has remained basically stagnant since the 1980s, most other developed nations have lowered their corporate rates. The U.S. rate is now one of the highest in the world. U.S. taxation has consequently become an enormous value burden for competing U.S. corporations.

Not only does the U.S. rate far exceed the rates of tax-haven nations, but it is out of line with the rates of other developed nations competing in similar commercial industries. Additionally, complexity and datedness within the U.S. system combine with the overall rate burden and other compliance costs to make the U.S. system something of a bear in the world tax market. "[T]here has to be a reason that no other countries are in a hurry to adopt rules anything like the U.S. rules...." They are inefficient, administratively challenging, costly with which to comply, enormously complex, often inequitable, and a ridiculous value drain on both the United States and its taxpayers. No one looks forward to dealing with the U.S. regime. In fact, companies around the world would prefer to avoid the U.S. rules altogether. U.S. MNEs continue to benefit from U.S. advancements and buyer and marketplace sophistication, but are pulled to organize foreign entities offshore to maximize value. The United States cannot deny the reality of

228. See Desai & Hines, supra note 1, at 937 (describing the new global reality of taxation); Shaviro, supra note 4, at 377-80 (discussing the ability of global entities to elect domestic or foreign incorporation on the basis of tax considerations).

229. See Avi-Yonah, supra note 6, at 1575-86 (describing global tax competition).

230. See id. at 1575 (discussing “international tax competition” and the “increased mobility of capital”); see also Shaviro, supra note 4, passim (writing on “The Rising Tax-Electivity of U.S. Corporate Residence”).

231. See Avi-Yonah, supra note 6, at 1576 (noting investors’ abilities to invest in any of the world’s major economies).

232. See Carroll, supra note 12, at 5 (comparing international corporate income tax rates over time).

233. Id.

234. See Carroll, supra note 3, at 1-4 (discussing the competitive burden that U.S. taxation places on U.S. entities).

235. See Carroll, supra note 12, at 5 (charting international income tax rates).

236. See JEC, supra note 3, at 1-4 (discussing the burden posed by the U.S. system).

237. Holmes, supra note 1, at 12 (citing James Hines, Remarks at Secretary Henry M. Paulson’s Conference on U.S. Business Tax Competitiveness (July 26, 2007)).

238. See Holmes, supra note 1, at 9-15 (describing complexity and other pitfalls within the U.S. corporate income tax system).

239. See, e.g., id. (discussing domestic and international hesitancy to deal with the U.S. tax system); JCT, supra note 7, passim (describing the effects of waning international willingness to succumb to U.S. taxation).

240. See, e.g., Holmes, supra note 1, at 9-15; JCT, supra note 7.

241. See Shaviro, supra note 4, at 377-80 (discussing rising corporate electivity and the draw of foreign over U.S. incorporation).
D. THE REGIME FAILS TO SUSTAIN THE CAPITAL TAX BASE

There is a further problem with the state of the Code in its relation to international business. It fails to sustain the U.S. capital tax base.\textsuperscript{243} Capital is more mobile than labor, especially now that capital assets are often not physical, but are financials or intangibles that can cross borders electronically.\textsuperscript{244} As capital moves offshore, MNEs are able to derive most of their income abroad, free of U.S. taxation.\textsuperscript{241}

Because much of what would arguably constitute U.S. capital (if there were no deferral) escapes the U.S. income tax, the tax increasingly becomes a tax on those left behind in the United States to carry the burden.\textsuperscript{246} This largely means that the U.S. labor force is left to fulfill the nation’s tax demands.\textsuperscript{247} The distributional bases underlying the income tax have become skewed by this reality.\textsuperscript{248} Rather than taxing capital where it accumulates, the government is left to draw primarily upon the income of those who remain behind in State.\textsuperscript{249}

This is fundamentally at odds with trickle-down economics. Free market capitalism presumes that as capital accumulates at the top of the market pyramid, the benefit of those assets will flow downward to serve the general welfare.\textsuperscript{250} In this case, however, some of the largest accumulations of capital assets have flown the home State to avoid tax contributions.\textsuperscript{251} Thus, the capital tax base erodes, and labor must support the nation.\textsuperscript{252} Moreover, this overseas capital continues to benefit from home-State association through non-tax advantages, including the rule of law and government supports made possible by labor force taxation.\textsuperscript{253}

No capitalist who believes in free-market capitalism could legitimately invite this backward paradigm. Thus, as the old rules are carried forward and applied in today’s business context, they allow an economic result that is fundamentally at odds with the model they purport. Addressing the rules in their capacity to create an economic model of wealth distribution that reflects today’s realities becomes more important than ever.

\textsuperscript{242} See Avi-Yonah, supra note 6, at 1575-86 (describing the dangers of global tax competition).
\textsuperscript{243} See \textit{id. pasim} (describing causes of, and issues related to, capital tax base erosion).
\textsuperscript{244} \textit{Id.} at 1575.
\textsuperscript{245} \textit{Id.} at 1577; see Annalyn Censky, GE: 7,000 Tax Returns, $0 U.S. Tax Bill, CNN MONEY, (Apr. 16, 2010), http://money.cnn.com/2010/04/16/news/companies/ge_7000_tax_returns (providing data on GE’s earnings and taxes paid on and offshore). GE earned $10.8 billion in foreign profits, but calculated losses in the United States. \textit{Id.} The company paid nothing to the U.S. federal government, instead receiving $1.1 billion back from the United States as a result of its reported deductions and adjustments. \textit{Id.}
\textsuperscript{246} Avi-Yonah, supra note 6, at 1577.
\textsuperscript{247} \textit{Id.}
\textsuperscript{248} Shaviro, supra note 4, at 402.
\textsuperscript{249} Avi-Yonah, supra note 6, at 1577.
\textsuperscript{251} Avi-Yonah, supra note 6, at 1577.
\textsuperscript{252} \textit{Id.} at 1575-86.
\textsuperscript{253} \textit{Id.} at 1575-77.
E. THE RULES ENCOURAGE DEBT OVER EQUITY

The corporate tax rules encourage debt over equity by taxing equity while allowing deductions on debt.254 As a result, U.S. entities have issued substantial amounts of debt to maximize accounting value.255 If Niall Ferguson is right, excessive debt is the key to this economic crisis, and no amount of demand or added liquidity can correct it.256 There is "no amount of money that can be created to restore the lost imaginary paper wealth."257

In a debt overhang, as Ferguson describes, there is a point at which as a result of inordinate debt the imaginary paper wealth just spins out of control.258 We can no longer keep track of or maintain the ledgers, and the only answer is to write down, or forgive, the debt.259 If this is so, we must take the corporate tax system's built-in debt preference seriously.

We must address the reality that we distort corporate investment financing decisions.260 According to the Congressional Research Service, the current favorable treatment of debt over equity makes the effective tax rate on debt 20 percent compared to a 48 percent effective rate on equity.261 In this way, the U.S. corporate tax contributes to instability in economic downturns and must be corrected.262

F. THE U.S. CORPORATE INCOME TAX RATE IS TOO HIGH INTERNATIONALLY

The overall corporate tax rate in the United States is much too high.263 As described above, the current rate burdens the U.S. economy. Tax rates and tax systems are subject to global competition, including competition from tax haven nations.264 Rates around the world provide greater national investment returns than does the U.S. rate,265 drawing U.S. and global business away from the United States and causing concern for the U.S. future.266

254. INTEGRATION, supra note 9, at 39.
255. Id. at vii-viii.
258. Ferguson, supra note 256.
259. Sullivan & Sheppard, Repatriation Aid, supra note 257, at 276; Ferguson, supra note 256. In contrast, the Federal Reserve has approached the crisis with a monetaristic view by attempting to inject liquidity into the system, while the Treasury Department has attempted to increase demand.
260. INTEGRATION, supra note 9, at vii.
261. Id. at 6.
262. Id. at vii.
263. Shaviro, supra note 4, at 377-78; Carroll, supra note 12, passim; Holmes supra note 1, at 15-17.
264. See JCT, supra note 7, passim (discussing international tax competition and concerns regarding the U.S. position); OECD REPORT, supra note 14, passim (describing the effects of harmful tax competition).
265. See Carroll, supra note 12, at 5 (highlighting international income tax rates).
266. See JCT, supra note 7, at 2-19.
The top U.S. corporate income tax rate is 35%. The combined federal-state rate is 39.2%. Among OECD countries, only Japan has a higher combined rate. Theirs is 0.3% higher than ours, at 39.5%. The U.S. combined rate runs from five to twenty percentage points higher than all other OECD country combined rates, apart from Ireland (Ireland, considered a tax haven nation, has the lowest OECD country combined rate at 12.5%).

In the 1980s, the United States’ overall corporate tax rate was relatively low internationally. Since then, corporate tax rates for OECD nations other than the United States have fallen, while the U.S. rate has remained largely unchanged. In 1988, the U.S. rate was 11.89 points below the average G-7 country rate. In 1993, it was 5.36 points below the G-7 average. In 2009, it was 5.44 points higher than the G-7 average. Today it is one of the highest. Further, the U.S. rate must remain “uncompetitively high” under today’s rules to accommodate the (at least) forty percent of earnings that U.S. corporations are likely to hold out of reach in offshore deferral. A rate correction alone cannot repair the regime’s failings, but is absolutely necessary and must be instituted within a system-wide overhaul.


Section 965 was enacted as part of the American Jobs Creation Act of 2004 (the Act). It enabled the U.S. parent shareholder of a CFC to repatriate income to the United States at sharply reduced tax rates. The United States wanted the influx of capital and revenue to spur job growth, and regulated the repatriations accordingly. Companies returning funds under the law were required to do so according to “domestic reinvestment plans” (DRIPs) which allowed the funds to be used only for ap-
proved reinvestment purposes. But DRIPs were unenforceable. Because money is fungible, MNEs were able to shuffle earnings around, technically complying with the letter of the law regarding their DRIPs, but actually using repatriated funds for prohibited uses such as share repurchases. Many actually laid off employees rather than create jobs.

By way of dividends received from their CFCs, U.S. parent corporations were allowed to return to the United States earnings they would otherwise have indefinitely retained offshore. These dividends were allowed an 85 percent income tax rate deduction. In effect, U.S. parents were able to repatriate dividend earnings from CFCs at an income tax rate of 5.25 percent.

Our tax rate generally serves as a disincentive for U.S. MNEs to repatriate dividends. Yet in 2005 when § 965 became effective, there proved sufficient non-tax incentives for U.S. MNEs to repatriate at the lowered rate. The reduced tax generated $362 billion in income. $315 billion qualified for the deduction, resulting in $16.5 billion in U.S. tax revenue.

Eight-hundred-thirty-two multinationals chose to repatriate under the Act. Of those, a group of forty of the largest U.S. MNEs generated 44 percent of the total repatriated earnings, or about $184.8 billion. Total earnings and profits for all CFCs in 2005 were $804 billion. To put this in perspective, the entire corporate tax generates only about $370 billion in annual revenue. Foreign-source deferred earnings thus represent a relatively enormous well of untapped potential U.S. capital. Even the portion of revenue voluntarily repatriated at the reduced rate under the current regime represents an approximate additional 4.5% of the total corporate income tax.

286. Boise, supra note 4, at 692.
288. Id. § 965(b)(4)(B).
289. Id. These purposes included "the funding of worker hiring and training, infrastructure, research and development, capital investments, or the financial stabilization of the corporation for the purposes of job retention or creation." Id. Section 965 specifically excluded using the funds as payment for executive compensation. Id.
291. Id.
292. Id.
293. Boise, supra note 4, at 690-91.
295. Boise, supra note 4, at 690.
297. Shaviro, supra note 4, at 379 (presenting the notion of tax versus non-tax reasons to incorporate within or without the United States).
298. See Sullivan & Sheppard, Repatriation Aid, supra note 257, at 278 (outlining the repatriation that occurred because of § 965).
299. Id.
300. Id.
302. Id. at 377.
303. Sullivan & Sheppard, Repatriation Aid, supra note 257, at 278.
304. Durst, supra note 4, at 315.
305. 4.46 percent of 370,000,000,000 = 16,502,000,000.
The deduction represented a one-time repatriation tax "holiday." It applied only to certain earnings over a specified base period. Total amounts that could be deducted were limited to "the greater of (1) $500 million, and (2) the amount of earnings shown on the U.S. shareholder's 'applicable financial statement' as 'permanently reinvested outside the [United States]." Section 965's success was in shining a light on the enormous untaxed capital wealth held offshore by U.S. CFCs. It made clear that some of the United States' most profitable companies are its MNEs, and that if handled properly, cross-border business incomes can account for a large portion of U.S. income tax revenue. This same income could additionally benefit the U.S. capital market.

Importantly, § 965 also demonstrated that a lowered tax rate could swing the balance in terms of tax and non-tax incentives to repatriate foreign earnings to the United States. In other words, though the U.S. corporate tax system and the high overall rate force U.S. MNEs to move and hold earnings abroad, U.S. parent companies would like to repatriate their CFCs' foreign earnings. There is a tax rate at which the disincentive to repatriate dissipates, and after tracking the repatriations spurred by § 965, we see that this rate can be higher than zero. This means that the United States still has plenty to offer in terms of a viable business environment, and can compete with tax havens on its own terms without instituting a territorial system or completely exempting foreign earnings from income tax.

With a healthy Code and related regulations, the U.S. economy can benefit from, and earn revenue on, repatriated foreign-source earnings while still supporting MNE competitiveness. To constructively address U.S. foreign-source income, the United States should end deferral and re-work its international provisions, its income tax rate, and the corporate tax system as a whole.

IV. Recommendations

Although the results of § 965's deferral experiment were enlightening, the rate holiday should not be repeated. Repetition would only enforce deferrals and encourage offshore earnings accumulations. Additionally, the United States should not address the issues highlighted by § 965 and current business practice by instituting piecemeal corrections for isolated problems. The Code is outdated, overly complex, largely irrele-

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306. See Dhammika Dharmapala, C. Fritz Foley & Kristin J. Forbes, Watch What I Do, Not What I Say: The Unintended Consequences of the Homeland Investment Act, at 1 (2010) (describing Section 965 as a tax holiday); Boise, supra note 4, at 692 (explaining that Congress intended the provision to be a "one-time affair").

307. Boise, supra note 4, at 690.

308. Id. at 691.

309. See Avi-Yonah, supra note 6, at 1585-86 (discussing cross-border capital flows and their relationship to income taxation).


311. See Sheppard & Sullivan, Multinationals Accumulate, supra note 301, passim (explaining that multinationals are encouraged to accumulate income offshore in expectation of repeated repatriation holidays). As a result of this expectation, by the end of 2007 a group of forty multinationals had already accumulated $518 billion offshore. Id. These funds were deliberately placed overseas in anticipation of reduced taxation. Id. Meanwhile, these placements deprive the United States of capital income and tax revenue. Id.

312. See Holmes, supra note 1, at 5-7 (discussing the detriments of such an approach in the current system).

313. Desai & Hines, supra note 1, passim.

314. JEC, supra note 3.
vant to current scenarios, and ineffective as a whole. It must be addressed and reconstructed from its foundational concepts to its rates and rules.

A. CREATE NEW ENTITY DEFINITIONS AND SOURCE RULES

With global business, mobile intangible assets, and horizontally integrated MNEs, value is generated by multiple entities in various jurisdictions. The IRC entity and source provisions fail to reflect this. I therefore recommend that the United States create new entity definitions and source rules to reach mobile, multi-jurisdictional, and seemingly jurisdiction-less international income and to close the gaps that allow deferral.

Under the IRC, a U.S. corporation is simply one that incorporates in the United States, while a foreign corporation does not. These rules are anchored by immobile business notions that no longer apply. Now that the U.S. owners of an MNE can benefit from U.S. laws and technology while sitting at a U.S. computer organizing foreign entities and exercising asset and management transfers to CFCs, these definitions fall short. Similarly irrelevant are the U.S. transaction and sourcing rules, which allow potential U.S. related income to escape the Code and its related regulations.

I do not advocate control and management-centered entity definitions. Because U.S. MNEs' resources are so vast, it would be too easy for an MNE to simply work around such static rules by transferring control and management offshore. I do recommend that the definitions of U.S. and foreign corporations, and the sourcing rules, take into account the dynamic nature of MNEs and their income. Their value-generating operations are integrated and essentially borderless. MNEs and their transactions should be recognized in a way that reflects this modern and evolving reality. The United States should re-define U.S. entities and source rules to capture all U.S. related value, including foreign and border-defying income.

315. Desai & Hines, supra note 1, passim.
316. Durst, supra note 4, at 314.
317. Benshalom, supra note 4, at 638-45.
318. See I.R.C. § 7701(a)(4)-(a)(5) (defining a foreign corporation as one that is not "created or organized in the United States or under the law of the United States or of any State . . . ").
319. Id.
320. See Benshalom, supra note 4, at 638-40 (explaining that today's cross-border businesses exploit traditional notions of legal ownership and fiscal tax jurisdiction); Holmes, supra note 1, at 17 (stating that "sophisticated MNCs have become more elastic" and unrestricted by geographic location, and that they are able to easily move resources and profits from burdensome to optimal jurisdictions); Miller, supra note 4, at 5 (stating that while non-Subpart F income entitled to deferral "was intended to represent immobile income . . . U.S. taxpayers are readily able to move non-Subpart F income to low-income jurisdictions and achieve deferral").
321. See Benshalom, supra note 4, at 638-40; Holmes, supra note 1, at 17; Miller, supra note 4, at 5.
322. See Benshalom, supra note 4, passim (writing about the inadequacies of the sourcing rules).
323. See Boise, supra note 4, at 676 (suggesting that the United States may alter the definition of a foreign corporation to reflect the corporation's place of management and control).
324. See Benshalom, supra note 4, at 645-648 (describing MNEs vast resources and abilities to re-distribute risks and benefits across multiple entities in various jurisdictions).
325. Id.
B. **Strengthen the Worldwide Income Tax System**

A worldwide income tax system is appropriate for embracing the reality of evolving global transactions. I recommend that the United States strengthen its worldwide system to embrace current and future business. MNEs are some of the largest earners in the U.S. tax structure. They require an income tax context that moves around and over borders with them, their transactions, and their income.

A territorial system that inherently ends at U.S. national boundaries is inadequate to encompass cross-border transactions. A territorial system is unsuitable for relating taxation to future global enterprise. Business entities are free to roam. Lest the United States find itself without strong capital resources, it must find ways to tax capital income that benefits from the home jurisdiction while, under current rules, calculating income outside of it.

Only a worldwide system provides a reasonable context for global exchanges and mobile capital assets, as well as for horizontally integrated entities whose value generations make minced meat of historical land-based legal partitions. Because cross-border transactions are only increasing, international concepts and a worldwide platform must carry the U.S. corporate income tax.

C. **Add Principles-Based Standards**

One of the most detrimental aspects of the rules is that they are largely prescriptive, outlining precise behaviors, cataloguing outcomes, and encouraging abusive avoidance. I recommend utilizing principles-based rules, per Rachelle Holmes, for simplification and dynamism. Principles-based rules would explicitly state on the face of the rules their underlying principles. In contrast, prescriptive rules prescribe outcomes for narrowly anticipated factual situations without necessarily communicating the principles being applied. To an extent, this is necessary in a tax code. But the prescriptive nature of the rules allows taxpayers to continually restructure and reclassify activities to remain steps ahead of the Code. In fact, companies are often years ahead of the IRS in structuring...
transactions. By the time the Code catches up to business trends, corporations have moved on, and even new provisions lack real-time relevance.

The U.S. corporate tax system is riddled with complex prescriptions. "Not only is the sheer volume of these rules staggering, but they often lack coherence, are both over- and under-inclusive, and fail to adequately adjust to evolving financial transactions." U.S. taxpayers spend hundreds of billions of dollars each year to comply with the rules and to exploit their prescriptive weaknesses. Prescriptive rules added to the Code to address violations after they are discovered are inadequate to control future tax avoidance.

Principles-based rules would express standards that convey the policies driving the rules. This would simplify the rules while also making them relevant to numerous situations. Principles-based rules would be highly appropriate to supplement, and often to replace, prescriptive rules in U.S. corporate tax law. They should be utilized in a revamped code.

Prescriptive rules should continue to govern commonplace transactions. They can provide certain tax costs wherever the provisions adequately address unchanging or relatively standard activities, especially where longstanding rules and regulations clearly work well. Where taxpayer behaviors or the business environment are evolving, as is the case relative to international transactions, principles-based rules should be used for simplicity and an elastic embrace of wide ranging scenarios.

New rules should expressly state the principles that rule makers seek to apply. In conjunction, limited revenue rulings should provide "targeted guidance" to taxpayers and administrators, while still allowing overarching principles to govern unspecified and unforeseen facts. Using principles-based rules should help to greatly simplify the Code and its related regulations, close loopholes, decrease compliance and enforcement costs, and support a reduction in the overall corporate tax rate.

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339. Id. at 14 (explaining tax administrators' difficulties in unraveling transactions because transactions can "have extraneous pieces that are included solely to befuddle auditors") (quoting David M. Schizer, Enlisting the Tax Bar, 59 TAX L. REV. 331, 335 (2006)); see id. at 25-30 & n.46 (describing the rapid pace of global transactional innovations relative to taxation).

340. See Holmes, supra note 1, passim (discussing the prescriptive rules' relationship to elastic MNE activity).

341. Id. at 7.

342. Id.


344. See Holmes, supra note 1, passim (outlining the drawbacks of prescriptive rules).

345. Id. passim.

346. Id.

347. Id. at 26-27, 36-37, 40, 53.

348. Id. at 26-27.

349. Id.

350. Id. at 27-28.

351. Id. at 6.

352. Id. at 30-31.

353. Id. passim.
D. END DEFERRAL

Deferral is an enormous revenue drain for the United States in today’s international business environment. I recommend that the United States end deferral. As described above, deferral causes a massive well of potential U.S. foreign-source income that sits just out of reach offshore. Once U.S. corporations and transactions are appropriately characterized, the United States should end deferral to capture U.S. foreign-source income for revenue purposes.

E. REDUCE THE TAX RATE

As an important part of these recommendations, I propose a reduced overall corporate tax rate at or below 10 percent. These recommendations would end deferral and significantly broaden the U.S. tax base. Along with clearer and more simplified rules, improved ease within the system, and the resulting reduced compliance costs, these changes should facilitate a reduced overall corporate tax rate. A reduced rate would help to make the United States competitive in the world tax market and a desirable investment and incorporation site.

I do not recommend a zero percent tax rate for foreign-source income. One of my primary considerations in making these recommendations is the United States’ need for revenue. A zero percent rate would not address this need. Further, a zero percent rate would defeat the purpose described in these recommendations of ending deferral and capturing U.S. related international income with new entity definitions and source rules. Why capture revenue if you are not going to tax it? Additionally, as a result of § 965, we see that a zero percent foreign-source income tax rate is not necessary to draw U.S. investment. But it is realistic to note that exempting MNE foreign-source income from U.S. taxation appears to be on the table when it comes to contemplating Code revisions.

It is important to take this alternative seriously. The way things are going, so much U.S. entity income is overseas (a minimum of forty percent and growing), and tax avoidance measures are so pervasive that the effective foreign-source income tax rate is already nearing zero percent. Explicitly exempting active foreign-source income would

354. Miller, supra note 4, at 7; Shaviro, supra note 4, at 380.
355. There is a rate that registers to the taxpayer as reasonable, rather than as an unjust transfer of wealth. The corporate rate should hover just below a rate that the corporation perceives as unreasonable. In part, I call for this 10 percent rate in an attempt to express reasonableness. But it is possible that U.S. companies are actually comfortable with a higher rate. If so, the tax rate should be set there. A reasonable rate should be determined, at least in part, by the ratio of income that U.S. companies are currently willing to invest in U.S. taxes, including planning, avoidance, and compliance costs. With a greatly simplified system, nearly that entire amount should funnel directly into tax payments.
356. See infra notes 363-65 (noting rate reductions facilitated by other systemic corrections).
357. See supra Part III.
358. See JEC, supra note 3, at 11 (discussing exempting foreign source income); Carroll, supra note 12, at 1-5 (considering exempting active foreign source income from U.S. tax).
359. Desai & Hines, supra note 1, at 939.
360. See Drucker, supra note 122 (reporting that “U.S. companies are sitting on at least $1.375 trillion” in foreign subsidiary earnings on which they pay no federal income taxes). Google alone saves roughly $1 billion in U.S. taxes annually by allocating certain profits to a subsidiary in Bermuda, from which it owes no U.S. income tax. Id. This subsidiary collected approximately $6.1 billion in royalties in 2009. Id. As of June 30, 2011, Google held $18.8 billion in cash in its foreign subsidiaries. Id.
only intensify the concerning results that our current system engenders. On the other hand, it may be the case that a tax on foreign income at a rate above zero percent would allow a domestic rate reduction.

In calculating a new rate, I begin by considering reductions ostensibly made possible by these recommendations severally. According to the U.S. Treasury Department, the CBIT integration prototype highlighted below would facilitate a revenue-neutral rate reduction of three percent (without instituting changes that greatly alter the effects of the current international provisions). Ending deferral would likely support at least a 1.5% revenue-neutral rate reduction. Other changes proposed here may further support reductions in the current rate. Additively, these changes should facilitate an overall rate reduction below 30.5 percent, with a lower potential boundary of 23.5%. But the CBIT and deferral-ending reduction calculations were apparently each made by considering particular changes within our current tax regime. It is difficult to assess the quantitative tax rate effect that a wholly re-envisioned tax structure may facilitate.

In addition to the hundreds of billions of dollars that U.S. entities spend annually on tax planning and compliance, the rules themselves currently contain hidden annual compliance costs of at least $260 billion. This should change with simplified rules. Losses and costs associated with U.S. MNE deferral abuses should lessen, be minimized, or be eliminated under these proposed changes. The loss of U.S. capital income that results under the current rules would also likely change as a result of these recommendations. Of course, there will be costs associated with restructuring the system and creating and implementing new rules. I have not begun to calculate those costs here.

Based on MNE sensitivity to the tax environment, it is difficult to predict corporate response to these changes. But it is possible to imagine that simplified rules, minimized compliance costs, and a lowered rate would be welcome. Logic dictates that making the rules easier to work with, and to account for at the bottom line, would benefit MNEs.

361. Integration, supra note 9 at 39.
362. Miller, supra note 4, at 7.
363. See Durst, supra note 4, at 315 (stating that correcting the dysfunctional aspects of the rules would likely allow a rate reduction of seven percentage points); Holmes, supra note 1, at 50 (stating that using principles-based rules within the tax system would likely allow the United States to lower its statutory corporate tax rate). Additionally, new entity definitions and source rules would likely generate increased revenue, which may further allow the United States to reduce the overall rate.
364. The current overall corporate income tax rate is 35%. I.R.C. § 11. A 3% reduction from CBIT changes, Integration, supra note 9, at 39, plus an additional 1.5% from ending deferral, Miller, supra note 4, at 7, would result in a 4.5% reduction (35% - 4.5% = 30.5%). Adding Durst's seven-percentage-point reduction, Durst, supra note 4, at 315, lowers the overall rate to 23.5% (35% - 4.5% - 7% = 23.5%). It is not clear whether Durst's calculations would overlap the others, or if he considered integration. If Durst considered ending deferral, but not integration, we might calculate a rate reduction of ten percentage points (Durst's seven points plus three points for CBIT integration) amounting to an overall rate of 25% (35% - 3% - 7% = 25%).
365. See Integration, supra note 9, at 39-60; Miller, supra note 4, at 7 (each analyzing changes within the overall current regime).
366. See Taxpayer Advocate, supra note 343 (indicating that U.S. taxpayers spend $193 billion annually in planning and compliance).
368. See, e.g., Integration, supra note 9, at viii (including costs associated with shifting certain aspects of the current tax structure). The CBIT purports to pay for itself. Id.
Additionally, improving returns for U.S., as opposed to foreign, incorporation and investment would likely attract business to the United States.

Overall, because of these recommendations, I would like to see the United States capture revenue from a greatly broadened capital tax base, including all U.S. related foreign-source income, to spread the tax burden far and wide. Fundamentally, the overall rate should be low enough, and the rules strong enough, that U.S. taxes are not worth abusing. I would therefore implement a ten percent or lower rate for foreign and domestic income alike, for equity purposes and to reduce the burden on individual entities.369 I recommend this rate to relieve the base while still allowing the United States to draw revenue from across the full income spectrum. U.S. entities should retain greater value while the United States benefits from taxing a much broader income base, including that of the growing international capital asset market.370 As previously described, this is preferable to continuing along our current path.

The non-tax incentives to invest and incorporate in the United States should augment these changes. The new rate should revitalize the United States as an international business and investment hub. This lowered rate should help to restore the United States as a global business leader.

Significantly, under these recommendations, this lowered rate would be instituted not as an isolated or harmful response to global tax competition.371 This system-wide reduction would be a crucial and a healthy aspect of a fully overhauled regime. It would be justified by other structural changes that together support efficiency, transparency, and cooperative international principles.372 These changes would continue to uphold the OECD’s recommendations for “counteracting harmful tax competition.”373

F. INTEGRATE THE CORPORATE AND INDIVIDUAL TAX SYSTEMS AS DESCRIBED BY THE CBIT PROTOTYPE

I recommend integrating the corporate and individual tax systems according to the Comprehensive Business Income Tax (CBIT) prototype put forth by the Treasury Department in its report entitled Integration of the Individual and Corporate Tax Systems: Taxing Business Income Once.374 In conjunction with the other recommendations in this paper, the CBIT would positively serve corporate income tax reconstruction.375

One of the effects of integrating the corporate and individual income tax systems would be elimination of the double taxation of corporations and their shareholders.376 These parties represent separate legal persons that are currently each taxed on the same income.

369. See supra note 355.
370. Id.; see Desai & Hines, supra note 1, at 938-39 (describing “The Rising Importance of Foreign Income”).
371. See OECD REPORT, supra note 14, passim (describing harmful taxation).
372. See id. (outlining measures for counteracting harmful tax competition). Factors including efficiency, transparency, and international cooperation support healthy taxation. Id. at 40-55.
373. Id. passim.
374. INTEGRATION, supra note 9, at 39-60.
375. Id.
376. See INTEGRATION, supra note 9, at 1 (explaining the two levels of income tax currently imposed on corporate equity investments). This is distinguishable from two national governments each taxing the same income. That is a different definition of a double tax.

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as it moves through their accounts. To explain double taxation in every day terms, consider an individual who gets paid at the end of the week. She brings her earnings to the store on the corner where she gives the shop owner her money in exchange for the items she buys. The shop owner puts the money in the register. Later, the shop owner pays her employee with the money from the register. All three parties are taxed on income from the same pile of money moving through their accounts.

In the United States, in conjunction with our decision to assign corporations separate legal person status, we also tax them separately from their shareholders for income tax purposes. We do this even when the individuals behind the corporate and shareholder accounts are the same natural people. We tax the corporation on its income. Then, when the corporation distributes a dividend out of that income to its shareholder, we tax the shareholder on that dividend. Although long held in the United States, the close association of corporations' separate legal status with their separate taxation is arbitrary. We do not have to tax in this way. The CBIT would therefore integrate corporate and shareholder income taxation, taxing that income only once.

In addition to eliminating the double corporate tax, integrating as described by the CBIT would simplify and improve the U.S. income tax system, treat all U.S. entities equally (except the smallest), treat equity and debt equally, and allow for a reduced corporate tax rate. Together, all of these recommendations would help achieve a revamped and robust corporate income tax system.

The CBIT would tax at the entity level so that a single level of tax would be collected on capital income. Neither debt holders nor equity holders would be additionally taxed on this income. Distributions of dividends or interest would not be taxed to shareholders or investors. Losses would similarly not pass through to shareholders. All corporate and non-corporate entities (with the exception of those entities with gross receipts of less than $100,000) would be taxed in this same way.

Treating equity and debt equally within the corporate tax system would go a long way toward removing rule-based distortions from investment financing decisions. It would help to move investment financing further toward equity than it is currently. This would consequently encourage capital structures that are less vulnerable to economic instabilities. Moreover, according to the Treasury Department Report, distortions in the cur-

377. Id. at 39-40.
379. INTEGRATION, supra note 9, at 1.
380. I.R.C. § 11; INTEGRATION, supra note 9, at 1.
381. I.R.C. § 101; INTEGRATION, supra note 9, at 1.
382. See INTEGRATION, supra note 9, passim (providing four examples of ways to integrate individual and entity taxation).
383. Id. at 39-40.
384. Id. at 39-60.
385. Id. at 39-40.
386. Id.
387. Id.
388. Id.
389. Id. at 41-43.
390. Id. at vii.
391. Id.
rent law raise the cost of capital for investment.392 These integration changes could help to reduce capital costs.393

Combining CBIT integration with this paper's other recommendations would help to create a wholly simplified U.S. income tax system that supports a healthy economy. The changes outlined here would contribute strength and dynamism to the U.S. position at home and abroad.

V. Conclusion

The U.S. corporate income tax system and its international provisions are failing.394 International business dealings are growing exponentially.395 MNEs are evolving as integrated economic units that defy jurisdictional-based income concepts.396 Meanwhile, the U.S. corporate tax system's static prescriptive provisions are tied to outdated immobile business ideas and land-based jurisdictional notions.397 Gaps in the rules related to these static concepts allow abusive deferral.398 As a result, billions—or possibly trillions—of dollars in potential U.S. income sits indefinitely offshore in foreign tax jurisdictions.399 All the while, the U.S. tax rate is “uncompetitively high.”400

Taxes have grown from domestic concerns to global commodities,401 but the U.S. rates and rules are comparatively over burdensome.402 Our rules are widely recognized as unwieldy and unworkable.403 Compliance is expensive.404 The tax burden is so heavy that the rules are worth exploiting and avoiding, even at great cost.405 Further, the rules them-
selves do not support a healthy economy. They encourage debt over equity, distort financial investment decisions, and can contribute to increased economic instability.

Migration of U.S. capital offshore is eroding the U.S. capital tax base. Many U.S. entities prefer to incorporate foreign subsidiaries to avoid the U.S. rules altogether. The effects of these rules cost the United States dearly in revenue, capital, and investment, and those costs are far reaching.

Tax lawyers joke that recommending U.S. incorporation verges on malpractice, but their jokes contain hints of reality. The easier it becomes to do business offshore, the more the U.S. system becomes a drag on the U.S. economy. The more U.S. capital moves overseas and stays there, the more deeply the United States must examine its tax structure to improve revenue, ease of business dealings, and U.S. investment.

These recommendations would improve the U.S. income tax system as a whole, from the inside out, restoring the United States to a place of strength and competitiveness in international business and investment. Simplified and clarified rules could reduce compliance costs, and a reduced tax rate across a broader tax base would relieve pressure on MNEs, other U.S. entities, and U.S. labor. These same changes should increase U.S. revenue and capital imports. Increased U.S. capital imports may even strengthen U.S. stock values, helping to improve many American savings accounts.

For these reasons, I recommend a restructured U.S. corporate income tax system that places the international provisions and related concepts at its core. Revamped rules should include the following: (1) new entity definitions and source rules that reflect evolving business realities, broaden the U.S. tax base, and help to close the gaps that allow deferral; (2) a strengthened worldwide income tax system to encompass border-defying transactions and value creation; (3) principles-based standards to simplify and clarify the rules and to allow the rules to remain dynamic and relevant; (4) ending deferral to return U.S. capital and revenue to the United States; (5) lowering the overall tax rate to relieve the base and to improve U.S. investment returns; and (6) integrating the corporate and individual income tax systems as outlined by the CBIT prototype. The CBIT would tax all U.S. entities at the entity level, would treat debt and equity equally, and would improve overall ease of business in the United States. Together, these recommendations would constitute an income tax regime overhaul for a renewed and revitalized U.S. position in global and domestic commerce.

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406. INTEGRATION, supra note 9, at vii (noting that the rules encourage entities to over-leverage themselves); see Avi-Yonah, supra note 6, at 1577 (describing the imbalance and inequity that occur when the capital tax base erodes).
407. INTEGRATION, supra note 9, at vii, 39.
408. JCT, supra note 7, at 69-79.
409. Shaviro, supra note 4, at 378 (describing multinationals wishing to escape the United States for tax purposes); see Miller, supra note 4, passim (outlining the many incentives for incorporating foreign entities).
410. JCT, supra note 7, passim.
411. Shaviro, supra note 4, at 378.
412. See Durst, supra note 4, at 316 (discussing restoring the United States via the income tax).
413. See id.
414. INTEGRATION, supra note 9, at 39-60.