Corporate Tax Avoidance: Addressing the Merits of Preventing Multinational Corporations from Engaging in the Practice and Repatriating Overseas Profits

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CORPORATE TAX AVOIDANCE: ADDRESSING THE MERITS OF PREVENTING MULTINATIONAL CORPORATIONS FROM ENGAGING IN THE PRACTICE AND REPATRIATING OVERSEAS PROFITS

By Alexander J. Morgenstern

I. INTRODUCTION

Even before the United States gained its independence from Great Britain, taxation was an issue at the forefront of the minds of many Americans. The American Revolutionary War began because of growing tensions between residents of Great Britain’s 13 North American colonies and the colonial government, which represented the British crown. In fact, for more than a decade before the outbreak of the American Revolution in 1775, tensions had been building between colonists and the British authorities concerning attempts by the British government to raise revenue by taxing the colonies. These attempts by the British crown to collect tax were met with zealous protest by many colonists because they resented their lack of representation in Parliament and demanded the same rights as other British subjects. Although the United States was eventually able to gain its independence from Great Britain, one thing the United States has not been able to gain independence from are issues concerning taxation.

Throughout American history, there have always been issues with interpreting and executing the tax code. The tax code can be notoriously complex and requires diligent attention to detail as well as legal and judicial interpretation. Judge Learned Hand once said,
“any one may arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one’s taxes.”

For more than two decades, the United States Treasury Department and the international community have been concerned with multinational corporations’ ("MNC") engagement in tax avoidance practices to mitigate their tax liabilities due to their respective nations. Tax avoidance, and the mechanisms that operate as a means to a lower tax or a tax-free end, are normalized processes in contemporary business. Corporate leaders have even expressed encouragement of these practices. Many corporate executives justify corporate participation in tax avoidance as being “capitalistic” or encompassed in their fiduciary duties owed to shareholders. However, these views seriously neglect the negative collateral effects that are imposed on governments and their citizens from the loss of revenue that results from decreased tax collection from MNCs. National tax policies have created a dilemma where, on the one hand, national tax policies are needed to foster tax system competition that keeps the global tax rate low. On the other hand, this competition allows MNCs the freedom to shop around different countries for a tax rate that is desirable.

The purpose of this Note is to analyze corporate tax principles; the methods by which MNCs have achieved their tax goals; how tax avoidance by United States-based MNCs

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9 Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934) (discussing many aspects of the U.S. tax code and why Americans take action to subvert it, despite legislative intent aimed at the contrary).

10 See, e.g., Multinational Corporation (MNC), ENCYCLOPEDIA BRITANNICA, https://www.britannica.com/topic/multinational-corporation (last visited Nov. 17, 2016) (defining a MNC as “[a] corporation that is registered and operates in more than one country at a time . . . and that has its headquarters in one country and operates wholly or partially owned subsidiaries in other countries”); Multinational Corporation, INVESTOPEDIA, http://www.investopedia.com/terms/m/multinationalcorporation.asp (last visited Nov. 17, 2016) (stating that “[a] multinational corporation has facilities and other assets in at least one country other than its home country. Such companies have offices and/or factories in different countries and usually have a centralized head office where they coordinate global management. Very large multinationals have budgets that exceed those of many small countries”).


12 See Lee Simmons, Why Corporate Tax Avoidance is Bigger Than You Think, GRADUATE SCHOOL OF STANFORD BUSINESS (May 24, 2016), https://www.gsb.stanford.edu/insights/why-corporate-tax-shifting-bigger-you-think (stating that many MNCs that face inconsistent tax rates and rules around the world, structure their operations in ways that channel earnings out of high-tax countries where the value is created).


14 See id. (“I am very proud of the structure that we set up. We did it based on the incentives that the governments offered us to operate. It’s called capitalism.”).


16 See infra, Part III.A.


18 See id.
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harm the United States; the affect that Donald Trump's presidency will have on tax avoidance; and possibilities for incentivizing or forcing MNCs to discontinue and disavow tax avoidance. Part II of this Note addresses current corporate income tax law in the United States. Additionally, it describes and defines what tax avoidance is compared with tax evasion, and how the scope of tax avoidance has grown exponentially. Further, Part II discusses the methods that MNCs utilize to avoid taxes and examples of corporations that engage in the practice. Part III of this Note addresses the negative effects on average Americans that result from MNCs engagement in tax avoidance. In addition, Part III delves into government actions that have already been taken in order to prevent MNCs from continuing their harmful tax conduct. Part III of this Note specifically discusses Donald Trump’s presidency and how his proposed policies will potentially affect the overall issue of tax avoidance in the United States. In Part IV of this Note, solutions are posed to address tax avoidance on a macro level.

II. BACKGROUND

A. Corporate Income Tax Law in the United States

The Internal Revenue Service ("IRS") is a bureau of the United States Treasury Department and was created pursuant to section 7801 of the Internal Revenue Code ("IRC"), which authorizes the Secretary of the Treasury to create an agency to enforce the IRC. As a result of this legislative grant of authority, the IRS was created along with an appointed commissioner to head the agency. As the revenue collector of the United States, the IRS administers the federal statutory tax law (i.e. the IRC) and collects taxes—one of which being income tax. Many people think that income tax is garnered solely from the paychecks of American citizens, but income tax is not only collected from individuals’ annual

19 See infra Part II.A.
20 See infra Part II.B.
21 See infra Part II.C.
22 See infra Part III.A.
23 See infra Part III.B.
24 See infra Part III.C.
25 See infra Part IV.
28 See id. (providing further statutory context for the establishment of the Internal Revenue Service).
29 See INTERNAL REVENUE SERV., supra note 26; see also 26 U.S.C. § 7803 (2016) (providing statutory authority for the appointment of a commissioner to supervise the administration of the internal revenue laws).
30 See INTERNAL REVENUE SERV., supra note 26; see also Corporations, INTERNAL REVENUE SERV. (July 8, 2016), https://www.irs.gov/businesses/small-businesses-self-employed/corporations (discussing the taxes of corporations that are subject to collection by the IRS).

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Corporations in the United States are also subject to income tax on their profits, pursuant to section 11 of the IRC. Corporate income taxation poses two questions: (1) what is a corporation and (2) what are the tax burdens that United States-based corporations are subject to? With regard to the first question, a corporation is an entity that "conducts business, realizes net income or loss, pays taxes and distributes profits to shareholders." As it relates to the second question, section 11(b)(1) of the IRC defines the amount of tax to be imposed as a percentage of the sum of taxable income based on how much income the corporation generates each year. In other words, a corporation's income tax rate is subject to change depending on how much income the corporation generated for that tax year. Corporations that are the most profitable are faced with higher tax burdens on their income, whereas those that are less lucrative benefit from the tax code by not contributing as much of a share to the tax revenue pool.

Section 11 of the IRC provides the following tax rates for corporations: (1) a corporation will be taxed 15 percent of its income if that income does not exceed $50,000, (2) a corporation that generates income of between $50,000 and $75,000 will be taxed at 25 percent, (3) a corporation that generates income of between $75,000 and $10,000,000 will be taxed at 34 percent, and (4) a corporation that generates income in excess of $10,000,000 will be taxed at 35 percent. A corporation satisfies its income tax obligation by filing a U.S. Corporation Income Tax Return (Form 1120), in which the corporation reports its income, gains, losses, deductions, and credits. With those figures, the corporation can compute its income tax liability using the prescribed formula that is found on Form 1120. After Form 1120 is filed with the IRS, the corporation has until the fifteenth day of the third month after the end of its tax year to pay the tax due.

tax year to pay its income tax in full. For example, if a corporation’s tax year ends on November 31, it must file its income tax return by February 15th. In 2016, Kyle Pomerleau and Emily Potosky conducted a study on behalf of the Tax Foundation. This study examined the top marginal corporate income tax rates among 188 different nations, including the United States, India, Brazil, and France. The study found that the United States—with a top combined corporate income tax rate of 39 percent—has the third highest corporate income tax rate in the world, only behind the United Arab Emirates and Puerto Rico. To put into perspective just how high the U.S. corporate tax rate is, consider the fact that the average tax rate across all of the 188 countries sampled was only 22.5 percent. Over the past 14 years, the worldwide average corporate tax rate fell by approximately seven percent—from a rate of 30 percent in 2003 to the current above-mentioned average for 2016 (22.5%). These figures are troubling for the United States because a nation’s corporate tax rate is one of the many factors that are analyzed when assessing whether to invest in that nation’s economy. Accordingly, if the United States retains such a high corporate tax rate while the rest of the world lowers theirs, the United States risks becoming uncompetitive and unattractive to foreign investment.

B. What Tax Avoidance Is and What It Is Not

The terms “tax evasion” and “tax avoidance” are often used interchangeably, though mistakenly, to refer to any practice of reducing tax payments; however, tax evasion is not the same as tax avoidance. Tax evasion pertains to illegally reducing tax payments through

44 See PUBLICATION 542, supra note 41.
45 See id.
47 Id.
48 Because the United States has separate state and federal corporate income tax rates, the study utilized “a combined . . . tax rate . . . [consisting of the federal tax rate of thirty-five percent plus the average tax rate among the states].” Id.
49 Id. (noting that Puerto Rico’s corporate income tax rate is thirty-nine percent, only one tenth of a percent higher than the United States; the United Arab Emirates has set their corporate income tax rate at fifty-five percent).
50 Id.
51 Id.
52 See also Factors Influencing Foreign Investment Decisions, THE LEVIN INSTITUTE, http://www.globalization101.org/factors-influencing-foreign-investment-decisions (last visited Nov. 18, 2016) (stating that the main factors that foreign investors consider include: the rules and regulations pertaining to the entry and operations of foreign investors; standards of treatment of foreign affiliates, compared to “nationals” of the host country; the functioning and efficiency of local markets; trade policy and privatization policy; business facilitation measures, such as investment promotion, incentives, improvements in amenities and other measures to reduce the cost of doing business; restrictions, if any, on repatriating earnings or profits in the form of dividends, royalties, interest or other payments).
53 See Pomerleau & Potosky, supra note 46.
conduct that usually involves "deception, concealment, or destruction of records," whereas tax avoidance pertains to legally reducing tax payments through strategic conduct that the taxpayer is willing to disclose to the IRS. To illustrate the difference between tax evasion and tax avoidance, consider the following simplified examples: a MNC engages in tax evasion by underreporting its income (an illegal activity), whereas a MNC engages in tax avoidance by paying income tax on profits in a country with lower taxes than their country of origin (a legal activity).

There are a numerous reasons why MNCs choose to engage in tax avoidance practices. Some MNCs that engage in tax avoidance are attempting to pay less in income tax than is required by a country's laws. Additionally, through tax avoidance practices, MNCs will pay income tax on profits earned in a country with a more favorable corporate tax rate. Or, in some cases, MNCs choose to engage in such tax practices in order to pay income tax later than when the profits were earned, so MNCs can deflate the amount of profit. Now that the distinction is clear, think of tax avoidance as existing in "the gray area between tax compliance and tax evasion."

The scale of tax avoidance is well described by Gabriel Zucman, a Berkeley economist, who notes that "[a]bout fifty-five percent of all the foreign profits of [MNCs] based in the United States are artificially booked to countries that tax [income] at zero or close to zero." This diversion of tax revenue away from our national tax system is nothing new. In 1952, corporate income tax revenue accounted for 32 percent of all federal revenue, whereas in 2009, corporate income tax revenue accounted for only about nine percent of all federal revenue. Moreover, as of 2015, MNCs based in the United States are estimated to have as much as $2.1 trillion in profits stored outside the United States for tax avoidance.

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57 See Fisher, supra note 15, at 340 (emphasis added); see also Tax Avoidance, INVESTOPEDIA, http://www.investopedia.com/terms/t/tax_avoidance.asp (last visited Jan. 9, 2017) (defining tax avoidance as "the use of legal methods to modify an individual's [or a corporation's] financial situation to lower the amount of income tax owed").

58 See INVESTOPEDIA, supra note 57.


60 See id.

61 See id.


65 See Corporate tax avoidance by multinational firms, Library Briefing, EUR. PARL. DOC. 1305574REV1 (2013).

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purposes. These figures are problematic for the United States because, amongst other reasons, our taxes are levied in order to fund public spending. Corporate income taxes are a major source of that funding, and without it, revenue to fund spending must be found elsewhere. As a result, the tax burden in the United States is being negatively skewed, where American families are bearing a much larger share of the tax burden than United States-based MNCs. To illustrate the point, consider the following: in 1952, when corporations' income tax constituted 32 percent of federal revenue, individual income tax accounted for about 42 percent of federal revenue. In 2015, while corporations' income tax decreased to only about 11 percent (a 21 percent decline), individual payroll taxes increased to 47 percent of all federal revenue. In addition, in 1952 payroll taxes from individual Americans constituted about 32 percent of federal revenue, while in 2015 payroll taxes declined to about 11 percent of federal revenue (a twenty-one percent decline). Even after more than 60 years, the clear imbalance that tax avoidance has created on the backs of American taxpayers is not resolved.

C. Methods That MNCs Utilize to Avoid and Reduce Taxes

Steve Forbes, the Editor-in-Chief of Forbes business magazine, expressed his feelings towards the United States tax code, stating that: "[t]he tax code is a monstrosity and there's only one thing to do with it. Scrap it, kill it, drive a stake through its heart, bury it and hope it never rises again to terrorize the American people." It is language such as this that reflects the widespread negativity towards the tax code, which MNCs have seized and utilized to prop up and contribute to the culture of contemporary tax avoidance. All methods that MNCs utilize have one thing in common: the shifting of income from a country with a higher tax rate to a country with a lower rate or no tax rate at all. Typically, this involves the use of tax havens, which are specific jurisdictions wherein extremely low tax rates and banking secrecy laws exist. Some common methods of tax avoidance fueled by the use of tax havens

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67 Richard Rubin, U.S. Companies Are Stashing $2.1 Trillion Overseas to Avoid Taxes, BLOOMBERG (Mar. 4, 2015), http://www.bloomberg.com/news/articles/2015-03-04/u-s-companies-are-stashing-2-1-trillion-overseas-to-avoid-taxes (noting that corporate giants such as Microsoft Corp., Apple Inc., Google Inc. and five other tech firms account for more than a fifth of the $2.10 trillion in profits that U.S. companies are holding overseas).

68 See EUR. PARL. Doc. 1305574REV1, supra note 65.

69 See EUR. PARL. Doc. 1305574REV1, supra note 65.

70 Such as: individual income tax, payroll taxes, excise taxes, and customs and duties.

71 See Press Release, supra note 66.


73 Id.

74 Id.


78 See EUR. PARL. Doc. 1305574REV1, supra note 65.

include: (1) inversions; (2) profit-shifting strategies; (3) transfer pricing; (4) payments for intangibles; (5) shell holding companies; (6) hybrid entities; and (7) company-specific tax rulings.

An inversion typically occurs when a MNC based in the United States acquires a smaller company based in a foreign country—usually a country with a low tax rate—and then relocates the residence of the combined company in the low tax country to limit tax obligations. Profit-shifting involves a MNC limiting its operational activities in a country with higher taxes by moving the activities to a subsidiary of the MNC located in a country with lower taxes. The MNC's profits from those same activities are then taxed based on the lower tax country's rate, thereby reducing or even eliminating the MNC's tax obligation. Transfer pricing is more complicated; it involves the setting of prices for transactions between entities that are all part of the same MNC. These transactions can involve physical goods, but it is more common now for them to involve the right to use certain intangible goods and services. The majority of transactions are “inter-company” transactions that ignore the “arms-length principle,” which MNCs are supposed to abide by. Instead, MNCs will artificially inflate or deflate the price of a transaction in order to pay the least amount of tax and gain the most profit. Another method involves MNCs payments to entities within the MNC for intangible goods and/or services. A MNC will create an entity in a lower tax area that has intellectual property ownership rights over intangibles, and will then charge another entity in a higher tax area for use of those intangibles, for example, a licensing fee. This allows a MNC to have an
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entity that owns its intellectual property in a country where no taxes are payable on license fees, and then charge its internationally affiliated enterprises to use them.9 2 The effect is tax-free profit for the sale of intangible goods/services used.9 3 Another important vehicle used by MNCs are shell holding companies, which are found in jurisdictions that offer low tax rates and have secrecy laws that are beneficial to the MNC.9 4 Typically, a “shell” company is one that is not engaged in real production, trading, or distribution activities;9 5 rather, the company is used merely as a holding company to effectuate tax planning goals in multiple ways.9 6

Hybrid entities are mechanisms that occur in counties that allow dual-residence companies, such as Ireland.9 7 Ireland has companies that are headquartered in Ireland, but for tax purposes, are legally based in another country—typically a tax haven—such as the Netherlands or Bermuda.9 8 One of the ingenious methods that has risen as a result of hybrid entities is the “Double Irish Dutch Sandwich,”9 9 which will be discussed below. Lastly, company-specific tax rulings provide for the direct negotiation of a tax rate between a MNC and the country that constitutes the tax authority.10 0 This has become a sensitive issue, particularly within the European Union, as special tax treatment for individual companies is viewed as undermining competition for foreign investment among member states.10 1

1. Google's “Double Irish Dutch Sandwich”

Google, a massive MNC based in the United States, who's parent company's10 2 motto paradoxically reads “Do the right thing,”10 3 is one of the major players in the realm of corporate tax avoidance.10 4 The company argues that it is simply exploiting legal means and the loopholes in the tax code to maximize shareholder profits, but the reality is that Google is minimizing its obligations to the countries from which it derives its earnings.10 5 Investigators and journalists who have studied the way Google handles its profits have dubbed the strategy

92 See EUR. PARL. DOC. 1305574REV1, supra note 65.
93 See EUR. PARL. DOC. 1305574REV1, supra note 65.
94 See EUR. PARL. DOC. 1305574REV1, supra note 65.
96 See EUR. PARL. DOC. 1305574REV1, supra note 65.
97 See EUR. PARL. DOC. 1305574REV1, supra note 65.
98 See EUR. PARL. DOC. 1305574REV1, supra note 65.
99 See EUR. PARL. DOC. 1305574REV1, supra note 65; see also Goldhammer, supra note 64 at 6 (discussing Google's engagement in the tax avoidance practice known as the "Double Irish Dutch sandwich").
100 See EUR. PARL. DOC. 1305574REV1, supra note 65.
101 See European Commission Press Release IP/16/2923, State Aid: Ireland Gave Illegal Tax Benefits to Apple Worth Up to 13 Billion Euros (Aug. 30, 2016) (discussing how Member States cannot give tax benefits to selected companies as it is illegal under EU state aid rules. Member States have already agreed to tackle the most prevalent loopholes in national laws that allow tax avoidance to take place and to extend their automatic exchange of information to country-by-country reporting of tax-related financial information of multinationals).
102 Larry Page, G is for Google, ALPHABET https://abc.xyz/ (last visited Jan. 15, 2017) (discussing how Alphabet is mostly a collection of companies, the largest of which is Google).
104 See generally Goldhammer, supra note 64 at 6; see also Julia Mead, How to Make a Double Irish Dutch Sandwich, THE NATION, Nov. 2016, at 8, 8.
105 Goldhammer, supra note 64, at 8.
as the “Double Irish Dutch Sandwich.” Here is how it works: before going public in 2004, Google U.S. transferred part of its “intangible capital” (search and advertising technologies) to Google Holdings, a subsidiary headquartered in Ireland. Google Holdings then created another Irish subsidiary, Ireland Limited, which for Irish tax reasons technically resides in Bermuda, where its “mind and management” are supposedly located. Ireland Limited then licenses Google’s intangible capital to affiliates in Europe, Africa, and the Middle East (e.g. Google France pays royalties to Ireland Limited in order to use Google’s intangible capital). Ireland Limited then takes the profits from these royalty payments and transfers them to Google BV, a shell company in the Netherlands. This transfer is tax free because both Ireland and the Netherlands are members of the European Union. Google BV pays all the earnings back to Ireland Limited, which as previously mentioned, is technically located in Bermuda. In Bermuda, the corporate tax rate is zero percent. The end result is that Google’s effective tax rate on foreign profits is extremely low, or none at all, because technically Google’s foreign profits are taxed in Bermuda. How successful has this strategy been for Google? According to Gabriel Zucman, “[Google’s] effective tax rate on foreign profits has ranged from two to eight percent.” Additionally, in 2015, Google avoided paying $3.6 billion in taxes by funneling $15.5 billion in profits to its Bermuda shell company, Ireland Limited.

2. International Business Machines

International Business Machines (“IBM”) is a United States-based hardware, software, and services firm that was incorporated in 1911 under the name Computing-Tabulating-Recording Company and was later renamed to International Business Machines in

106 See id.; see also Philip Elmer-DeWitt, Apple’s tax strategies: ‘Double Irish with a Dutch Sandwich’, FORTUNE (Apr. 29, 2012), http://fortune.com/2012/04/29/apples-tax-strategies-double-irish-with-a-dutch-sandwich/ (discussing how companies such as Apple and Amazon employ the same methods as Google to avoid taxes); Danny Hakim, Europe Takes Aim at Deals Created to Escape Taxes: The Tax Attraction Between Starbucks and the Netherlands, THE NEW YORK TIMES (Nov. 14, 2014), https://www.nytimes.com/2014/11/15/business/international/the-tax-attraction-between-starbucks-and-the-netherlands.html (noting that “the laws in Netherlands shield a variety of profits from taxation, making it attractive for big multinational companies like Starbucks, Google and IBM to set up offices. Even rock stars like the Rolling Stones and U2 have taken advantage of Dutch tax shelters”).

107 See Mead, supra note 104.

108 See id.

109 See id.

110 See id.

111 See id.

112 See Mead, supra note 104.

113 See id.; see also Jon Stone, It’s our sovereign right to set 0% corporation tax rate, UK-protected tax haven Bermuda says, INDEPENDENT (Dec. 12, 2016), http://www.independent.co.uk/news/uk/politics/tax-havens-bermuda-worst-zero-per-cent-corporation-tax-rate-a7469386.html.

114 See Mead, supra note 104, at 8.

115 Goldhammer, supra note 64, at 8.

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1924. With over 370,000 employees and operations in more than 170 countries, IBM is easily considered one of the major players in the technology industry. Not surprisingly then, shares of the company trade on the New York Stock Exchange for around $175 each as of February 2017, and in 2015, IBM was able to generate approximately $82 billion in revenue.

In a perfect world, because IBM makes more than $10 million in income, the company technically should be subject to the corporate income tax rate of 35 percent that is set out by our federal tax code. In reality, from 2008 through 2012, IBM paid U.S. corporate income taxes equal to just 5.8 percent of its $45.3 billion in U.S. profits over this five year period. How was IBM able to avoid more than 29 percent of its income tax obligation in the United States? Through utilizing a tax strategy that sends profits through a Dutch subsidiary, IBM has been able to cut their tax rate to the lowest it has been in 20 years.

More specifically, IBM utilizes IBM International Group BV, which was incorporated in 1999 under Dutch laws that are notorious for their tax favorability. IBM International Group BV is a subsidiary of IBM that acts as a holding company for more than 40 IBM-owned companies worldwide, including its operations in Ireland. As a result,

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121 See id.

122 See supra, note 40 and accompanying text.

123 IBM Paid 5.8 Percent Federal Income Tax Rate Over 5 Years, CITIZENS FOR TAX JUSTICE (Feb. 7, 2014, 10:05 AM), http://ctj.org/ctjreports/2014/02/ibm_paid_58_percent_federal_income_tax_rate_over_5_years.php#.WJYThrYrKYU; see generally Citizens for Tax Justice Staff, IBM’s Nonsensical Response to CTJ’s Finding that It Paid 5.8 Percent Effective Federal Tax Rate, TAX JUSTICE BLOG (Feb. 11, 2014), http://www.taxjusticeblog.org/archive/2014/02/ibms_nonsensical_response_to_c.php#.WJYhMLYrKCO.


125 See id.; see generally The Netherlands: the undisputed European champion in facilitating corporate tax avoidance, OXFAM INTERNATIONAL (May 24, 2016), https://www.oxfam.org/en/research/netherlands-tax-haven (discussing reasons why the Netherlands is used as a tax haven by corporations).

126 See generally Holding Company, INVESTOPEDIA, http://www.investopedia.com/terms/h/holdingcompany.asp (last visited Jan. 10, 2017) (defining a holding company as “a parent corporation, limited liability company or limited partnership that owns enough voting stock in another company to control its policies and management [and also] exists for the . . . purpose of controlling another company, which might also be a corporation, limited partnership or limited liability company, rather than for the purpose of producing its own goods or services”).
IBM funnels its overseas profits through this subsidiary to lower its tax burden on profits earned overseas, instead of repatriating those profits and being subject to a corporate income tax of 35 percent in the United States. Additionally, as it relates to profits earned in the United States, nothing is stopping IBM from shifting those profits to the same Dutch subsidiary utilizing any of the previously mentioned methods.

To put this in perspective, as of year’s end in 2012, IBM accumulated $44.4 billion of offshore profits that it had not paid U.S. taxes on—the sixth-highest total of any American company. In its business results for the end of 2013, IBM listed its effective tax rate as 15.6 percent worldwide, down from 24.2 percent in 2012. IBM said its tax rate was lower than it had forecast because of a “more favorable expected geographic mix” of revenue, but not surprisingly, the company did not provide any further details.

Ed Outslay, an accounting professor at Michigan State University, explained IBM’s conduct in other words: “[n]o company is better than IBM at managing their annual effective tax rate.”

III. ISSUES

A. Effects of Tax Avoidance on Average American Citizens

One of the main issues with tax avoidance practices is the effect on the United States economy and American citizens in general. Middle class Americans take an even harder hit than most because lost tax revenue will have to be generated elsewhere, usually by cutting funding from essential programs. In practice, this means that our government will be unable to spend tax dollars on things such as improving schools, making college more affordable, generating jobs, and rebuilding our national infrastructure. Cutting funding from investments in the future of the middle class, at the expense of allowing MNCs to utilize loopholes in our tax code, is an issue that President Obama addressed. Obama explained, “[i]t’s perfectly legal. And that’s the problem. It’s not that they’re breaking the laws. It’s that the law is poorly designed.”

Barack Obama is not alone in his remarks towards MNCs’ exploitation of the tax code and the affect it has on the American public. In fact, this problem has been around for two decades. In 2002, legislators from Massachusetts and Connecticut proposed the Corporate Patriot Enforcement Act. In doing so, the legislators expressed their disgust of the
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manipulation that occurs at the hands of MNCs to the detriment of average Americans and the American economy by stating:

Corporate expatriates are former U.S. companies who set up paper headquarters in tax havens in order to avoid U.S. taxes... In fact, such expatriates continue to reside in the United States, take advantage of our education system, our public utility systems and, of course, our national defense. In this time of war, they are saying, “Thank you but we aren’t going to pay our fair share.” This is outrageous. Congress must act expeditiously to close this loophole. . . . Speaking of corporate tax avoidance, try and keep a straight face when you tell your constituents that it is perfectly legal for a company to rent a post office in Bermuda and avoid paying taxes. This is utterly ridiculous. One of the effects of corporations not paying their taxes is that we cannot give seniors and working families a prescription drug benefit, or that we cannot fund the President’s education bill or hire more cops. Moreover, we are in the middle of a war, and we are effectively permitting U.S. companies to place a higher value on earnings than on patriotism.139

Clearly, the impacts of tax avoidance are widespread and have a trickle-down effect that touches the majority of American citizens in a negative way. It seems that the only real winners when it comes to tax avoidance are the MNCs that are paying less to receive the same benefits.

B. Government Actions to Curb MNCs Negative Tax Practices

According to Congress’ Joint Committee on Taxation, inversions by MNCs will cost the U.S. Treasury Department approximately $40 billion over the next ten years.140 On April 4, 2016, the United States Treasury Department took action and set out new regulations to combat tax loopholes that allowed corporations to partake in so-called “inversions.”141 Inversions are normally done on paper without the MNC actually moving its operations overseas.142 Because inversions are in essence a legal fiction, MNCs are able to enjoy the benefits of being a U.S. company, such as having access to U.S. markets; rule of law; patent and intellectual property enforcement by the federal government; support for research and development; and American workers.143 The new Treasury regulations seek to make it more difficult for companies to invert, and to limit the economic benefits of doing such.144

The Treasury Department took action pursuant to its existing authority under our current tax laws to limit corporate inversions in two ways: (1) addressing “serial inverters” and (2) addressing “earnings stripping” (referred to previously as profit-shifting).145 In a serial

139 148 CONG. REC. H2477.
140 See Hanlon, supra note 82.
141 See id.
142 See id.
143 See id.
144 See id.
145 See id.
inversion, a U.S.-based MNC acquires a foreign MNC that has already been inverted or that has grown larger by way of U.S. companies’ acquisitions.146 Serial inverters are able to avoid penalties under existing law if the foreign firm in an inversion transaction is below a certain size compared to the U.S. firm that is acquiring it.147 For example, a U.S. company inverts overseas by moving its residence to another country for tax purposes by purchasing a smaller foreign firm and then locating the residence of the MNC in the foreign country.148 Then another U.S. MNC engages in an inversion by acquiring the new foreign MNC that was created in the first transaction.149 This practice allows one inversion to bring into existence another inversion, or in other words, one American company can follow another American company with impunity.150

So how does the Treasury Department’s new regulations prevent this practice? The new regulations “restrict serial inversions by not counting inversions or foreign acquisitions of U.S. [MNCs] occurring within the last three years when applying the formula that determines whether an inversion is subject to penalties or blocked by existing tax code rules.”151 In this way, MNCs cannot utilize a recent inversion or a recent foreign acquisition to enable an inversion and avoid triggering penalties.152

Earnings stripping is a method that foreign MNCs used to avoid paying U.S. taxes by artificially shifting their profits out of the United States.153 Typically, a foreign MNC will make a large loan to a U.S. subsidiary for tax purposes, though in actuality, the loan is completely unnecessary.154 Normally, as a part of lending money via a loan, the lender charges a fee for lending the money in the form of interest against the person who is borrowing until the loan is repaid.155 In an earnings stripping situation, the interest on the aforementioned loan is deductible, and that deduction operates to offset the taxes that the U.S. subsidiary owes to the United States Treasury Department on its earnings.156 For example, when foreign MNC “A” loans “X” sum of money to U.S. subsidiary “B” at “Y” interest rate, U.S. subsidiary “B” deducts the “Y” interest from the “X” loan from its earnings, thereby lowering the amount that the U.S. Treasury Department will tax U.S. subsidiary “B” based on its offset earnings.

How will the new Treasury Department regulations curb earnings stripping practices? The new rules keep foreign MNCs from stocking up their U.S. branches with unnecessary debt because the interest to be paid by the U.S.-based subsidiaries will no longer be deductible.157 Essentially, this new regulation by the U.S. Treasury Department serves as a patch fix for creative accounting undertaken by MNCs. Although these measures taken by the

146 See Hanlon, supra note 82
147 See id.
148 See id.
149 See id.
150 See id.
151 See id.
152 See Hanlon, supra note 82
153 See id.
154 See Sahadi, supra note 80.
156 See Sahadi, supra note 80.
157 See id.
CORPORATE TAX AVOIDANCE

Treasury Department are a substantial step in the right direction, curbing corporate inversions will necessitate Congressional action to close such loopholes by drafting new laws that will operate as a permanent solution.158

C. Donald Trump's Presidency and Its Effect on Tax Avoidance

As of noon on January 20, 2016, Donald Trump recited the Oath of Office and was sworn in as the 45th President of the United States.159 Soon thereafter, President Trump began the process of nominating cabinet level officials to run his administration.160 As the Secretary of the United States Treasury Department, President Trump selected former Goldman Sachs banker, Steve Mnuchin.161 Mnuchin graduated from Yale in 1985 and went on to spend 17 years at Goldman Sachs, until his departure in 2002.162 Mnuchin then decided to start his own Investment Firm, Dune Capital Management, that was later renamed OneWest and sold to CIT Group in 2015.163 Even though he has no prior political experience, as the Secretary of the Treasury, Mnuchin is responsible for supervising banks, issuing debt securities, supervising the IRS, and enforcing tax laws on behalf of every American citizen.164 Furthermore, Mnuchin is charged with implementing the Trump Administration’s proposed business tax plan, which is targeted at growing the United States’ economy.165

1. President Trump’s Tax Proposal and Its Enforcement

Under President Trump’s tax proposal, taxes on corporate income will be reduced from the current rate of 35 percent to 15 percent166 and the corporate alternative minimum tax (“AMT”) will be repealed.167 Trump’s tax plan also seeks to limit the top income tax rate on pass-through businesses168 such as partnerships, LLCs, and S Corporations to no more than 15

158 See id.
162 See id.
163 See id.
167 Corporate alternative minimum tax is a supplemental tax imposed by the Government in addition to baseline income tax for certain corporations that utilize exemptions or other circumstances for lowering payments of standard income tax. Id.
168 "Refers to how individual owners of a business pay taxes on income derived from that business on their personal income tax returns. Pass through taxation applies to sole proprietorships, partnerships, and S-Corporations. This is opposed to traditional, or C-Corporations, where the company itself pays corporate taxes.
Additionally, the Trump plan will repeal most tax breaks for corporations, sometimes referred to as deductions or tax subsidies. President Trump's tax plan has the potential to create significant changes to our tax code that could ultimately benefit not just U.S.-based MNCs, but also American citizens. The effects to be derived from Trump's proposal may seem tenuous now, but over the next few years there will be dramatic changes that will, for better or for worse, affect the United States' position in the global economy.

Ironically, the person who is in charge of collecting our nation's tax revenue, changing the tax code, and repealing tax breaks, has—himself—been accused of avoiding taxes. In a Senate Committee on Finance session, Senator Ron Wyden, D-Oregon, pressed Mnuchin hard with questions that focused on tax inequality and offshore tax avoidance. As a result, it came to light that Mnuchin's financial disclosure records show that he has seven personal trusts, including one based in Anguilla and another known as a "dynasty trust," that could shield tens of millions of dollars from taxes. Even more concerning is Mnuchin's admission that he initially failed to include major personal financial assets—including homes and real estate valued at roughly $95 million—in his federal financial disclosure statement. Secretary Mnuchin's financial disclosures are alarming because the conduct that Secretary Mnuchin has engaged in seems to directly contradict the very actions he claims he will take to prevent such conduct, actions such as, restructuring the tax code to make America more economically viable, and preventing offshore tax abuse as Secretary of the Treasury. Being that we are not even a year into Donald Trump's presidency, the United States will just have to wait and see where Secretary Mnuchin's loyalties really lie.
2. Border Tax

One tax that is already making headlines because of President Trump is, as Trump has called it, a “border tax.” Trump, in a series of tweets, threatened several companies with a “big border tax” if they expand manufacturing facilities abroad for products that will be sold in the U.S. The border tax would require U.S.-based MNCs that move out of the United States to pay a 35 percent tax on products they ship back to the U.S. for sale. In January 2017, Sean Spicer, the White House Press Secretary and Communications Director, gave reporters some insight as to the purpose of the tax, stating that Donald Trump “had been focused on [taxing] U.S.-based employers that move overseas for the express purpose of selling [goods] back to the U.S. market [utilizing] non-U.S. workers.” Just as President Trump’s other tax proposals seek to keep U.S.-based MNCs in the United States and keep them from avoiding taxes, Trump’s border tax could accomplish the same objective with the added benefit of gaining revenue from MNCs that subject themselves to border tax liability. In January 2017, Ford Motor Company scrapped a $1.6 billion plan to build a car factory in Mexico after receiving criticism from President Trump, including threatening the company with the border tax. Subsequently, the company is set to invest $700 million to expand the Flat Rock, Michigan factory and add 700 new jobs to that factory. Ford CEO Mark Fields said, “our view is that we see a more positive U.S. manufacturing business environment under President-elect Trump and the pro-growth policies and [tax] proposals that he’s talking about, so this is a vote of confidence for President-elect Trump and some of the policies that [he] may be pursuing.” Ford’s behavior might signal the end of a tax avoidance era, where new taxes will be structured to be unavoidable while still benefiting the companies they are levied against and the people whom the revenue generated is meant to serve.

IV. SOLUTION

Due to the negative effects of tax avoidance by MNCs and the unfair financial burden that it imposes on American citizens, it is obvious that things need to change; however, this will not be easy because, as previously mentioned, the majority of practices that MNCs engage in are technically legal under the current tax code. Until we have broad tax reform in the United States and significantly change the incentives that fuel compliance with the tax code, tax avoidance by the largest and most profitable MNCs will continue unabated.

179 See id.
180 See id.
181 See id.
184 See id.
185 See id.
186 See supra Part II.
A. The Trump Administration’s Proposal and Possible Modifications

Towards this end and as it relates to unrepatriated foreign income of MNCs based in the United States, President Trump has proposed new tax laws that could move the Nation one step closer to a viable solution. The legislation that has been proposed by President Trump seeks to impose a one-time transition tax of up to ten percent on existing foreign income of MNCs based in the United States that will be payable over ten years. For example, if ABC Company had $20 million in profits held overseas, ABC Company would be required to pay $2 million over the course of ten years in addition to their regular income tax obligation. Being that ABC Company’s domestic tax liability under Trump’s proposed plan would be assessed at 15 percent, ABC Company would owe the IRS $3 million in income tax. Adding ABC Company’s income tax obligation to their one-time transition tax, one is faced with a $5 million total tax liability due to the IRS. Though this number may seem high, if one were to compare this number with what would be owed under the current income tax rate of 35 percent, one could manifestly observe that there would be $3 million in savings for ABC Company, as its tax obligation would be $7 million under the current scheme. Further, under Trump’s plan, future profits of foreign subsidiaries of MNCs based in the United States would be taxed each year as the profits are earned, thereby ending the current law’s deferral of tax on these profits until they are repatriated.

Large reductions in the corporate tax rate, along with ending deferral of tax until the profits are repatriated, could reduce the incentive for MNCs to re-characterize their domestic profits as foreign-sourced to avoid United States tax liabilities. Moreover, the lower corporate tax rate could also decrease the incentive for MNCs based in the United States to engage in inversions, as discussed previously, through moving their tax residence overseas. The ten percent tax on profits held overseas by MNCs based in the United States, and taxing those MNCs’ future overseas profits, could trigger a huge inflow of funds back to the United States, thereby alleviating some of the financial burdens that are being placed on American citizens and our federal budget.

Despite the benefits that may result from President Trump’s tax proposal, there are some deficiencies that may require alternative solutions that have not yet been proposed. For one, MNCs may not be willing to pay a one-time transition tax in addition to their normal income tax obligation (consider the aforementioned example with ABC Company).

187 Repatriation occurs when U.S.-based MNCs relocate their overseas profits back to the United States, thereby subjecting those profits to the United States Tax Code.
188 Trump Pence, supra note 165.
189 Nunns et. al, supra note 166.
190 Trump Pence, supra note 165.
191 Nunns et. al, supra note 166.
192 Id.
193 Id.
195 See Cong. Rec., supra note 139.
B. Alternative Solutions

As an alternative, the United States Treasury Department could levy a five percent annual tax on the stock of unrepatriated offshore profits of United States based MNCs.196 A five percent tax on the approximately $3 trillion in stock held overseas would produce $150 billion in tax revenue per year, while also inducing companies to repatriate their profits back to the United States, where they would then have to pay corporate income tax.197 Because the five percent tax continues until the MNC repatriates its profits, there is a continual incentive for the MNC to act. The only shortcoming that might be unattractive to MNCs is the requirement that the MNC pay domestic income tax in addition to the annual tax.

A possible solution to this shortcoming could be having the IRS provide a discounted rate for a specified term, for example, providing an income tax rate of only ten percent for five years to a MNC that is repatriating its offshore profits. For example, if ABC Company decided to repatriate its overseas profits ($20 million) in 2017, ABC Company would have to pay $1 million towards the five percent annual tax and $2 million towards their domestic income tax obligation for a total of $3 million. Going forward until 2022, instead of paying 15 percent under President Trump’s proposal or 35 percent if the proposal is rejected, ABC Company would continue to make a ten percent income tax contribution ($2 million) for a total of $10 million over five years as opposed to between $15 and $35 million for the same period.

A solution that is perhaps more onerous on the MNCs, would be if the United States Treasury Department set a minimum tax rate of at least 25 to 30 percent on profits of all European and American MNCs.198 Although this solution is the most unattractive to MNCs, if one country, such as the United States, takes a tough stance on this issue, the hope is that other countries around the world will follow suit.199 This domino effect would create a beneficial impact not only for American citizens, but also on the global economy because justly due revenue will no longer be escaping the grasps of jurisdictions that are rightly owed.

C. Senator Bernie Sanders’s Corporate Tax Dodging Prevention Act of 2017

In March of 2017, Senator Bernie Sanders, I-Vermont, offered legislation in the form of the Corporate Tax Dodging Prevention Act of 2017.200 The bill is aimed at preventing corporations from avoiding U.S. taxes and stops rewarding companies with tax breaks that send jobs and factories overseas.201 If this bill is enacted, it is projected to raise at least $1 trillion in revenue over the course of ten years.202 Senator Sanders’s motivation for drafting

196 See Goldhammer, supra note 64, at 8.
197 See id.
198 See id.
199 See id.
the bill stems from the fact that most MNCs pay less than the statutory corporate tax rate of 35 percent.203 When addressing the bill, Sanders stated, “the truth is that we have a rigged tax code that has essentially legalized tax-dodging for large corporations.”204

Accordingly, the Corporate Tax Dodging Prevention Act seeks to reform the tax code in seven major ways: (1) ending the rule allowing American corporations to defer paying federal income tax on profits of their offshore subsidiaries;205 (2) transitioning to new rules by imposing a one-time tax of 35 percent on profits currently held offshore by American corporations;206 (3) closing loopholes allowing American corporations to artificially inflate or accelerate their foreign tax credits;207 (4) preventing American corporations from claiming to be foreign by using a tax haven post office as their address;208 (5) preventing American corporations from avoiding U.S. taxes by inverting;209 (6) prevent foreign-owned corporations from stripping earnings out of the U.S. by manipulating debt expenses;210 and (7) preventing large oil companies from disguising royalty payments to foreign governments as foreign taxes.211

The first reform is necessary as the Congressional Research Service has indicated that this type of tax avoidance costs the U.S. Treasury approximately $100 billion annually.212 Ending this rule should contribute to curtailing the incentive to either move operations/jobs to a lower tax country, or to use accounting tricks to make U.S. profits appear to be earned in a lower-tax county.213 Under the second reform, the one-time tax would serve as a transition to the new rules under this bill, where corporations would be allowed to pay the tax over a period of eight years and could still use foreign tax credits.214 Under the third reform, foreign tax credits generated by profits earned in one country could not be used against U.S. income tax on profits earned in another country.215 This would end the current practice of MNCs using foreign tax credits to pay less tax on their U.S. taxable income than they would if all income was from solely U.S. sources (thereby ending MNCs competitive advantage over companies that are entirely based in the U.S.).216 The fourth reform would prevent a corporation from claiming to be foreign if its management and control operations are located in the United States.217 Under the fifth reform, MNCs that carry out a tax inversion to locate

203 Jagoda, supra note 201.
204 See id.
205 S. 586, 114th Cong. § 2.
206 Id.
207 Under current legislation, U.S. taxpayers are taxed on their income worldwide, but are entitled to a dollar-for-dollar tax credit for any income taxes that are paid to a foreign government (i.e. the foreign tax credit). American corporations are allowed to receive the same credit, which operates to reduce their federal income tax liability by an amount equal to whatever income taxes are paid to foreign governments on their overseas profits. Tax Dodging Act of 2017, supra note 201; S. 586, 114th Cong. § 4.
208 S. 586, 114th Cong. § 5.
209 Id.
210 S. 586, 114th Cong. § 6.
211 S. 586, 114th Cong. § 3.
212 Tax Dodging Act of 2017, supra note 201.
213 Id.
214 Id.
215 Id.
216 Id.
217 Id.
corporate tax avoidance

its operations abroad would be taxed as an American corporation so long as a majority of the inverted corporation is owned by the American party to the inversion.\textsuperscript{218} As it relates to the sixth reform, often times loans are made between entities owned by the same parent company, which means that they are really an accounting fiction and the only real consequence is a lower U.S. income tax liability.\textsuperscript{219} Under the sixth reform, a U.S. affiliate of a foreign owned MNC "would not be allowed to deduct interest expenses that are disproportionate to its share of income of the entire corporate group (the entire group of corporates owned by the same parent company)."\textsuperscript{220} In regards to the seventh reform, "U.S. oil and gas companies have been disguising royalty payments to foreign governments as foreign taxes in order to claim foreign tax credits."\textsuperscript{221} Under the seventh reform, this loophole would be closed.\textsuperscript{222}

In proposing this bill, Senator Sanders has done a remarkable job researching the major issues that plague our tax system as it relates to corporate tax avoidance. The methods of reform are issue-focused, reasonable—and most importantly—practical, in light of the magnitude of the tax avoidance problems facing this country. However, one refinement that could be made to Senator Sanders's Corporate Tax Dodging and Prevention Act would be to change the one-time tax of 35 percent under the second reform to somewhere between 15 and 25 percent. Having a lower one-time tax rate could create more of an incentive to repatriate overseas profits in that that lower rate presents itself as a "deal" at the negotiating table with MNCs, rather than the default rate (35 percent) that MNCs would have to pay anyway.

V. CONCLUSION

The United States is a global economic leader with one of the most advanced economies in the world.\textsuperscript{223} Other countries are not so fortunate, and therefore, it is incumbent upon the United States to make economic decisions that will serve as an example to developing nations and those with whom we stand on an equal playing field.\textsuperscript{224} This includes making tedious decisions with regard to how our government treats the entities that are able to reap the numerous benefits that are afforded to them by way of United States citizenship or by way of incorporation under United States law. Adopting an isolationist position or an anti-globalization position, as has been floated around by President Trump,\textsuperscript{225} is dangerous because of the negative effects that could impact our domestic economy and the global economy at large.

Unless our legislators change their position on the structure of the tax code, tax avoidance practices will continue to thrive and evolve as MNCs continue to develop ever more clever strategies for avoiding their tax obligation. The key is to find a way to change how MNCs think of income tax and how they approach it. This might involve setting new income tax rates, new exemptions, or any other device that enables a MNC based in the

\textsuperscript{218} Id. See supra Part III.B.
\textsuperscript{219} Tax Dodging Act of 2017, supra note 201.
\textsuperscript{220} Tax Dodging Act of 2017, supra note 201.
\textsuperscript{221} Id.
\textsuperscript{222} Id.
\textsuperscript{224} See id.
\textsuperscript{225} See generally id.
United States to pay their income tax as a normal course of operation, without avoiding the obligation as being cost-ineffective for its shareholders. The Treasury Department will need to continue to develop tax plans and incentives that are attractive to MNCs based in the United States, as well as foreign MNCs, if the United States is to remain a global economic leader.
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