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I. Introduction

U.S. multinational corporations (MNCs) expatriating to minimize income subject to federal income taxation is often harshly criticized. MNCs invert their headquarters to achieve more favorable taxation conditions. Due to the diminished tax revenue base, the U.S. Treasury Department reports that these MNC inversions cost the U.S billions of dollars annually. It is essential to remember corporate executives who decide to undergo corporate inversions are acting as officers of the corporations. Officers of corporations have a duty to shareholders of maximizing profits. Corporate executives are not citizens with their continued employment resting upon public approval of their moral fiber. Instead of blaming MNCs for the negative effects of corporate inversions, the underlying conditions leading to expatriation should be examined. MNCs are not eager to undergo the expenses of unnecessary corporate inversions. U.S. corporate tax policies have seemingly resulted in the current necessity for corporate inversions.

The American Jobs Creation Act of 2004, adding section 7874 to the Internal Revenue Code (section 7874), appears to resolve the issue of corporate inversions in the U.S. However, a closer evaluation of the legislation reveals MNCs responded to section 7874 by pursuing alternative methods of minimizing the amount of foreign-generated revenue that is subject to

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U.S. taxation. Instead of expatriating, MNCs can now leave their corporate structure intact and trap income in foreign subsidiaries by indefinitely deferring the revenue so long as it is reinvested overseas. U.S. MNCs have been able to shift an estimated seventy-five billion dollars abroad to active sectors like Ireland manufacturing. The increased MNC revenue allocation resulting from alternative tax planning geared at avoiding U.S. corporate taxation illustrates how “simply halting inversions would be tantamount to addressing the symptoms without bothering to examine the disease because . . . the fundamental illness is the outdated international tax rules that place certain [MNCs] at a competitive disadvantage in the world market.”

The U.S. Government’s attempt to reverse the corporate inversion trend by enacting legislation eliminating the recognition of corporate inversions for tax purposes has failed because such legislation only addresses the effects of corporate inversions; however, the U.S. Government could effectively reverse the corporate inversion trend by eliminating section 7874 and decreasing the corporate tax rate because decreasing the corporate tax rate eliminates the incentive to expatriate and substantial tax revenue otherwise lost due to expatriating multinational corporations will, in turn, be regained.

The U.S. has maintained its once competitive corporate tax rate while fellow Organization for Economic Cooperation and Development (OECD) countries have collectively lowered their relative rates. Today’s internationally integrated economy has developed beyond the confines of U.S. corporate tax policy. By retaining the once competitive rate of the 1980s

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8 Id. at 472.
while fellow OECD countries collectively lower theirs, the U.S. has incentivized MNCs to engage in aggressive tax scheming in order to minimize effective U.S. tax rates. Changes to the current system must be made in order for the U.S. to remain a leader in the global economy. Retaining a competitive edge in the global corporate market depends upon the ability of the U.S. to adapt to the changing global economy.

The United States applies a worldwide system of taxation. Under a worldwide tax system, MNCs are subject to taxation in their country of residence for all of their income regardless of the source of such income. A territorial tax system, in contrast, exempts resident MNCs from tax liability for most, if not all, of the MNC’s income generated from foreign sources. The proposal to adopt a territorial tax system in place of a worldwide tax system in the United States has been amply discussed. President Barack Obama and the current administration have made it clear that they are unwilling to implement a complete overhaul of the U.S. worldwide tax system in favor of a territorial tax system. Because the argument supporting a territorial tax system in place of the existing worldwide tax system in the U.S. has been adequately addressed in prior studies and rejected by current policymakers, this paper will avoid rehashing the worldwide versus territorial tax system argument.

12 Id. at 16–20.
14 Id. (providing that, except under certain exceptions, MNCs are subject to taxation on all income from whatever source derived).
U.S. MNCs have been forced to find alternative ways to remain globally competitive.\(^{18}\) Foreign MNCs are not subject to the same worldwide corporate taxes as U.S. MNCs. Foreign MNCs in countries with territorial tax schemes, unlike the U.S. worldwide tax scheme, are not subject to taxation on income originating from foreign sources.\(^{19}\) The U.S. lacks authority to tax foreign revenue generated by foreign MNCs, because the U.S. is neither the country of source nor residence. These foreign MNCs potentially hold a financial advantage because less of their revenue is taxable at the relatively high rate of thirty-five percent that all U.S. MNC revenue is subject to.\(^{20}\) Subjecting MNCs to unequal taxation depending on their place of incorporation potentially creates inequality when a U.S. and foreign MNC compete for a new investment in a capital importing country with a corporate tax rate below the applicable thirty-five percent U.S. rate.\(^{21}\) Because the bids offered by the U.S. and foreign MNCs both need to offer the requisite after-tax return to their respective investors, the U.S. MNC bid would presumably be higher to reflect the additional U.S. corporate tax that will apply in addition to the capital importing country’s tax.\(^{22}\) Foreign MNCs located in a country implementing a territorial scheme, or a worldwide scheme with tax rates below those of the capital importing country, will have revenue generated in Ireland subject only to the Irish taxation rate—a rate substantially lower than that of the U.S.\(^{23}\) However, U.S. MNCs under a worldwide taxation scheme with a relatively high

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\(^{22}\) See id.

thirty-five percent tax rate will be subject to Irish taxation as well as U.S. corporate taxation minus any foreign tax credits given for the initial Irish taxation. Therefore, the foreign MNC is at an advantage when the two competing MNCs generate equal profits in Ireland. In order to compensate for this competitive loss, U.S. MNCs are driven to pursue tax planning schemes, like corporate inversions, in order to prevent foreign-generated revenue from being subject to U.S. worldwide corporate taxation.24 Despite this disparity, some tax advisors do not believe MNCs seeking to remain globally competitive is the cause of corporate inversions.25

The U.S. created the exodus of U.S. MNCs undergoing corporate inversions by maintaining a high corporate tax rate.26 Corporate inversions potentially save U.S. MNCs millions of dollars annually by minimizing revenue subject to high U.S. corporate taxes and maximizing revenue subject to lower foreign corporate taxation.27 Maintaining a high corporate tax rate leaves business-minded corporations with a rather straightforward option: stay incorporated in the U.S. and pay more money or expatriate and save millions of dollars.

When the corporate tax base has been eroded, the burden of filling the revenue gap is shifted to alternative sectors.28 The U.S. tax base has been eroded through the elimination of taxable corporate income.29 Despite the loss of billions of annual tax dollars, the U.S. Treasury is still responsible for generating adequate revenue to fund the government budget. The burden of generating tax revenue is shifted to individuals and domestic businesses when MNCs

26 Id. at 561; See also Rachelle Y. Holmes, Deconstructing the Rules of Corporate Tax, 25 AKRON TAX J. 1, 18 (2010).
27 Cooper Industries and Ingersoll-Rand are examples of MNCs anticipated large savings as a result of undergoing corporate inversions. Rachelle Y. Holmes, Deconstructing the Rules of Corporate Tax, 25 AKRON TAX J. 1, 18–19 (2010).
expatriate.\textsuperscript{30} The threat of public perception that the U.S. tax system is operating unfairly by allowing corporations to escape taxation, while requiring individuals to pick up the slack, corrodes the legitimacy of the governmental tax system.\textsuperscript{31} In order to regenerate revenue and maintain legitimacy of the tax system, the U.S. tax base must be restored. Reducing the incidences of U.S. corporate tax avoidance, including MNC inversions, by eliminating the incentive to pursue avoidance restores the U.S. tax base by increasing the corporate revenue base subject to U.S. taxation. In turn, individuals and domestic businesses are relieved from the burden of providing the otherwise lost tax revenue.

Substantially lowering the U.S. corporate tax rate would regain substantial tax revenue that is otherwise lost from expatriated corporations because decreasing the corporate tax rate significantly lowers or eliminates the incentive to expatriate. However, lowering the corporate tax rate poses a risk of losing current tax revenue generated by taxing existing U.S. MNCs because the MNCs’ tax liability will fall to a smaller percentage of their overall revenue. Corporate inversions carry costs including expensive tax planning, possible exit taxes under Internal Revenue Code Section 367, remaining U.S. tax liability for MNC income effectively connected to the U.S., among other obstacles.\textsuperscript{32} If the costs of undergoing corporate inversions remain the same to U.S. MNCs but present little or no long-term financial benefit as they now do, then U.S. MNCs will lack the incentive to undergo the process of expatriation. Tax revenue regained by preventing the expatriation of current U.S. MNCs and expected repatriation of


former U.S. MNCs should more than offset the revenue lost from the decrease in tax rates on U.S. corporations with no intent of expatriating.

Part II of this paper will explain why corporate inversions emerged as a megatrend, the effects of such MNC behavior, and the previous attempts at addressing the issue. Part III will explain why past attempts to curtail corporate inversions are ineffective as well as provide support for lowering the corporate tax rate in order to resolve the underlying problems of U.S. corporate tax policy. Part IV will provide concluding observations.

II. Background

A. Legislative Developments Addressing Corporate Inversions

Internal Revenue Code section 367 was in place prior to section 7874, and its purpose was to serve as a significant deterrent to U.S. MNCs contemplating expatriation by imposing exit taxes on shareholders with stock in the inverted corporation. The section 367 barriers are contemplated when weighing the costs and benefits of a corporate inversion, but they are certainly not “an insurmountable barrier” as lawmakers had hoped for.

Section 7874 applies when a foreign corporation acquires stock or assets of a U.S. MNC through an inversion, sixty percent or more of the foreign corporation’s stock or assets are held by former owners of the U.S. MNC’s stock or assets, and the MNC now controlled by the foreign corporation has no substantial business activities in the foreign corporation’s country of incorporation. Section 7874 was enacted by Congress in 2004 as an attempt to circumvent

34 See Id.
recognition of expatriated MNCs as foreign corporations for tax purposes.\textsuperscript{36} Although section 7874 has arguably halted the corporate inversion megatrend as it was designed to do,\textsuperscript{37} the legislation is merely another addition to the piecemeal legislation dealing with each issue of corporate tax avoidance independently.\textsuperscript{38}

What section 7874 has done is cut off the pressure to the faucet formerly generating a stream of lost U.S. tax revenue through corporate inversions. When an outlet for monetary savings is cut off from MNCs, tax professionals for these MNCs are pushed to pursue inventive bypasses for alternative savings. One such alternative avenue of tax planning has been increasing the amount of foreign-generated income being permanently deferred as active income.\textsuperscript{39} U.S. MNCs remain capable of permanently deferring a bulk of their income generated abroad in hope of a future tax holiday or some alternative means of repatriating these funds without being subject to the current, high U.S. corporate tax rate. Piecemeal legislation has cut off the pressure, but it has done nothing to stop this drip of taxable revenue lost through alternative methods of avoidance, including indefinite deferrals. Instead of patching the current tax system for taxable revenue leaks every time a new form of avoidance becomes prominent, the U.S. should attempt to alleviate the pressure causing the faucet’s leaks. Lowering the U.S. corporate tax rate is just such a long-term solution. By decreasing tax liability on income generated by U.S. MNCs, the pressure to minimize income subject to U.S. taxation is alleviated. In turn, the incentive to undergo tax avoidance schemes like corporate inversions and indefinite


\textsuperscript{37} Id. at 700.


deferrals becomes miniscule and any remaining leaks to the U.S. tax revenue base become isolated and can subsequently be effectively addressed.

Although section 7874 is widely believed to have curtailed corporate inversion tendencies,\textsuperscript{40} MNCs are now able to erode the U.S. tax revenue base through alternative methods including income trapping using indefinite deferrals of active income in foreign countries, repatriation of excessive foreign tax credits and avoidance of taxation on holding companies in low-tax jurisdictions using “check the box” regulations and hybrid entities, continuing to increase debt shares in high-tax jurisdictions to take advantage of applicable interest credits, and related tax planning behavior.\textsuperscript{41} Section 7874 has failed to fully regain the substantial tax revenue lost due to expatriated MNCs because MNCs have responded to the legislation with innovative tax planning schemes. Section 7874 should be eliminated and the corporate tax rate should be decreased because section 7874 only remedies the effects of corporate inversions and does not address the cause of expatriation by eliminating the incentive to avoid U.S. corporate taxation.

B. What are Corporate Inversions?

Corporate inversions are the corporate form of expatriation.\textsuperscript{42} Inversions are more attractive to MNCs engaging in international operations than domestic corporations operating only within the U.S. because revenue generated within the U.S. remains subject to U.S. corporate taxation.


taxation regardless of its point of origin.\textsuperscript{43} Therefore, domestic corporations generating their entire revenue within the U.S. have nothing to gain by undergoing corporate inversions because the revenue will always be subject to U.S. taxation.\textsuperscript{44}

Generally, corporate inversions involve MNCs operating in the U.S. as well as internationally.\textsuperscript{45} The U.S. MNC engaged in international operations begins by creating a foreign corporation incorporated in a country with a favorable corporate tax system, like the Bahamas.\textsuperscript{46} This Bahaman corporation then creates a subsidiary within the U.S.\textsuperscript{47} The Bahaman subsidiary proceeds to merge with the original U.S. corporation responsible for initially creating the Bahaman corporation.\textsuperscript{48} All branches of the original U.S. MNC located in any other countries will be symbolically bought out and merged as subsidiaries to the Bahaman corporation in similar fashion.\textsuperscript{49} When the Bahaman subsidiary merges with the initial domestic corporation, the title of the Bahaman subsidiary is lost to retain an indistinguishable domestic corporation while the Bahaman subsidiary stocks replace the former domestic corporation’s stocks.\textsuperscript{50} After all of these acquisitions are complete there will remain a Bahaman MNC with subsidiaries located internationally.\textsuperscript{51} The structure of the MNC is thus inverted as the newly...

\textsuperscript{44} An exception to this general postulation would be licensing, royalty, or copyright allowances when revenue is generated by products/services provided within the U.S. but is subject to payment/allocation of revenue at the foreign location of the safeguard protections for such products/services. This exception will not be included in an effort to prevent unneeded complexity.
\textsuperscript{46} Id.
\textsuperscript{47} Id. (explaining the general mechanics behind corporate inversions).
\textsuperscript{48} Id. (explaining the general mechanics behind corporate inversions).
\textsuperscript{49} Id.
\textsuperscript{50} Id. (explaining the general mechanics behind corporate inversions).
\textsuperscript{51} Id. at 555–56.
created Bahaman corporation becomes the headquarters and the former U.S. headquarters becomes a subsidiary.\textsuperscript{52}

After MNCs have successfully undergone corporate inversions, the result is an operationally unaltered corporation with revenue generated outside of the U.S. no longer subject to the U.S.’s worldwide taxation scheme.\textsuperscript{53} Income generated in the United Kingdom (UK), for example, would be subject to U.S. taxation minus foreign tax credits representative of the UK corporate tax rate if the MNC were incorporated in the U.S.\textsuperscript{54} Once the MNC is a Bahaman corporation, the U.S. lacks the authority to collect tax revenue on a foreign corporation generating revenue in a foreign country because the U.S. is neither the country of source nor residence.\textsuperscript{55}

\textbf{C. The Causes of Corporate Inversions}

The U.S. corporate tax rate was relatively low in 1986 in comparison to fellow OECD countries.\textsuperscript{56} Multinational corporations could incorporate in the U.S. in 1986 and have access to the enormous U.S. consumer base and well-established corporate protections while remaining subject to a globally competitive corporate tax rate. In the decades that followed, however, the U.S. has maintained this corporate tax rate of around thirty-five percent while other countries have lowered their rates.\textsuperscript{57} Average statutory tax rates in OECD countries declined from forty-

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{52} Id. at 555.
\item \textsuperscript{53} See id. at 555–56.
\item \textsuperscript{54} Id. at 552–53.
\item \textsuperscript{55} Michael J. Graetz, Foundations of International Income Taxation 5 (2003).
\end{itemize}
\end{footnotesize}
three percent in 1979 to twenty-nine percent in 2002. In 2002, Japan was the only OECD country with a higher statutory corporate tax rate than the U.S.

By failing to adjust with the global integration of the world economy, the U.S. has in turn placed its corporate tax rate in danger of becoming unable to compete globally for MNC incorporations. The U.S. has established itself as an enormous consumption market for the past half-century. Market power is established along with this consumption power, giving the U.S. significant influence over the quantities and prices of traded goods. Because MNCs want access to the U.S.’s enormous consumption market, the U.S. is arguably able to charge MNCs higher corporate tax rates than other countries. As the holder of this valuable consumption power, the U.S. has been able to maintain its demand for higher corporate taxation as the cost of access to an exponentially valuable market. The U.S. corporate tax rate has, in essence, raised the cost of market access relative to comparable global access costs by maintaining its high corporate tax while fellow OECD countries have lowered their corporate taxes to rates below that of the U.S. The allure of incorporating in the U.S. may not be as substantial as it once was, but MNCs still want to remain in the U.S. to have access to the corporate protections and enormous market.

U.S. MNCs must find ways to cut costs that are not imposed on their competitors in lower tax jurisdictions in order to remain globally competitive. While the competing MNCs are

61 Id.
62 Id.
63 See Id.
64 Id. at 474.
subject to similar taxation on revenue generated within the U.S., the revenue generated in a foreign country is not taxed equally.\textsuperscript{65} Assume that two competing corporations each earned $100 million on products sold in Australia and $100 million on products sold in the U.S, and the corporate tax rate is thirty percent in Australia.\textsuperscript{66} The foreign MNC in this hypothetical is assumed to be incorporated in a country that applies either a territorial tax system or a worldwide tax system with a minimal tax rate below the thirty-percent Australian rate.\textsuperscript{67} The foreign MNC would be liable for roughly thirty-five million dollars in the U.S. under a thirty-five percent corporate tax, but only liable for thirty million dollars in Australia due to the thirty percent corporate tax. The U.S. MNC remains liable for the thirty-five million dollars in U.S. taxes, but the MNC will also be liable for five million dollars to the U.S. on top of the thirty million dollars owed to Australia. The foreign MNC retains five million dollars more than the U.S. MNC based on equal revenue. In order to maintain operations while competing against this hypothetical foreign MNC, the U.S. MNC must find a way to cut costs and maximize profits. The U.S. MNC has an incentive to undergo a corporate inversion in order to eliminate U.S. taxation on foreign-generated profits and place itself on an equal footing with the foreign MNC. By inverting its corporate headquarters to a foreign country with lower tax rates, the MNC is no longer subject to the additional five percent U.S. corporate tax on revenue generated from sales in Australia. The revenue generated in Australia is now subject to thirty million dollars in corporate taxes for both MNCs.

There are tax and economic advisors who consider the argument that U.S. corporate tax laws lead to corporate inversions by MNCs attempting to remain globally competitive to be a

\textsuperscript{65} Rachelle Y. Holmes, Deconstructing the Rules of Corporate Tax, 25 Akron Tax J. 1, 17 (2010).
\textsuperscript{66} The 30% Australian tax rate being applied here is hypothetical and not meant to be regarded as the actual Australian corporate tax rate.
\textsuperscript{67} Again, the 30% Australian rate being applied here is hypothetical and for reference only.
mere myth that has gone on for so long that it presents only an illusion of the truth.68 These individuals criticize the U.S. Treasury for depicting the U.S. tax system as noncompetitive without adequately substantiating the assertion.69 However, if one MNC is subject to a thirty percent tax while another MNC is subject to a thirty-five percent tax, then there logically appears to be a competitive advantage favoring the MNC subject to the lower thirty percent tax. MNCs collectively save billions of dollars by expatriating to a jurisdiction with a tax rate of zero percent or any percentage significantly lower than the thirty-five percent charged by the U.S., so the inverted MNCs are finishing with profits similar to those of foreign MNCs never subject to U.S. corporate taxation. Cooper Industries and Ingersoll-Rand, for example, anticipated $55 million and $40 million in annual U.S. tax savings respectively in the first year following an inversion and greater savings in the years to follow.70 Millions of dollars in annual savings leads to increased efficiency and a greater competitive advantage in the global economy. Therefore, MNCs are taking it upon themselves to create a competitive market by undergoing corporate inversions in an attempt to become subject to equal taxation policies.

D. The Effects of Corporate Inversions

By respecting the corporate form, the U.S. is no longer able to collect profits generated in foreign countries by inverted MNCs. The money retained by inverted MNCs no longer subject to U.S. taxation on foreign income comes at the expense of the U.S. government. Tax revenue is


being lost to countries with conditions more favorable for MNCs. Policymakers charged with controlling the U.S. tax system are recognizing the need to adapt in order to prevent further erosion of the U.S. tax base.

A new financial stream must fill the void when revenue subject to taxation is removed from the pool of collectible funds. The burden to satisfy the U.S. Treasury’s financial needs shifts from MNCs to domestic corporations and individuals as taxable MNC income decreases. Governmental financial needs remain unhindered when MNCs elect to expatriate. Workers at the U.S. factories of the former U.S.-incorporated MNC remain employed. These workers may need government funding for building and maintaining roads to get to and from work, educational funding for their children, or similar programming included in the government’s budget. MNCs deciding to invert may be an exercise of their right to engage freely in prudent business decision-making, but individuals and domestic corporations are the parties left to satisfy the tax burden left by the former U.S.-incorporated MNC.

Constituent displeasure with higher individual taxes leads to more pressure upon elected members of Congress to address the issue of corporate inversions. Americans rarely pay taxes with enthusiasm. Decisions to shift the burden of taxation left by inverted MNCs to individuals will increase the amount of taxes citizens are already obligated to pay. The elected officials responsible for raising individual taxes should hear of any displeasure with this decision at the ballot-box based on the U.S. election system. Congressional members wishing to remain in

71 Id. at 3.
72 Id. at 4.
73 Id. at FN 15.
74 Corporate Inversion: Hearing on S. 2119 Before the Senate Subcomm. on Treasury and General Government of the Comm. on Appropriations, 107th Cong. 35 (Oct. 16, 2002).
office and voice the concerns of constituents will be motivated to eliminate the erosion to the
U.S. tax base caused by corporate inversions to the best of their ability. Congress can lower
individual taxation obligations of constituents by reducing corporate inversions and generating a
larger revenue base.\textsuperscript{77}

Members of Congress cannot avoid addressing the issue of corporate inversions by
shifting the full burden of filling the void left by expatriated MNCs solely onto domestic
corporations instead of individuals. Domestic corporations both help fund the campaigns which
contribute to Congressional employment and employ constituents responsible for electing the
members of Congress. Requiring domestic corporations to entirely fill the void left by
expatriating MNCs would subject the U.S. domestic industry to billions of dollars in additional
taxes as a whole. Under potential additional economic burdens imposed by shifting the entire tax
burden left by expatriated MNCs onto domestic corporations, domestic corporations would be
less able to employ individuals at current wages, and the desirability to shift operations to a more
favorable jurisdiction altogether increases. The pitfalls of this policy decision pose the same
issues as shifting the burden to individuals. Congressional members strive to maintain satisfied
constituents and domestic corporations. In order to maintain satisfaction, and in turn support,
members of Congress in charge of policymaking must address the issue of corporate inversions
by U.S. MNCs and implement a solution to heal the eroding U.S. tax base.

III. Analysis

A. Alternative Approaches to Addressing the Corporate Inversion Megatrend

If there were a corporate tax policy in place capable of halting the erosion of the U.S. tax base while regaining already lost revenue, then corporate inversions would not be an issue. Section 7874, however, has only halted corporate inversions while continuing to allow erosion to the U.S. tax base. Out of the many potential alternatives to the current tax regime, there are three prevailing approaches worth considering: ban corporate inversions outright, create more of a taxable gray area by replacing bright-line prescriptive rules with principle-based rules, or lower the corporate tax rate. Each alternative is considered here. Any system developed to effectively tax MNCs will be the result of a compromise between worldwide capital allocation, protecting competitiveness of U.S. MNCs, and government revenue maximization.

Congress essentially banned corporate inversions by passing Internal Revenue Code section 7874 under the American Jobs creation Act of 2004. Congress introduced multiple anti-inversion bills in 2002 and 2003, but section 7874 was the first legislation to be passed. Under section 7874, expatriated MNCs are still subject to U.S. corporate tax laws if two requirements are met: (1) at least sixty percent of the MNC’s stock or assets are owned by the same owners as before the inversion and (2) the expatriated MNC does not have substantial business activities in the new country of incorporation.

82 Id. at 701.
83 Id. at 700.
have had a severe chilling effect on inversions of publicly held corporations, but these inversions may stage a comeback.**84**

Experienced tax professionals are more capable of finding loopholes to exploit or circumvent tax provisions when the tax code is more complicated.**85** One such loophole MNCs have been able to take advantage of under the new legislation is indefinitely deferring U.S. taxation on the MNC’s foreign income by trapping the income overseas.**86** Instead of classifying the MNC’s foreign entity as the headquarters, as you would under a corporate inversion, the MNC’s foreign operations are carried out through a foreign-chartered subsidiary corporation.**87** The MNC’s foreign income is not subject to U.S. taxation so long as the foreign subsidiary’s income is reinvested overseas to remain active.**88** If the MNC’s foreign income becomes passive, then it may be subject to U.S. taxation even without being repatriated under the Subpart F provision of the Internal Revenue Code.**89** Therefore, MNCs are able to indefinitely defer U.S. taxation on their foreign income so long as the income stays active.**90**

Creating an outright ban on corporate inversions inadequately addresses MNCs undergoing legitimate restructuring independent from any potential tax savings.**91** Section 7874 does not apply when the MNC has substantial business activities in the MNC’s foreign country

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84 Id.
87 Id.
88 Id.
89 Id.
90 Id.
of incorporation. Section 7874 creates additional complexity to the Internal Revenue Code by requiring a determination of whether MNCs do or do not engage in “substantial business activities” in the foreign corporation’s country of incorporation. MNCs that conduct business activities in multiple countries will likely be unable to prove even ten percent of the MNC’s worldwide business activities occurs in any one country, including the MNC’s foreign country of incorporation. Banning corporate inversions creates an obstacle to MNCs and may have an impact on foreign capital investments in the U.S. economy by creating undesirable tax consequences for new foreign investors. Putting a stop to corporate inversions through section 7874 attacks the effects of expatriation while leaving the underlying cause of the situation unaltered. Legislation, instead, should eliminate the underlying incentives of U.S. tax avoidance. Professor John Tiley, a leading UK tax advisor, has described inversion bans as an ineffective and inappropriate approach. Section 7874’s additional corporate tax law complexity will eventually result in more opportunities for corporate tax professionals to find room to continue restructuring in a way that places MNCs one step ahead of the game. Instead of going after MNCs that have resorted to self-help solutions, the underlying defects in the U.S. corporate tax system should be repaired in order to solve the problem instead of eliminating

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93 See Id. at 710–14.
94 Id. at 711.
95 See generally Roger Douglas, Don Jones & Robin Park, Emerging Issues for Non-U.S. Shareholders in corporate Inversions, 42.5 THE TAX ADVISOR 298 (May 2011) (discussing how section 7874 may increase withholdings and create double taxation on dividends received by foreign investors).
corporate inversions as a “stop-gap ‘Band-Aid’” until the next MNC tax avoidance scheme comes along.\textsuperscript{99}

An alternative approach to the current U.S. corporate tax system is replacing the bright-line prescriptive rules as they now exist with a more malleable principles-based corporate tax regime.\textsuperscript{100} This approach aims to close loopholes in the existing corporate tax laws by reducing the complexity of tax regulations and, in turn, eliminates the ease by which taxpayers can circumvent complicated tax regulations.\textsuperscript{101} Instead of eliminating complexity, a principles-based approach merely shifts the complexity from understanding the corporate tax code itself over to understanding when transactions are in compliance with corporate tax laws.\textsuperscript{102} Principle-based rules also strive to increase the tax system’s ability to respond to an evolving, internationally integrated market by articulating the underlying purpose of a tax regulation rather than providing explicit situations of when a tax regulation shall apply.\textsuperscript{103} These principle-based rules provide guidance in particular situations that may not have been anticipated when the rules were implemented.\textsuperscript{104} Court interpretations of what is meant to be included under the principle-based rules will once again add complexity to the corporate tax rules.\textsuperscript{105} Principle-based rules also lack the certainty of application associated with prescriptive rules.\textsuperscript{106} The government benefits from this creation of “desirable uncertainty” because it allows the court to condemn taxpayer transactions after the fact despite the taxpayer lacking guidance explaining the inability to

\textsuperscript{101} \textit{id.} at 14, 24–26.
\textsuperscript{102} Ellen P. Aprill, \textit{Tax Shelters, Tax Law, and Morality: Codifying Judicial Doctrines}, 54 SMU L. Rev. 9, 10 (2001).
\textsuperscript{104} \textit{id.} at 27–28.
\textsuperscript{105} \textit{id.} at 31.
\textsuperscript{106} \textit{id.} at 28.
engage in such a transaction ahead of time.\textsuperscript{107} This ad hoc approach to corporate taxation creates unnecessary confusion and punishes MNCs for behavior the court deems inappropriate without affording the MNC a fair opportunity to observe and comply with clearly established rules.

Lowering the U.S. corporate tax rates will reduce the incentives for MNCs to undergo corporate inversions.\textsuperscript{108} U.S. MNCs remaining incorporated in the U.S. will prevent the further erosion of the U.S. tax base by retaining greater amounts taxable revenue. The risk with this alternative is diminishing the existing tax base while failing to effectively curtail expatriating MNCs.\textsuperscript{109} Tax revenue lost due to the decreased tax rate must be offset by increased revenue from MNCs that are no longer incentivized to expatriate.\textsuperscript{110} Otherwise, the loss in additional tax revenue will lead to an even greater reliance on individuals to take over the burden again left by decreased corporate taxation.\textsuperscript{111} This risk, however, should be offset by the increased foreign direct investment, increase in repatriated dividends, and overall broadened tax base from MNCs being discouraged from inverting.\textsuperscript{112} Lowering the U.S. corporate tax rate to thirty percent should maximize revenue while discouraging corporate inversions.\textsuperscript{113} A corporate tax rate of thirty percent in the U.S. would be relatively competitive with other OECD countries.\textsuperscript{114}

\textsuperscript{107} See Id. at 28–30.
\textsuperscript{110} See Id. (citing Robert S. McIntyre & T.D. Coo Nguyen, Corporate Income Taxes in the 1990s, INST. ON TAX’N & ECON. POL’Y 10–11 (2000)).
\textsuperscript{111} See Id. (citing Robert S. McIntyre & T.D. Coo Nguyen, Corporate Income Taxes in the 1990s, INST. ON TAX’N & ECON. POL’Y 10–11 (2000)).
\textsuperscript{112} See Id.
\textsuperscript{113} Id.; Kimberly A. Clausing, The Role of U.S. Tax Policy in Offshoring, BROOKINGS TRADE FORUM 457, 481 (2005); See Harry Grubert & Rosanne Altshuler, Corporate Taxes in the World Economy: Reforming the Taxation of Cross-Border Income, 5 (draft Dec. 12, 2006)(suggesting that the “optimal” rate structure would include a corporate rate of twenty-eight percent).
B. Implementing a Lower Corporate Tax Rate to Increase U.S. Revenue

Lower corporate tax rates eliminate the incentive for U.S. MNCs to undergo corporate inversions and create an environment where MNCs are able to generate revenue comparable to foreign MNCs without undergoing self-help inversion remedies. There is a general consensus among economists that a broad tax base with low tax rates is preferable to a narrow tax base with high tax rates.\textsuperscript{115} The high U.S. corporate tax rate of thirty-five percent was found to have generated approximately half as much revenue as the average OECD country applying a corporate tax rate of approximately twenty-nine percent.\textsuperscript{116} Although there may be some situations in which a high tax rate seems preferable, the broadening of the tax base, eliminating incentives to expatriate, and pursuing MNC incorporation in the U.S. will benefit the U.S. corporate tax base in the long-run.

Bringing the U.S. corporate tax rate more in line with fellow OECD rates creates less competition disparity. In turn, the incentive to expatriate is diminished. Applying a revenue-maximizing rate of thirty percent in the U.S. instead of the current thirty-five percent rate results in a decrease on taxes owed for all income generated by the U.S. MNC. Admittedly, the U.S. conversely appears to walk away with a decrease in tax revenue equal to the amount saved by the MNC compared with what would have otherwise been obtained under the existing corporate tax system. However, if the savings in taxes owed by the U.S. MNC after the U.S. corporate tax decrease are sufficient to place the MNC below the threshold for when it becomes viable to undergo a corporate inversion, then the U.S. will in fact be expanding its taxable revenue base.

\textsuperscript{116} \textit{Id.} at 474.
Consider if, for example, a U.S. MNC has operations generating $100 million in a country with a thirty percent corporate tax rate, $100 million in a country with a twenty percent corporate tax rate, $150 million in a country with a twenty-six percent corporate tax rate, $100 million in a country with a twenty-seven percent corporate tax rate, and $150 million in a country with a twenty-eight percent corporate tax rate. The tax revenue generated by the U.S. on the foreign income earned from this hypothetical U.S. MNC based upon a thirty percent U.S. corporate tax would be $0 from the $100 million being taxed at a thirty percent foreign rate equal to that of the proposed U.S. rate, $10 million from the $100 million being taxed at a twenty percent foreign rate, $6 million from the $150 million being taxed at a twenty-six percent foreign rate, $3 million from the $100 million being taxed at a twenty-seven percent foreign rate, and $3 million from the $150 million being taxed at a twenty-eight percent foreign rate for a sum of $22 million in foreign income tax owed by the U.S. MNC. After this sum is offset by $5 million lost from taxing the U.S. MNC at thirty percent instead of thirty-five percent on $100 million in revenue generated in the U.S., we are left with $17 million in U.S. tax revenue. The potential amount of revenue that would be generated from the income amounts set out above with a thirty-five percent U.S. corporate tax rate would be $5 million, $15 million, $13.5 million, $8 million, and $10.5 million respectively for a sum of $52 million in foreign income tax owed by the U.S. MNC.

The threshold for when a corporate inversion will be beneficial for a U.S. MNC is much more likely to be crossed when the U.S. MNC is expected to pay $52 million in U.S. taxes compared with $22 million. Assuming this threshold has been crossed by the amount due under a thirty-five percent U.S. corporate tax rate and the U.S. MNC becomes a former-U.S. MNC through a corporate inversion, the U.S. will lose access to the $52 million in tax revenue earned.
from foreign profits by the MNC and it will have $10 million from the increased burden of thirty-five percent on the $200 million in U.S.-generated income by the hypothetical foreign MNC and former U.S. MNC.\textsuperscript{117} If the threshold for when it is beneficial to expatriate has not been crossed by the lesser $22 million owed, however, then the U.S will finish with a tax revenue of $12.5 million after accounting for the $10 million decrease caused by the $200 million in U.S.-generated income being taxed at thirty percent instead of thirty-five percent. As a consequence, the U.S. has the potential of earning $2.5 million more in tax revenue than the $10 million otherwise collectible from the U.S.-generated income previously being taxed at a rate of thirty-five percent while saving a U.S. MNC $30 in foreign taxes previously owed under the higher U.S. tax rate if the U.S. MNC does not undergo a corporate inversion.

The illustration laid out above admittedly relies on assumptions of hypothetical tax rates, foreign-generated revenue totals, and a threshold amount triggering corporate restructuring somewhere between $22 and $52 million. The results of this hypothetical, however, represent a savings of $52 million for the MNC formerly incorporated in the U.S. if it elects to undergo a corporate inversion with the existing thirty-five percent U.S. corporate tax rate in effect. This anticipated savings is in the range of the $55 million and $40 million expected annual U.S. tax savings by Cooper Industries and Ingersoll-Rand respectively when the U.S. MNCs elected to undergo corporate inversions. While certainly not conclusive, this similarity at least demonstrates that the hypothetical laid out before is in the range of anticipated savings by actual U.S. MNCs that will meet the threshold savings requirement before undergoing a corporate inversion is viewed as desirable by the U.S. MNC.

\textsuperscript{117} See Supra FN 66–67 and accompanying text, for comments on this hypothetical U.S.-generated income.
The appeal surrounding expatriation decreases as the corporate tax rate decreases. U.S. MNCs will only invert operations when doing so will result in positive returns. Corporate inversions often subject shareholders, and possibly the MNC itself, to exit taxes. The combined expenditures of employing tax advisors to plan out an inversion strategy in compliance with complex corporate tax laws and exit taxes resulting from the inversion itself must be outweighed by the expected benefit of decreasing taxable foreign income. If this cost exceeds the benefit, corporate inversions by MNCs are illogical and violate obligations to shareholders of maximizing profits. It follows that decreasing the tax rate eliminates the incentive to expatriate due to the decreased benefits of tax revenue savings while the costs remain relatively the same through structuring fees and exit taxes.

Despite the incentives surrounding the reduction of the U.S. corporate tax rate, the possibility of taking such action has not been exhaustively contemplated by policymakers until more recently. "The existing corporate tax rate of thirty-five percent has been identified as a cause of the recent rash of corporation inversion." Reducing the corporate tax rate should be legitimately evaluated considering the perceived correlation between the relatively high tax rate and prevalence of corporate inversions as well as the anticipated benefits of rate reductions.

121 Id. at 572.
122 Id. at 571 (citing 26 U.S.C. § 11 (2006)).
IV. Conclusion

Unresponsive U.S. Tax Rates over the past decades have resulted in U.S. MNCs being thrust to the forefront of corporate inversions.\textsuperscript{123} The U.S. maintaining the status quo with regard to its corporate tax rate may arguably be perceived as a failure to adapt to an increasingly integrated international market. Countries around the world have continued to decrease corporate tax rates in the past twenty-five years.\textsuperscript{124} In contrast, the U.S. corporate tax rate has gradually increased relative to the rates of other countries by hovering at a consistent rate of around thirty-five percent.\textsuperscript{125} Due to the U.S. failing to adjust statutory tax rates with the competing countries, U.S. MNCs have resorted to corporate inversions in order to maximize after-tax returns for shareholders and retain a competitive edge in the global marketplace.\textsuperscript{126} Corporate inversions executed by U.S. MNCs have resulted in a depletion of revenue taxable by the U.S. and in turn have undermined the U.S. tax base. In order to regain a substantial amount of taxable revenue and eradicate the incentive for MNCs to incorporate in foreign countries with favorable tax conditions, the U.S. must bring its corporate tax system into the twenty-first century.

Section 7874’s implementation has not eliminated MNC avoidance of U.S. taxation.\textsuperscript{127} Legislation addressing only the effects of corporate inversions, rather than the underlying cause of such behavior, is an ineffective attempt to eliminate erosion to the U.S. corporate tax base.\textsuperscript{128} Instead, legislation should aim to address the underlying cause of U.S. MNC tax avoidance by

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\textsuperscript{123} Rachelle Y. Holmes, Deconstructing the Rules of Corporate Tax, 25 AKRON TAX J. 1, 18 (2010).
\textsuperscript{124} Id. at 6 (citing Cong. Budget Office, Corporate Income Tax Rates: International Comparisons (Nov. 2005)).
\textsuperscript{126} Rachelle Y. Holmes, Deconstructing the Rules of Corporate Tax, 25 AKRON TAX J. 1, 18 (2010).
\end{flushleft}
eliminating the incentive to engage in innovative tax planning schemes. Section 7874 can be repealed after realization of its failure to address the underlying problems in the U.S. tax system, and a reduction of the U.S. corporate tax rate can emerge as the solution to achieve the long-term results hoped for when section 7874 was passed.

The U.S. will regain substantial tax revenue otherwise lost due to MNC expatriation by lowering its corporate tax rate. The expected benefits obtained from the absence of U.S. taxation after a corporate inversion must outweigh the costs of the inversion itself before a U.S. MNC will expatriate. Benefits of expatriation should be minimized to increase the incentive to remain incorporated as a U.S. MNC. Minimizing benefits of expatriation equates to creating a more desirable environment for MNCs in the U.S. The U.S. continues to have an enormous consumer market and legitimate corporate protections in place, but the corporate tax rate in the U.S. remains higher than most fellow OECD countries. Lowering the U.S. corporate tax rate to a revenue-maximizing level will decrease the incentive for MNCs to expatriate by creating corporate tax rates at a globally competitive level while retaining the attractive market variables. U.S. MNCs involved in corporate inversions should not be ridiculed for engaging in self-help remedies fueled by an outdated corporate tax rate. Instead, erosion of the U.S. tax base should be halted by eliminating the incentive to avoid U.S. taxation and thereby resolve the underlying problems in the U.S. corporate tax system.

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129 See Id. at 560–61.