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The Declining Allure of Being "American" and the Proliferation of Corporate Tax Inversions: A Critical Analysis of Regulatory Efforts to Curtail the Inversion Trend

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THE DECLINING ALLURE OF BEING "AMERICAN" AND THE PROLIFERATION OF CORPORATE TAX INVERSIONS: A CRITICAL ANALYSIS OF REGULATORY EFFORTS TO CURTAIL THE INVERSION TREND

I. INTRODUCTION

In the realm of tax policy, within which there is rarely broad-based consensus, there are few topics as polarizing as corporate tax inversions. An inversion is a paper transaction in which a US corporation reincorporates abroad to realize strategic tax benefits, without actually transplanting its operations overseas.[1] These transactions necessarily reduce the US corporate income tax base, because although an inverted corporation is still taxed the same amount on income earned within the United States, it will no longer have to remit tax payments to the US Department of the Treasury ("Treasury") for income earned abroad.[2] This reduction in the tax base is especially troubling given that the national debt exceeds $19 trillion,[3] the US credit rating is experiencing unprecedented volatility,[4] and the annual US government deficit ranges from hundreds of billions to more than a trillion dollars per year.[5] Given the current state of the domestic economy, the notion of successful US corporations nominally moving their headquarters abroad to alleviate their tax burden is unpalatable for many.[6] Others do not fault inverters for acting in the interests of their shareholders, and simply see the trend as evidence of the

1. James Mann, Note, *Corporate Inversions: A Symptom of a Larger Problem, the Corporate Income Tax*, 78 S. CAL. L. REV. 521, 521 (2005) (discussing the tax costs and benefits of inversions).

2. *See id.* at 528.

3. *See* USDEBTCLOCK.ORG, http://www.usdebtclock.org/ (last visited Mar. 22, 2016).

4. *See generally* William Constantine, *Justice or Retribution: The S&P Downgrade and Lawsuit*, 33 REV. BANKING & FIN. L. 504 (2014) (discussing the 2011 downgrade of US debt by Standard and Poor's).

5. The seven-year average annual deficit is approximately $1 trillion. Dave Manuel, *A History of Surpluses and Deficits in the United States*, DAVEMANUEL.COM, http://www.davemanuel.com/history-of-deficits-and-surpluses-in-the-united-states.php (last visited Feb. 28, 2016), *archived at* https://perma.cc/2FXF-8KE6; *see also Historical Amount of Revenue by Source*, TAX POLICY CTR., http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=203 (last visited Jan. 18, 2016), *archived at* https://perma.cc/DX3Q-4M39. In 2014, individual income tax receipts accounted for roughly $1.4 trillion in revenue, whereas corporate income tax receipts accounted for "only" about $321 billion. *Historical Amount of Revenue by Source*, *supra*. While any change to the tax base has important consequences, the vast majority of the income taxes collected are from individuals, limiting the impact of changes to the corporate tax regime.

6. *See infra* note 54 and accompanying text.

need for substantial corporate tax reform so that the United States can become more globally competitive as a home for businesses.[7] However, those with opposing viewpoints may be closer together than they realize, and meaningful reform may be attainable if productive dialogue can be facilitated.[8]

This Note provides an overview of trends in corporate taxation,[9] the thirty-year history of inversions and governmental attempts to contain them,[10] and an analysis of recent anti-inversion regulations proposed by Treasury in September 2014.[11] Finally, this Note critiques the legislative and regulatory framework that attempts to restrict the practice of inversions, and provides a suggestion for constructively responding to the trend.[12] Given the passion and diversity of viewpoints on the issue, arriving at a national consensus on how to respond to the recent proliferation of inversions presents an extraordinary challenge. There may, however, be enough common ground for lawmakers to craft a solution that removes the incentive for corporations to invert, thereby shoring up the tax base and making the US economy more competitive globally.[13] In light of the substantial—and rapidly growing—national debt, there is no better time to critically reevaluate the policies and priorities of corporate taxation.

II. ORIGINS OF THE INVERSION PHENOMENON

A. Domestic and Global Taxation of Corporations

The United States has consistently taxed corporations since the beginning of the twentieth century, when the Corporate Excise Tax Act of 1909[14] was passed.[15] Under this law, all annual corporate income in excess

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7. *See infra* notes 139–74 and accompanying text.

8. The tax code "would seem ready made for a bipartisan compromise to cut the rate, cut the deductions, and make the system overall more fair and efficient. It is easy in theory to imagine a bill that a Republican Congress might pass that President Obama would happily sign." Neil Irwin, *Where Might Obama and the G.O.P. Agree? Here Are Possibilities*, N.Y. TIMES (Nov. 5, 2014), http://www.nytimes.com/2014/11/06/upshot/where-might-obama-and-the-gop-agree-here-are-possibilities.html?_r=1&abt=0002&abg=1.

9. *See infra* Part II.A.

10. *See infra* Parts II.B–C.

11. *See infra* Part III.

12. *See infra* Parts II.D, IV.

13. "'The political noise on inversions obscures the broad similarity of the political parties' approach to tax reform,' wrote Terry Haines, head of political analysis at ISI Evercore, in a report." Irwin, *supra* note 8.

14. Corporate Excise Tax Act of 1909, ch. 6, 36 Stat. 11, § 38, 36 Stat. 112, 112–17.

of $5,000 was taxed at a rate of 1 percent.[16] Several years later, the Sixteenth Amendment to the Constitution[17] was ratified, permitting the federal government to levy direct income taxes on both citizens and corporations.[18] By 1918, corporations were being taxed at a rate of 12 percent of annual income earned in excess of $2,000.[19] The maximum corporate tax rate then fluctuated between 10 percent and 19 percent until 1940, when it leapt to 38.3 percent to support wartime spending.[20] While there continues to be a degree of annual fluctuation, the US corporate tax rate has not fallen much below 35 percent,[21] where it remains today.[22] In many ways, the decision to tax the income of corporations is a policy determination reflecting values of progressive taxation,[23] a system under which individuals and corporations with greater income bear a larger tax burden.[24] Arguably, much of the distinction between corporate and individual taxation is illusory because "corporations are owned, directly or indirectly, by individuals who (ultimately) receive a share of the corporations' incomes."[25]

The United States utilizes a "worldwide" system of corporate taxation, under which US corporations are taxed by the United States on income

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15. For a discussion of the history of corporate taxation in the United States, see Marjorie E. Kornhauser, *Corporate Regulation and the Origins of the Corporate Income Tax*, 66 IND. L.J. 53 (1990).

16. JACK TAYLOR, INTERNAL REVENUE SERV., STATISTICAL DATA SECTION, CORPORATION INCOME TAX BRACKETS AND RATES, 1909–2002 287–89 (2003), *available at* http://www.irs.gov/pub/irs-soi/02corate.pdf (providing annual US corporate income tax rates since 1909).

17. U.S. CONST. amend. XVI.

18. *Id.* ("The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.").

19. TAYLOR, *supra* note 16, at 287.

20. *See id.*

21. *See id.* at 287–89.

22. INTERNAL REVENUE SERV., U.S. DEP'T OF THE TREASURY, 2015 INSTRUCTIONS FOR FORM 1120: U.S. CORPORATE INCOME TAX RETURN 17 (2016), *available at* http://www.irs.gov/pub/irs-pdf/i1120.pdf (establishing an escalating corporate tax rate, peaking at 38 percent for income in excess of $15 million but not over $18,333,333, and returning to 35 percent for all income earned over that amount).

23. *See* CITIZENS FOR TAX JUSTICE, WHY WE NEED THE CORPORATE INCOME TAX 1–2 (2013), *available at* http://ctj.org/pdf/whyweneedacorporatetax.pdf, *archived at* https://perma.cc/WKV8-TCWV (offering several justifications for the taxation of corporations, including the need to tax retained profits, the fact that two-thirds of corporate profits would never be payable as personal income tax, and the fact that the corporate income tax is very progressive).

24. *See* Leo P. Martinez, *"To Lay and Collect Taxes": The Constitutional Case for Progressive Taxation*, 18 YALE L. & POL'Y REV. 111, 117 (1999) (postulating that "each dollar matters more to a poor person than it does to a wealthy person" and that this serves as a justification for progressive taxation).

25. TAYLOR, *supra* note 16, at 284.

earned both domestically and internationally.[26] Conversely, the vast majority of other countries utilize a "territorial" system of corporate taxation, whereby they only tax corporate income earned domestically.[27] While multinational corporations conduct business around the globe, treatment of multinationals under the United States' Internal Revenue Code (the "Code") turns primarily on whether a corporation is classified as "domestic" or "foreign," regardless of where it is formally incorporated.[28] At the most basic level, this is determined using a "place-of-incorporation test."[29] Justifications for the place-of-incorporation test include a theory of legal personhood,[30] administrative simplicity,[31] symbolic importance,[32] and a need for revenue.[33] While these explanations are intellectually satisfying to varying degrees, one might particularly question the validity of administrative simplicity as a justification[34] for a system that puts businesses incorporated in the United States at a disadvantage compared to their foreign competition.[35]

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26. Pat Regnier, *Everything You Need to Know About Companies Leaving America for Taxes*, TIME MONEY (Sept. 23, 2014), http://time.com/money/3378719/corporate-tax-inversions-leaving-america/; *see also* Michael S. Kirsch, *The Congressional Response to Corporate Expatriations: The Tension Between Symbols and Substance in the Taxation of Multinational Corporations*, 24 VA. TAX REV. 475, 564–65 (2005) (arguing that a "benefits theory" justifies the worldwide corporate taxation system employed by the United States); Orsolya Kun, *Corporate Inversions: The Interplay of Tax, Corporate, and Economic Implications*, 29 DEL. J. CORP. L. 313, 342 (2004) (explaining that the tax on income earned abroad is the incremental difference between the United States' corporate tax rate and the rate of the country in which the income is derived).

27. *See* Hale E. Sheppard, *Fight or Flight of U.S.-Based Multinational Businesses: Analyzing the Causes for, Effects of, and Solutions to the Corporate Inversion Trend*, 23 NW. J. INT'L L. & BUS. 551, 552–53 (2003) (explaining differences between the United States' system of worldwide corporate taxation and the territorial system, which is overwhelmingly favored by other countries).

28. *Id.* at 551–52. "In the case of a foreign corporation, the United States imposes a tax only on income that has a sufficient nexus with the country." *Id.* at 552.

29. *See* Kirsch, *supra* note 26, at 567. Under the place-of-incorporation approach, the jurisdiction in which a corporation is chartered determines whether it is counted as a domestic or foreign corporation. *See id.*

30. *Id.* ("Perhaps the most fundamental justification for a place-of-incorporation test is that the corporation derives its legal existence from the jurisdiction in which it is incorporated. Under this view, the corporation, as an artificial person, resides in the country whose laws create the legal fiction.").

31. *Id.* at 569 (emphasis added) ("Perhaps the *strongest* justification for a place-of-incorporation test . . . is its administrative simplicity.").

32. *Id.* at 572 (arguing that aligning the tax treatment of corporations with a public perception that a corporation is "American" may justify the place-of-incorporation test).

33. *Id.* at 573 (explaining that the United States can collect more in taxes using the place-of-incorporation test than it might be able to using another test).

34. *See, e.g.*, *id.* at 576 ("[A]dministrative simplicity standing alone is a feeble normative basis upon which to base a definition with such significant tax consequences. After all, many arbitrary rules might be administratively simple, yet would not form a sound basis for imposing tax.").

35. *See id.* at 579 (demonstrating that corporations originally incorporated outside the United States have significant advantages compared to similar corporations incorporated domestically, even

Proponents of the United States' worldwide corporate tax system invoke a "benefits theory"[36] to justify what may otherwise seem to be an uncompetitive scheme. This theory postulates that favorable and well-enforced property and contract laws, as well as more sophisticated public infrastructure, can be used to validate the US system,[37] even though it objectively results in greater tax liability for domestic corporations. Proponents also argue that worldwide taxation incentivizes domestic businesses to locate their active investments in the United States, rather than moving them abroad simply for tax reasons.[38]

In addition to the United States' comparatively less desirable[39] worldwide theory of corporate taxation, the 35 percent maximum rate is no longer competitive from the perspective of multinational corporations.[40] The extent to which the United States' corporate tax scheme has fallen behind the systems used by other countries is evidenced by its tax competitiveness being ranked thirty-second out of thirty-four countries in the Organisation for Economic Co-operation and Development ("OECD") by *Forbes* magazine.[41] This decline in competitiveness has not escaped notice. Former President Bill Clinton recently told CNBC:

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when operations and management are very similar, because of tax advantages associated with being incorporated abroad).

36. *Id.* at 564–65.

37. *Id.* (noting that "protections of property and contract law, the benefits of the transportation infrastructure, and other public services including police and fire protection" are all justifications advanced under the "benefits theory").

38. Theoretically, this is because there should be no tax advantage for earning income abroad, rather than domestically, as long as a business remains incorporated in the United States. *See* Kun, *supra* note 26, at 332.

39. Worldwide taxation is less desirable for US multinational corporations seeking to maximize profits for shareholders, who would benefit from the lower tax burden that would result from a territorial system.

40. "When the current 35% [US] corporate tax rate was signed into law in 1993, it was on par with other nations around the globe. Many of those foreign [countries] have since lowered their corporate tax rates, setting the scene for the current tax inversion-friendly environment." Laura Lorenzetti, *Clinton Says Corporate Tax Rate He Approved Needs to Change*, FORTUNE (Sept. 23, 2014, 1:19 PM), http://fortune.com/2014/09/23/clinton-says-corporate-tax-rate-he-approved-needs-to-change/. The US corporate tax rate has remained high, despite declining averages on every other continent over the past decade. *See Corporate Tax Rates Table*, KPMG, https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html (last visited Jan. 22, 2016), *archived at* https://perma.cc/YDP5-ABP9.

41. The list was ordered by corporate, consumption, property, and individual tax rankings, as well as a ranking of the countries' international tax rules. Kyle Pomerleau & Andrew Lundeen, *The U.S. Ranks 32nd Out of 34 OECD Countries in Tax Code Competitiveness*, FORBES (Sept. 22, 2014, 3:57 PM), http://www.forbes.com/sites/realspin/2014/09/22/the-u-s-ranks-32nd-out-of-34-oecd-countries-in-tax-code-competitiveness/.

> America has to face the fact that we have not reformed our corporate tax laws . . . . We have the highest overall corporate tax rates in the world. And we are now the only OECD country that also taxes overseas earnings on the difference between what the companies pay overseas and what they pay in America.[42]

Clinton, who was President when the current corporate tax structure was signed into law in 1993,[43] has acknowledged that the global economy was in a different place at that time and has accepted that reform is now necessary.[44] President Obama has also called for "revenue-neutral" reform of the corporate tax structure, but thus far he "has not put much political capital behind the proposal."[45]

While the relatively heavy tax burden placed on United States corporations allows the government to collect more in corporate tax revenue,[46] there are major countervailing considerations that suggest significant reform is needed.[47] One issue created by the current corporate tax regime is that US corporations are incentivized to hold earnings overseas, rather than repatriating foreign-earned income to the United States,[48] at which point such earnings would be immediately subject to US

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42. Zach Carter, *Obama Will Probably Be Annoyed with Bill Clinton's Latest Corporate Tax Proposal*, HUFFINGTON POST (Sept. 24, 2014), http://www.huffingtonpost.com/2014/09/23/obama-bill-clinton-corporate-taxes_n_5870908.html, *archived at* https://perma.cc/NR52-7GS8 (internal quotation marks omitted). Clinton suggested that the government could collect "at least as much money" as provided for by current tax receipts by closing loopholes and simultaneously lowering the overall corporate tax rate. *Id.* In comparison to the current 35 percent US corporate tax rate, Canada's rate is "between 11% and 15%" and Ireland's is "about 12.5%." Lorenzetti, *supra* note 40.

43. Lorenzetti, *supra* note 40.

44. Clinton recalled the situation in 1993, explaining that "[w]e were deciding we had to reduce the deficit to get interest rates down and spark an investment boom in America, and it worked." John Hayward, *The Clintons Torpedo Obama's 'Corporate Inversion' Campaign*, BREITBART (Sept. 24, 2014), http://www.breitbart.com/InstaBlog/2014/09/24/The-Clintons-torpedo-Obama-s-corporate-inversion-campaign, *archived at* https://perma.cc/CZ9V-9BX8 (internal quotation mark omitted).

45. *See* Carter, *supra* note 42. Obama's approval rating suffered from the beginning of 2013 through the fall of 2014, when the Notice was issued. *Gallup Daily: Obama Job Approval*, GALLUP, http://www.gallup.com/poll/113980/Gallup-Daily-Obama-Job-Approval.aspx (last visited Mar. 22, 2016).

46. *See supra* note 33 and accompanying text. Using a place-of-incorporation test subjects more corporate earnings to US taxation. *Id.*

47. *See* Pomerleau & Lundeen, *supra* note 41 ("The U.S.'s tax code, which is far out of line with other nations', is driving investment overseas, reducing our economic potential.").

48. KIMBERLY CLAUSING, TAX POLICY CTR., CORPORATE INVERSIONS 4 (2014), *available at* http://www.taxpolicycenter.org/UploadedPDF/413207-corporate-inversions.pdf (articulating that many US corporations have succumbed to their own tax planning success by accumulating large sums of income overseas, which they cannot feasibly use for dividends or repurchasing shares of stock). According to Bill Clinton, "'[a] lot of [corporate] executives, even if they wanted to bring the money home, they think [the US tax regime] is crazy.'" Hayward, *supra* note 44.

corporate income taxes.[49] There may be $1-2 trillion held overseas by US corporations seeking to manage their tax burdens.[50] Congress addressed this issue in 1994 by granting a "tax holiday" for the repatriation of dividends at a reduced rate,[51] but that relief has not been offered since.[52] Despite the arguments made by those in favor of additional tax holidays,[53] others oppose their usage.[54] Critics point out that tax holidays incentivize corporations to leave their foreign earnings overseas and simply wait for Congress to grant relief.[55]

Another consequence of the current US corporate tax system is that it slows domestic investment by US corporations,[56] while simultaneously making it more difficult for them to compete with multinationals incorporated abroad.[57] This is a major concern for the United States, given that a quarter of its economy is tied to exports.[58] In light of these problems,[59] many commentators fear that the Code is pushing investment overseas and minimizing US economic power.[60]

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49. *See* CLAUSING, *supra* note 48, at 3. Deferring the repatriation of earnings allows a corporation to delay the payment of US taxes, perhaps indefinitely. *See id.*

50. CLAUSING, *supra* note 48, at 4 (estimating that "nearly a trillion dollars" may be held abroad by US corporations); *see also* Carter, *supra* note 42 (noting that Bill Clinton estimates that "nearly $2 trillion" is being held overseas).

51. American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418; *see also* CLAUSING, *supra* note 48, at 5 (explaining that dividends could be temporarily repatriated at a rate of 5.25 percent).

52. CLAUSING, *supra* note 48, at 5.

53. Tax holidays result in an immediate infusion of tax revenue, albeit at a lower than usual rate, and stimulate spending by corporations and their shareholders. *See generally* Robert Bloink, *Is United States Corporate Tax Policy Outsourcing America? A Critical Analysis of the Proposed Tax Holiday for Trapped CFC Earnings*, 56 VILL. L. REV. 833 (2012). Proponents include Bill Clinton, who "called to 'give incentives to repatriate . . . nearly $2 trillion overseas,' suggesting that the U.S. grant a tax holiday on money deliberately kept out of the country to avoid paying U.S. taxes on it." Carter, *supra* note 42.

54. *See, e.g.*, Allan Sloan, *Positively Un-American Tax Dodges*, FORTUNE (July 7, 2014, 7:00 AM), http://fortune.com/2014/07/07/taxes-offshore-dodge/ (arguing that inverting corporations are "un-American" and that tax holidays provide the wrong incentives to corporations).

55. *See id.*

56. *See* Jim Randle, *White House Criticizes Corporate Tax 'Inversions' as Squabble Escalates*, VOICE OF AMERICA (Sept. 2, 2014, 5:46 PM), http://www.voanews.com/content/white-house-looks-to-stem-corporate-tax-inversions/2436506.html, *archived at* https://perma.cc/E4XN-HFEN.

57. *Id.* ("When foreign firms have lower expenses, [based on their lower corporate tax burden,] they can offer lower prices than American firms.").

58. *Id.*

59. *See supra* notes 47–58 and accompanying text.

60. *See* Pomerleau & Lundeen, *supra* note 41; *see also infra* Part IV.

B. Corporate Tax Inversions: The Reaction of US Business

Given the unfavorable treatment of US corporations[61] under an outdated corporate tax system that has had no significant overhaul since the mid-1990s,[62] many businesses are reincorporating abroad to take advantage of more favorable tax laws.[63] This is accomplished through a process that has come to be known as "inversion."[64] In an inversion, a US corporate parent utilizes one of several methods[65] to effectuate its reincorporation in either a low-tax or no-tax foreign jurisdiction.[66] This generally occurs when a US corporation acquires or merges with a foreign one.[67] The US company then becomes either a subsidiary of the foreign corporation or establishes a new overseas parent that is incorporated in a tax-friendly country, which holds both the US corporation and its foreign counterpart.[68] When an inversion transaction is successful, "U.S. tax can be avoided on foreign operations and on distributions to the foreign parent, and there are opportunities to reduce income from U.S. operations by payments of fees, interest, and royalties to the foreign entity."[69] Accordingly, the extent to which inversion transactions are regulated is of tremendous consequence to both corporations seeking to maximize after-tax profits[70] and to the United States government, which receives 11 percent of its annual revenues from corporate income taxes.[71]

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61. *See supra* notes 47–58 and accompanying text.

62. Lorenzetti, *supra* note 40.

63. *See* CLAUSING, *supra* note 48, at 2.

64. "The term 'inversion' itself refers to the upside-down structure that often results from the transaction, with the smaller foreign holding corporation now owning the larger U.S. operating company." Joseph A. Tootle, Note, *The Regulation of Corporate Inversions and "Substantial Business Activities*,*"* 33 VA. TAX REV. 353, 355 (2013). Inversions are distinguishable from other foreign business arrangements like outsourcing and "runaway plants." Kirsch, *supra* note 26, at 478–80.

65. *See* Kun, *supra* note 26, at 319–28.

66. John Kelly, Note, *Haven or Hell: Securities Exchange Listing Standards and Other Proposed Reforms as a Disincentive for Corporate Inversion Transactions*, 14 MINN. J. GLOBAL TRADE 199, 199 (2004).

67. *Id*. at 200–02.

68. *Id.* at 200–01.

69. *New Guidance Describes Forthcoming Regs Cracking Down on Corporate Inversions*, CHECKPOINT DAILY NEWSSTAND (Thomson Reuters Tax & Accounting News, Carrollton, Tex.), Sept. 24, 2014, *available at* https://tax.thomsonreuters.com/media-resources/news-media-resources/ checkpoint-news/daily-newsstand/new-guidance-describes-forthcoming-regs-cracking-corporate-inversions/, *archived at* https://perma.cc/F8Z9-GF28 [hereinafter *Forthcoming Regs*].

70. *See supra* note 69 and accompanying text.

71. CTR. ON BUDGET AND POL'Y PRIORITIES, POLICY BASICS: WHERE DO FEDERAL TAX REVENUES COME FROM? (2016), *available at* http://www.cbpp.org/research/policy-basics-where-do-federal-tax-revenues-come-from; *see also supra* note 33 and accompanying text.

The first major inversion transaction that garnered significant attention from the US public occurred in 1983, when McDermott International reincorporated in Panama.[72] Congress responded quickly with changes to the Code[73] to complete what has now become the prototypical cycle: businesses find innovative ways to avoid the pricey US tax regime, and Congress and its regulatory counterparts scramble to cut off the new escape route.[74] Even so, US corporations continue to pursue inversions with increasing frequency.[75] From January 2011 through August 2014, "12 corporate inversions involving US companies [had] been completed, and at least 10 more prospective deals [were] in the works."[76]

While a number of factors[77] may contribute to the increase in inversions, the primary motivation remains the fact that multinationals can lower their global tax liability by relocating to a country espousing a territorial tax system.[78] Upon expatriation, formerly US multinationals are no longer subject to certain unfavorable tax provisions, like those found in IRS Subpart F,[79] or to the rules relating to interest expense allocation.[80]

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72. Kelly, *supra* note 66, at 199.

73. "Congress promptly remedied the deficiency in the Subpart F rules by adopting a narrowly constrained measure that denied entities the specific benefit of the McDermott transaction." Kun, *supra* note 26, at 316. However, the form and purposes underlying recent inversions are significantly different from those seen in the McDermott reincorporation. *Id.*

74. *See* Hayward, *supra* note 44 (internal quotation mark omitted) (equating the war on inversions to a strategy of "kneecap[ing] everyone who tries to climb over the wall to escape our nutty tax system").

75. Inversions may be occurring with more frequency because the inversion solution is increasingly perceived as an acceptable corporate strategy and because the amount of cash eligible for repatriation, but still held offshore, has grown to staggering heights. CLAUSING, *supra* note 48, at 5.

76. *Id.* at 2. AbbVie targeting Shire ($54 billion), Burger King targeting Tim Hortons ($11 billion), and Mylan targeting Abbott Labs ($5.3 billion) were the largest pending tax inversion deals as of September 2014. John D. McKinnon et al., *New Tax Rules Will Slow, Not Halt, Inversion Deals*, WALL ST. J. (Sept. 24, 2014, 12:57 PM), http://online.wsj.com/articles/firms-to-feel-tax-inversion-crackdown-for-now-1411504445. "Thirteen . . . deals worth $178 billion [were] announced [in 2014], according to Dealogic." Lorenzetti, *supra* note 40.

77. Factors may include:

> (1) modest transactional tax costs; (2) continued access to capital markets, market acceptance, and eligibility for government contracts following the inversion; (3) corporate motivations and the absence of shareholder awareness, including inadequate emphasis on corporate governance changes; (4) non-enforcement of potential anti-inversion measures; and (5) deficiencies in the conceptual framework of the tax law for the taxation of multinationals.

Kun, *supra* note 26, at 359. Inversions may have increased because of shareholder turnover, declines in stock markets, and growing acceptance of inversions. Kelly, *supra* note 66, at 200. Inversions also generally cause at least a marginal increase in stock price. *See id.* at 204–05.

78. Tootle, *supra* note 64, at 356. "Expatriated multinationals can further reduce their worldwide tax liability by entering into 'earnings stripping' or 'base erosion' transactions with their U.S. operating companies." *Id.*

79. Subpart F rules "require[] U.S. shareholders of 'controlled foreign corporations' (CFCs) to pay U.S. tax on their pro rata share of certain types of CFC income." *Id.* at 358.

Ultimately, corporations invert if they believe that anticipated future tax benefits[81] resulting from the inversion outweigh any perceived unpatriotic sentiment[82] and the added regulatory burden associated with the transaction.[83]

C. Criticism of Inversions and Policies Seeking to Stem the Tide

Notwithstanding the economic benefits realized by corporations that reincorporate abroad,[84] the concept of inversion has been controversial since these transactions began taking place in the 1980s.[85] As inversions have recently become more commonplace,[86] and in light of the 2008 economic downturn,[87] scrutiny of the practice has increased.[88] For some people, the notion of successful corporations "deserting" America is unconscionable,[89] and with strong opinions on both sides of the debate, corporate tax inversions have become one of the most polarizing tax policy issues today.[90] President Obama has taken a firm anti-inversion

80. *Id.*

81. The anticipated tax benefits include a reduction of US tax on foreign income by switching to a country with a territorial tax system and a reduction of US tax on US income by employing strategies such as earnings stripping. *See* Kirsch, *supra* note 26, at 489–96.

82. Corporate tax inversions have been called "immoral," "wrong," "contemptible," and "unpatriotic tax dodge[s]." Sheppard, *supra* note 27, at 558 (internal quotation marks omitted). The White House calls inverters "corporate deserters." Randle, *supra* note 56. *But see* Zachary Warmbrodt & Jon Prior, *James Downplays Tax Inversions*, POLITICO (Sept. 9, 2014, 11:42 AM), http://www.politico.com/story/2014/09/tony-james-corporate-tax-inversion-110749, *archived at* https://perma.cc/7Q7T-FBLT ("A major Wall Street backer of . . . Obama . . . said corporate tax inversions sound 'scary' and seem 'un-American' but will not have a big economic impact on the United States. . . . 'This is one where the emotion and the noise and the rhetoric is wildly bigger than the issue economically . . . .'"). This is because "firms are not moving people out of the country, they pay full income taxes on U.S. income and such a move triggers upfront tax payments." Warmbrodt & Prior, *supra*.

83. *See supra* notes 73–74 and accompanying text.

84. *See supra* notes 78–81 and accompanying text.

85. *See supra* text accompanying note 72.

86. *See supra* notes 75–76 and accompanying text.

87. *See generally* Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 N.C. BANKING INST. 5 (2009) (providing helpful background on the financial crisis).

88. *See* Kun, *supra* note 26, at 314 ("Corporate inversions became a noticeable phenomenon between 1998 and 2002, when a number of large U.S.-based multinational corporations elected to expatriate.").

89. Inversions are a "new kind of American corporate exceptionalism," and inverters are "companies that have decided to desert our country to avoid paying taxes but expect to keep receiving the full array of benefits that being American confers, and that everyone else is paying for." Sloan, *supra* note 54.

90. *See* Regnier, *supra* note 26 ("Everybody on the Hill says inversions are just a symptom of a messed up tax code. The trouble is Republicans and Democrats are sharply divided on how to fix it.").

position, and his administration has sought to limit these transactions as much as possible.[91] The President asserts that inverters are not being fair to their domestic competitors or the proverbial "hard-working American taxpayer."[92] Obama's 2015 budget included a plan to lessen the incentives for corporations to invert and to make the transaction more difficult to accomplish.[93] With so much at stake in terms of tax revenue[94] and America's ability to attract and retain prosperous businesses,[95] the President has understandably chosen to focus his attention on the interrelated problems of necessary corporate tax reform and the resulting increase in inversions.[96]

Opponents of inversions make several arguments to justify increasing governmental regulation. In addition to the above-mentioned loss of significant tax revenue,[97] some critics posit that inversions undermine public confidence in the US tax system because "the big guys" avoid taxes and leave everyone else to make up the difference.[98] Successful inversions also encourage other US corporations to expatriate in order to remain competitive, so that the problem actually compounds itself.[99] Critics also raise corporate governance concerns,[100] speculating that shareholder rights may be impinged when corporations relocate to less-developed economies,[101] especially if shareholders are not afforded the same

91. Randle, *supra* note 56 ("[T]he Obama administration is looking at possible options to respond to the problem of 'corporate deserters.'").

92. *Id.* (alteration in original) ("'[These large companies] don't want to give up the best universities and the best military and all the advantages of operating in the United States. They just don't want to pay for it,' said the president.").

93. Press Release, U.S. Dep't of the Treasury, Treasury Announces First Steps to Reduce Tax Benefits of Corporate Inversions (Sept. 22, 2014), *available at* http://www.treasury.gov/press-center/press-releases/Pages/jl2647.aspx.

94. "Congress's Joint Committee on Taxation projects that failing to limit inversions will cost the Treasury an additional $19.5 billion over 10 years . . . ." Sloan, *supra* note 54.

95. Limiting the ability of corporations to invert may actually cause the United States to lose jobs to overseas competitors. *See* Sheppard, *supra* note 27, at 559–60.

96. *But cf.* CLAUSING, *supra* note 48, at 7 ("Some policymakers[, including President Obama,] seem open to targeted legislation that would tackle the inversion problem without waiting for broader corporate tax reform.").

97. *See supra* note 94 and accompanying text.

98. *See* Sheppard, *supra* note 27, at 565. A "potential lack of public confidence represents a serious risk to the U.S. tax system, which is based on voluntary compliance." Kun, *supra* note 26, at 372.

99. *See* Sheppard, *supra* note 27, at 563–64.

100. *See id.* at 566.

101. *Id.* Bermuda is a popular destination for inverted companies. *See* Kun, *supra* note 26, at 343. Moreover, Bermuda may actually provide acceptable protections for shareholders:

> The Bermuda standard [for the fiduciary duty of care] imposes a two-fold requirement . . . . First, officers must "act honestly and in good faith with a view to the best interests of the

protections that US law provides.[102] Furthermore, because inversions will generally cause stockholders to realize taxable capital gains, some argue that these transactions are actually economically harmful to stockholders.[103] This conclusion is questioned, however, by a number of tax experts who consider the impact from any initial taxable capital gains negligible.[104]

Opponents of inversion transactions support a number of potential legislative and regulatory measures that would make it more difficult for companies to reincorporate abroad.[105] Suggested near-term reforms include redomestication of expatriated corporations, utilization of a "managed and controlled" test to determine corporate headquarters, refusal to award federal contracts to companies that have inverted, unfavorable tax treatment of inverters, restrictions against the listing of inverted companies on US securities exchanges, and reformation of § 163(j) of the Code with respect to earnings stripping.[106] Those who favor a tough stance on inversions also advocate for the use of the "business purpose doctrine,"[107] which looks beyond whatever nominal purpose for reincorporating outside the United States is offered and instead evaluates

> company." Second, officers must "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances."

Id. at 349 (footnotes omitted). However, there are no shareholder derivative actions in Bermuda, so shareholders lack that vehicle to protect themselves. *Id.* at 349–50.

102. "Most . . . inverting corporations were initially incorporated in Delaware." Kun, *supra* note 26, at 345.

103. *See* Sheppard, *supra* note 27, at 560. However, the fact that corporations are subject to adverse tax consequences if they invert, but choose to reincorporate abroad anyway, indicates that any negative tax consequences should be outweighed by the benefits they expect to realize by inverting. *See* Press Release, U.S. Dep't of the Treasury, Fact Sheet: Treasury Actions to Rein in Corporate Tax Inversions (Sept. 22, 2014), *available at* http://www.treasury.gov/press-center/press-releases/Pages/jl2645.aspx [hereinafter Treasury Fact Sheet].

104. Thinking that initial capital gains taxes paid by stockholders are harmful to those stockholders is a flawed conclusion because stockholders have an interest in making the corporation as profitable as possible. *See* Sheppard, *supra* note 27, at 560. Additionally, a large amount of stock is held by tax-exempt or tax-indifferent entities like pensions or mutual funds. *Id.* at 557. The disincentive provided by the prospect of paying taxes on capital gains is significantly reduced when the market is down and shareholders will realize few, if any, gains. *See* Kelly, *supra* note 66, at 205. Furthermore, the "'exchangeable share technique' may postpone the shareholder-level tax." Kun, *supra* note 26, at 322.

105. *See infra* note 106 and accompanying text.

106. *See* Kelly, *supra* note 66, at 208–25 (detailing proposed reforms); Randle, *supra* note 56 ("U.S. Senator Bernie Sanders . . . has said companies that do inversion deals should not be allowed to compete for federal contracts."); *see also* Tootle, *supra* note 64, at 361 (describing "interest stripping," a common earnings-stripping tactic where a US operating company pays nominally tax-deductible "interest payments" to its new foreign parent and deducts the payment amounts from the US source's taxable income).

107. 26 C.F.R. § 1.368-2(g) (2016) (providing that reorganizations "must be undertaken for reasons germane to the continuance of the business of a corporation a party to the reorganization").

the tax treatment of inverters based on whether they have legitimate business reasons for expatriating.[108] While these and other proposed measures[109] may have an impact on the inversion trend, some critics argue that most of the actions that can be taken are merely symbolic,[110] and that the debate surrounding the issue is more politically significant than the actual economic implications of inversions.[111]

The historical pattern of companies reincorporating abroad for tax purposes through creative expatriation transactions and the legislative and regulatory responses that invariably follow has repeated itself many times since the 1983 McDermott transaction.[112] Following that transaction, Congress enacted § 1248(i)[113] and § 163(j)[114] of the Code to prevent US shareholders from realizing earnings at the capital gains rate through the liquidation of a controlled foreign corporation ("CFC") and to deter corporations from engaging in interest stripping.[115] The 1994 Helen of Troy transaction[116] was also quickly addressed by regulators, who made changes to § 367(a)[117] of the Code, making transfers of stock from domestic corporations to foreign corporations taxable in specific circumstances.[118] However, these responses[119] did not sufficiently deter prospective inverters and the United States experienced a wave of

108. Kun, *supra* note 26, at 368 ("The business purpose doctrine denies tax-free reorganization treatment to any transaction entered into solely for the purpose of achieving a particular tax result and not 'for reasons germane to the continuance of the business of a corporation [that is] a party to the reorganization.'").

109. *See, e.g.*, Kirsch, *supra* note 26, at 482 (discussing the Homeland Security Act of 2002, whereby Congress imposed an "alternative sanction" under which inverted corporations were forbidden from contracting with the US Department of Homeland Security).

110. *Id.* at 507–20. "[M]ost citizens have only a foggy knowledge of public affairs . . . . In this context . . . the principal function of much legislation . . . is to provide symbolic reassurance to the public, while only a small group of interested, involved persons generally receives any tangible benefit from the legislation." *Id.* at 508 (internal quotation marks omitted) (quoting Michael S. Kirsch, *Alternative Sanctions and the Federal Tax Law: Symbols, Shaming, and Social Norm Management as a Substitute for Effective Tax Policy*, 89 IOWA L. REV. 863, 921–22 (2004)).

111. *See supra* note 82 and accompanying text.

112. *See supra* notes 72–76 and accompanying text.

113. I.R.C. § 1248(i) (2014).

114. *Id.* § 163(j).

115. *See* Tootle, *supra* note 64, at 365; *see also supra* note 106 and accompanying text.

116. "'The 1994 Helen of Troy transaction was the first of the modern wave of outbound inversions and . . . [came] to be regarded as the prototypical 'pure' inversion transaction.'" Kun, *supra* note 26, at 317 (alteration in original) (quoting New York State Bar Assoc., Tax Section, *Outbound Inversion Transactions*, 96 TAX NOTES 127, 129 (2002)).

117. I.R.C. § 367(a) (2014).

118. "[T]ransfers of stock of domestic corporations to foreign corporations [became] taxable if, in the aggregate, all U.S. transferors owned 50% or more of the stock of the foreign parent by vote or by value immediately after the exchange." Tootle, *supra* note 64, at 366.

119. *See supra* notes 113–18 and accompanying text.

inversions during the late 1990s and early 2000s.[120] A number of large corporations inverted, including Triton Energy, Tyco, and Fruit of the Loom.[121] In response to this wave of inversions, Congress passed the American Jobs Creation Act of 2004,[122] which contained the most comprehensive anti-inversion legislation up to that point.[123] The Act created § 7874 of the Code,[124] which "seeks to eliminate most inversion transactions by removing all of their tax *benefits*,"[125] rather than attempting to "deter inversions by imposing tax *costs* on the inversion transaction itself," as had been the approach taken in previous attempts to limit the practice.[126] Nonetheless, regulators have never been able to permanently halt the practice of inversions,[127] despite these reform efforts.[128]

Opponents of inversions understandably treat the continued legality of these transactions as a domestic policy priority with serious and lasting implications for the United States.[129] Examining a recent inversion illuminates what is at stake behind the policy debate. Consider Medtronic,[130] a multinational, Minnesota-based medical corporation that acquired Covidien, an Irish corporation. The transaction resulted in a change of Medtronic's nominal headquarters to Ireland, a country with a significantly more advantageous corporate tax regime than the United States.[131] Covidien was "itself a faux-Irish firm that [was] run from Massachusetts except for income-taxpaying purposes."[132] Medtronic, like many similarly-sized corporations, held a significant amount of cash

120. *See* Tootle, *supra* note 64, at 366–67.

121. *Id.*

122. American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418.

123. *Id.* § 801, 118 Stat. at 1562–66; Tootle, *supra* note 64, at 368.

124. I.R.C. § 7874 (2014).

125. Tootle, *supra* note 64, at 368 (emphasis added).

126. *Id.* (emphasis added).

127. *See supra* notes 75–76 and accompanying text.

128. *See supra* notes 113–26 and accompanying text.

129. *See generally* David Brodwin, *Corporate Tax Inversions Leave You with the Bill: Consumers and Small Business Lose When America's Largest Companies Avoid Taxes*, U.S. NEWS & WORLD REPORT (Aug. 1, 2014, 10:00 AM), http://www.usnews.com/opinion/economic-intelligence/2014/08/01/corporate-inversion-tax-avoidance-hurts-small-businesses-and-consumers.

130. MEDTRONIC, http://www.medtronic.com/ (last visited Feb. 28, 2016).

131. *See supra* note 42 and accompanying text (comparing Ireland's 12.5 percent corporate tax rate to the United States' 35 percent rate). As with most mergers, Medtronic is paying a premium price for Covidien. *See* Sloan, *supra* note 54. Medtronic is indemnifying "directors and executive officers for [the] excise tax [associated with 'the value of options and restricted stock owned by top officers and board members of inverting companies'] because they should not be discouraged from taking actions that they believe are in the best interests of Medtronic and its shareholders." *Id.*

132. Sloan, *supra* note 54.

offshore because the United States' worldwide tax system would have made it very expensive to repatriate the money.[133] Of the estimated $14 billion held overseas by Medtronic in 2014, $3.5 billion to $4.2 billion likely would have needed to be paid immediately to the IRS if those overseas earnings were to have been brought to the United States outside the context of an inversion.[134] In addition to conferring other advantages,[135] its recent inversion allows Medtronic to pay dividends on the entirety of its cash held overseas, without first subjecting the money to corporate income taxation in the United States.[136] For those opposed to inversions, this lost tax revenue, coupled with the notion that other corporate and individual taxpayers will have to make up the difference,[137] makes the thought of continuing to allow such transactions unpalatable.[138]

D. An Alternative Solution: Comprehensive Corporate Tax Reform

Fundamental opposition to inversions is not universal. Many economists, legislators, academics, and businesspeople do not vilify corporations that choose to expatriate. Instead, they consider inversions to be symptoms of a greater problem, not problems themselves.[139] In light of the comparative disadvantages facing businesses incorporated in the United States,[140] including the 35 percent corporate tax rate and worldwide system of taxation, many multinationals have concluded that moving

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133. *Id.*; *see also supra* note 50 and accompanying text.

134. Sloan, *supra* note 54. $3.5 billion to $4.2 billion represents the difference between the 35 percent US corporate tax rate and the taxes Medtronic has already paid overseas, generally at a rate of 5 percent to 10 percent. *Id.*

135. *See supra* notes 63–69 and accompanying text.

136. *See* Sloan, *supra* note 54.

137. Of course, to the extent that other taxpayers do not make up for Medtronic's lower tax bill and the government does not reduce its spending in anticipation of collecting less in revenue, Medtronic's inversion could also indirectly impact the escalating national debt. *See supra* note 3 and accompanying text.

138. *See* Sloan, *supra* note 54. Companies should "[f]ight to fix the tax code, but [shouldn't] desert the country." *Id.* Furthermore:

> "[F]iduciary duty" [is] the obligation to produce the best long-term results for shareholders, not "get the stock price up today." Undermining the finances of the federal government by inverting helps undermine our economy. And that's a bad thing, in the long run, for companies that do business in America.

Id. "Inverters don't hesitate to take advantage of the great things that make America [a land of opportunity] . . . . But inverters do hesitate—totally—when it's time to ante up their fair share of financial support of our system." *Id.*

139. *See* Pomerleau & Lundeen, *supra* note 41. "[T]he U.S.'s tax code has fallen behind significantly, but the U.S. can take a couple of important steps to catch up." *Id.*; *see also supra* note 90 and accompanying text.

140. *See supra* notes 21–27, 40–42 and accompanying text.

abroad is necessary to remain competitive.[141] As such, a company that opts to invert can be compared to a person who chooses "flight" in a "fight or flight" scenario.[142] Whether that choice is a smart business decision or a condemnable act of desertion depends largely on one's views regarding the duties of a corporation,[143] where the blame for the inversion problem should lie,[144] and what a solution should look like.[145]

It is well established in the US legal tradition that business corporations are "organized and carried on primarily for the profit of the stockholders."[146] Defenders of inversions apply this traditional doctrine and argue that US businesses that choose to invert and reincorporate abroad are merely maximizing value for their shareholders,[147] in accordance with their directors' fiduciary duties.[148] Corporations that have chosen to invert tend to have a number of similarities. They are generally larger, less leveraged, and pay more in taxes than other businesses in their industries.[149] Accordingly, undergoing an inversion may simply reflect the pursuit of a course to ameliorate a corporation's already significant tax burden, thereby increasing value, maximizing shareholder profits, and satisfying directors' fiduciary obligations.[150] Under such a construction, it

141. *See supra* note 35 and accompanying text.

142. *See* Sheppard, *supra* note 27, at 551–52.

143. This duty could be seen as merely running to shareholders, thereby obligating the corporation to maximize its value, or it could be construed more broadly, such that it runs to all stakeholders, including the US public at large. *See generally* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733 (2005).

144. Opponents of inversions generally place the blame on the corporations that choose to expatriate. *See supra* notes 85–104 and accompanying text. On the other hand, proponents of tax reform are inclined to argue that the blame lies with the White House and Congress, which have failed to pass needed comprehensive corporate tax reform. *See infra* notes 152–74 and accompanying text.

145. "The GOP wants to move away from the worldwide tax system to a 'territorial' one . . . . Democrats have generally opposed this, preferring to impose new rules . . . ." Regnier, *supra* note 26.

146. Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919). "The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself . . . ." *Id.*; *see also* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010) (holding that the implementation of corporate policy that "specifically, clearly, and admittedly seeks *not* to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders" is impermissible).

147. Inverting is a strategic decision, arguably no different from choosing to incorporate in Delaware. *See* Sheppard, *supra* note 27, at 562.

148. "[Former President] Clinton said that publicly traded companies, in particular, 'feel duty bound to pay the lowest taxes they can pay.'" Hayward, *supra* note 44.

149. *See* Kun, *supra* note 26, at 318–19.

150. Maximizing profits for shareholders in the short term can become a director's primary duty in particular situations, such as when a merger or other sale of the company becomes imminent, as may be the case in some inversions. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (holding that the board's duty "changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit"); *see also* Colin Campbell, *Bill Clinton: Executives Think the US Tax Code Is 'Crazy'*, BUS. INSIDER

is easy to see why so many corporations have chosen to invert over the past several decades.[151]

For those who are sympathetic toward these businesses, reform efforts should be directed toward addressing the underlying problem that creates the incentive for inversions: the US corporate tax scheme.[152] Rather than attempting to block each new method by which a corporation can invert, *ex post*,[153] and hoping that the route taken by a given corporation will be closed to those that would follow it, policymakers should reform the Code to make the United States more competitive on the global stage.[154] Proponents of this philosophy argue that lawmakers and regulators will perpetually be a step behind the innovative businesspeople and lawyers who inevitably seem to find creative new ways to accomplish the transaction in an evolving regulatory landscape.[155] Proponents of tax reform argue that instead of continuing to waste effort and resources in an ideological clash, which regulators would struggle to ever truly "win,"[156] the government should put away its "stick" and should try using the "carrot" to attract businesses and the talent, tax revenue, and innovation they bring to America.[157]

(Sept. 23, 2014, 12:52 PM), http://www.businessinsider.com/bill-clinton-executives-think-the-us-tax-code-is-crazy-2014-9, *archived at* https://perma.cc/MH7L-A93K. When asked if inverted companies were "unpatriotic," Bill Clinton was evasive in saying "[w]hether [they are] or not, companies . . . have a short-term perspective." *Id.*

151. *See supra* notes 75–76 and accompanying text.

152. Randle, *supra* note 56 ("Some Republicans and former U.S. President Bill Clinton say the inversion deals are a symptom of the larger problem, which requires comprehensive tax reform to resolve."). *But see* Kirsch, *supra* note 26, at 502–03 (noting that opponents of this view argue that portraying the problem as related to worldwide taxation is merely a red herring meant to distract from earnings stripping).

153. *See supra* notes 112–27 and accompanying text.

154. Bill Thomas, the former Chairman of the House Ways and Means Committee, opined that he was less inclined to prohibit corporations from inverting than he was to "treat [inversions] as a symptom, examine the underlying disease[,] . . . the tax code and [its] failure to be even minimally useful to [businesses,] and deal with the fact that the U.S. is out of sync with the rest of the world." Kirsch, *supra* note 26, at 500–01.

155. *See supra* notes 113–27 and accompanying text.

156. Historical precedent for regulation following major inversions, but failing to "win" by reversing the trend completely, can be observed from the 1983 McDermott transaction through the present. *See supra* notes 112–27 and accompanying text.

157. *See* Kirsch, *supra* note 26, at 501 (noting that Chairman Thomas argued: "We are not well equipped to deal with trade in the 21st century; we have to change our tax code."); *cf.* Randle, *supra* note 56 (suggesting that major corporate tax reform probably would not happen until 2015 at the earliest, so the President would likely use executive actions to make inversions more difficult in the meantime, likely with limited success). *But see* Sloan, *supra* note 54 (emphasis added) (proffering the views of John Buckley, a former Democratic tax attorney, who stated that the inversion trend is not occurring because there is *no* prospect for corporate tax reform, but rather "because there *is* a prospect of reform. If reform comes, [Buckley] says, there will be winners and losers—and it's the likely losers-

For those who see inversions as merely an indicator of greater problems rooted in the US corporate tax system, there are several proactive changes that could be made to the Code,[158] in lieu of perpetuating the pattern of reactive regulations following every major inversion transaction.[159] Significantly, reformers seek a change from the country's current worldwide tax regime to a territorial system, which would bring the United States into conformity with the majority of developed countries around the globe.[160] Additionally, reformers want the United States to lower its corporate income tax rate to bring it closer to prevailing rates elsewhere in the world.[161] While these two reforms would likely achieve the most in terms of removing incentives for corporations to expatriate,[162] pragmatists have also proposed several other approaches to reforming the US corporate tax regime and reducing the number of inversion transactions it encourages.[163]

These approaches include allowing self-help territoriality,[164] pressuring other countries to change their tax laws,[165] addressing multiple tax

to-be that are inverting. 'Even minimal tax reform would hurt a lot of these companies badly,' he says.").

158. *See infra* notes 160–70 and accompanying text.

159. *See supra* notes 72–80 and accompanying text.

160. *See* Sheppard, *supra* note 27, at 567–71. Sheppard identifies several flaws with this solution, including that the timing may not be right for such a change, that it could actually enhance tax avoidance by legitimizing moving operations offshore, that implementation of a territorial system would take too long, that the loss of revenue from inversions is slight compared with the cost associated with changing the Code, that a territorial system may not be the best approach, and that a change to a territorial system has already been met with significant legislative resistance. *Id. But see supra* notes 26–27 and accompanying text (outlining the higher costs imposed on corporate taxpayers under the United States' worldwide taxation system relative to the costs imposed on taxpayers under a territorial system).

161. *See* Sheppard, *supra* note 27, at 571–72. The US rate of 35 percent is significantly out of sync with the rates of other OECD countries, including Canada, which has rates between 11 percent and 15 percent, and Ireland, which has a corporate tax rate of about 12.5 percent. *See supra* notes 41–42 and accompanying text.

162. *See generally* PHILIP DITTMER, TAX FOUND., SPECIAL REPORT: A GLOBAL PERSPECTIVE ON TERRITORIAL TAXATION 1 (2012), *available at* http://taxfoundation.org/article/global-perspective-territorial-taxation (arguing that the United States' decision to employ "the highest top marginal tax rate in the developed world," in addition to its being one of only a few countries that still maintains a worldwide system of corporate taxation, has become "exceptionally burdensome" for US businesses).

163. *See infra* notes 164–70 and accompanying text.

164. Governmental inaction will allow corporations to "proceed to legally invert, thereby opting to take advantage of self-help territoriality." Sheppard, *supra* note 27, at 572.

165. "Perhaps the most outlandish proposal to halt inversions was offered by Senator Max Baucus . . . who suggested that the United States might pressure 'the Bermudas of the world' so that they 'stop this.'" *Id.* at 573. "While the United States is no stranger to applying economic sanctions or enlisting the assistance of its political and/or economic allies in times of need, the idea that the United States can unilaterally obligate Bermuda to relinquish its sovereign right[s] . . . smacks of excessive hubris." *Id.*

problems simultaneously,[166] redomestication effected by new rules for corporate residency,[167] or simply disregarding attempted inversions.[168] Reformers also consider more comprehensive approaches[169] and other, less orthodox solutions.[170] Ultimately, while there may be disagreement about the appropriate means by which to achieve the desired end,[171] reformers urge that the focus should not be on corporations that have legally expatriated in the past.[172] Instead, they assert that efforts should be centered on modernizing the US tax system so that multinationals will view the United States as a "model country in which to organize, manage and operate."[173] Reformers insist that if this can be achieved, the incentives for corporations to invert will be eliminated and positive changes will follow for the nation as a whole.[174]

III. SEPTEMBER 2014 TREASURY NOTICE

On September 22, 2014, the Department of the Treasury announced its latest effort to stymie inversions in I.R.S. Notice 2014-52[175] (the "Notice"), which addresses changes to how the transactions will be treated. In the Notice, officials describe regulatory changes under five sections of the Code, hoping to make inversions more difficult to complete

166. Corporate tax inversions could be addressed simultaneously with other international tax issues, including tax shelters and the overall competitiveness of the United States' international corporate tax regime. *Id.* at 574; *see also generally* Adam H. Rosenzweig, *Why Are There Tax Havens?*, 52 WM. & MARY L. REV. 923 (2010) (discussing the "capital neutrality paradox" as it applies to the existence of tax havens).

167. Sheppard, *supra* note 27, at 578 (footnote omitted) ("As a way to discourage inversions, some experts suggest scrapping the existing place-of-residency rules and replacing them with a management-and-control test. Under this new standard, the legal residency of [a] corporation would be based on where the decision-makers . . . are located, as opposed to where the parent corporation is legally organized.").

168. *Id.* at 579–81.

169. *See id.* at 581–83.

170. Suggested unorthodox approaches include prohibiting inverted corporations from being awarded government contracts; potentially exposing executives of inverting corporations to criminal charges, as well as exerting "various forms of economic and market pressure," including the encouragement of public boycotts of corporations that have expatriated; and running advertisements to educate the public about inversions. *Id.* at 583–85.

171. *See supra* notes 160–70 and accompanying text.

172. Sheppard, *supra* note 27, at 588.

173. *Id.*

174. *See id.* In addition to slowing or entirely halting the pace of inversions, major tax reform would likely have the effect of broadening the corporate tax base, thereby increasing revenues and decreasing the rate of growth of the national deficit.

175. I.R.S. Notice 2014-52, 2014-42 I.R.B. 712.

and less profitable moving forward.[176] Treasury Secretary Jacob Lew proclaimed that "[i]nversion transactions erode our corporate tax base, unfairly placing a larger burden on all other taxpayers, including small businesses and hard-working Americans . . . . It's critical that this unfair loophole be closed."[177] The Notice was effective immediately and applied to all deals that were not already completed.[178] Secretary Lew expressed his desire that Treasury's actions would make inversions economically unviable, at least for some companies considering them.[179]

A. Targeting "Hopscotch" Loans: § 956(e)

One of the provisions addressed in detail by the Notice is § 956(e)[180] of Subpart F of the Code.[181] The purpose of § 956 is to prevent US shareholders of CFCs from deferring payment of US taxes by delaying the repatriation of income earned abroad.[182] Following an inversion, an expatriated foreign subsidiary can no longer be considered a CFC, a tactic that formerly allowed the avoidance of US taxes, even on earnings and profits that predated the transaction.[183] American-owned multinationals are required, however, to pay taxes on income earned by their CFCs when that money is repatriated back into the United States.[184] If a CFC attempts to circumvent this tax by investing in US property, the Code considers the domestic parent to have received a taxable dividend from its subsidiary.[185] Addressing § 956(e) of the Code, the Notice specifically targets so-called "hopscotch" loans, a common tool used by inverters to avoid this unfavorable tax construction.[186]

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176. John D. McKinnon & Damian Paletta, *Obama Administration Issues New Rules to Combat Tax Inversions*, WALL ST. J. (Sept. 22, 2014, 11:52 PM), http://www.wsj.com/articles/treasury-to-unveil-measures-to-combat-tax-inversions-1411421056.

177. Tom Huddleston, Jr., *Obama Administration Releases New Rules to Fight Tax Inversions*, FORTUNE (Sept. 22, 2014, 6:48 PM), http://fortune.com/2014/09/22/obama-administration-releases-new-rules-to-fight-tax-inversions/ (internal quotation marks omitted).

178. McKinnon & Paletta, *supra* note 176.

179. *See* Hayward, *supra* note 44. "Today, Treasury is taking action to reduce the tax benefits of—and when possible, stop—corporate tax inversions." Treasury Fact Sheet, *supra* note 103.

180. I.R.C. § 956(e) (2014).

181. *See* I.R.S. Notice 2014-52, 2014-42 I.R.B. 712, 712.

182. *See id.*

183. *See id.*

184. Mike Patton, *Will U.S. Government Succeed in Closing This Corporate Tax Loophole?*, FORBES (Sept. 25, 2014, 11:57 AM), http://www.forbes.com/sites/mikepatton/2014/09/25/congress-attempts-to-close-corporate-tax-loophole/.

185. *Id.*

186. *See infra* notes 187–89 and accompanying text.

Prior to the Notice, inverted companies were able to bypass the rule that reclassifies CFC investments in US property if a CFC made a loan to the newly created foreign parent, rather than the US parent.[187] Such hopscotch loans[188] were not regarded as US property and were not taxed as dividend payments.[189] The Notice's changes to the implementation of § 956(e) remove the benefit of these loans by simply treating them as US property for purposes of the anti-avoidance rule.[190] The same tax rules now apply whether the CFC issues the loan to the US parent before the inversion or to the newly created foreign parent afterward.[191]

The Notice also provides that, for purposes of § 956, any stock or other obligation of a foreign related person will be treated as US property to the extent that it is acquired by a foreign subsidiary following expatriation.[192] A "foreign related person" is defined under § 7874(d)(3) and, for purposes of the new regulations, does not include expatriated foreign subsidiaries.[193] The Obama administration and the Department of the Treasury hope that effecting this change will prevent corporations from utilizing hopscotch loans to avoid paying US taxes on income earned abroad.[194]

B. Scrutinizing the Reorganization of Foreign Subsidiaries: § 7701(l)

Following an inversion, some US multinationals avoid paying US taxes on deferred earnings by their CFCs when the new foreign parent purchases enough stock in the CFC to take control away from the prior US parent.[195] Such a "'de-controlling' strategy" allows the new foreign parent to use the deferred earnings without paying US tax on the income.[196] Section 7701(*l*)

187. *See* Patton, *supra* note 184.

188. "An inversion transaction may permit the top corporate parent in the newly inverted group, a group still principally comprised of U.S. shareholders and their CFCs, to avoid section 956 by accessing the untaxed earnings and profits of the CFCs without a current tax [on] the U.S. shareholders." I.R.S. Notice 2014-52, 2014-42 I.R.B. 712, 717. This would be impossible, but for the inversion. *Id.* "The ability of the new foreign parent to access deferred CFC earnings and profits would in many cases eliminate the need for . . . CFCs to pay dividends to the U.S. shareholders, thereby circumventing the purposes of section 956." *Id.*

189. *See* Patton, *supra* note 184.

190. *Id.*

191. *See* Treasury Fact Sheet, *supra* note 103. "[S]olely for purposes of Code Sec. 956, any obligation or stock of a foreign related person . . . will be treated as U.S. property within the meaning of Code Sec. 956(c)(1) to the extent such obligation or stock is acquired by an expatriated foreign subsidiary during the applicable period." *Forthcoming Regs*, *supra* note 69.

192. I.R.S. Notice 2014-52, 2014-42 I.R.B. 712, 717.

193. *Id.*

194. *See supra* notes 175–93 and accompanying text.

195. *See* Treasury Fact Sheet, *supra* note 103; *see also* Patton, *supra* note 184.

196. Treasury Fact Sheet, *supra* note 103.

of the Code provides that "[t]he Secretary may prescribe regulations recharacterizing any multiple-party financing transaction as a transaction directly among any 2 or more of such parties where the Secretary determines that such recharacterization is appropriate to prevent avoidance of any tax imposed by [the Code]."[197]

In light of the Notice, a newly created foreign parent "would be treated [under § 7701(*l*)] as owning stock in the former U.S. parent, rather than the CFC, to remove the benefits of the 'de-controlling' strategy."[198] The Notice's changes to the construction of § 7701(*l*) should facilitate the recharacterization of transactions that formerly permitted the avoidance of US taxes on an expatriated foreign subsidiary's profits from before its inversion.[199] This recharacterization will allow the United States to recapture some taxable income from inverted corporations and therefore serves as a disincentive for companies considering an inversion.[200] Accordingly, the changes implemented under § 7701(*l*) should reduce the tax benefits of a strictly "paper" inversion transaction.[201]

C. Preventing Tax Avoidance by Reclassifying Stock Sales to CFCs: § 304(b)

The Notice also describes forthcoming regulations applying to § 304(b)[202] of the Code. The changes related to this section close a loophole by prohibiting inverted corporations from transferring money or other property from a CFC to a newly created foreign parent in a maneuver that previously enabled a complete avoidance of US taxes.[203] Prior to these changes, a new foreign parent would sell its stock in the former US parent to a CFC holding deferred earnings, effectively producing a tax-free repatriation of cash through the circumvention of the original US parent.[204] Following the Notice, such transactions are

197. I.R.C. § 7701(*l*) (2014).

198. Treasury Fact Sheet, *supra* note 103.

199. *See Forthcoming Regs*, *supra* note 69.

200. *See* I.R.S. Notice 2014-52, 2014-42 I.R.B. 712, 719.

201. *See id.*

202. I.R.C. § 304(b) (2014).

203. *See* Treasury Fact Sheet, *supra* note 103.

204. *See id.* I.R.C. § 304(a)(1) states that if:

> [O]ne or more persons are in control of each of two corporations, and . . . in return for property, one of the corporations acquires stock in the other . . . from the person . . . so in control, then . . . such property shall be treated as a distribution in redemption . . . of the corporation acquiring such stock.

I.R.C. § 304(a)(1)(A)–(B). The new regulations under § 304 are effected to prevent the removal of untaxed foreign earnings and profits from CFCs. *See Forthcoming Regs*, *supra* note 69.

disallowed for the sake of applying § 304(b)(5)(B), because for the determination of the taxability of § 304(b)(2) dividends, the IRS now only considers the earnings and profits of the acquiring corporation, rather than the issuing corporation.[205]

The transactions with which the changes related to § 304 are primarily concerned are those where earnings of a CFC are artificially reduced to facilitate the repatriation of cash or other property held by the CFC, without paying the normal US taxes.[206] In response to such tax-avoiding transactions, and pursuant to the Notice, Treasury will determine, for the purposes of § 304(b)(5)(B), whether at least 50 percent of the dividends arising under § 304(b)(2) are subject to US corporate income tax based solely on the income of the acquiring corporation.[207] Regulators hope these changes will reduce the erosion of the US corporate income tax base caused by inversion transactions and that they will provide a disincentive for companies considering inversion.[208]

D. Reducing Inversion Gains Through Consideration of Ownership Stakes, "Spinversions," and Deemed Dividends: § 7874 and § 367

In response to an increasing trend of domestic entities distributing property to their prior shareholders or partners in order to dilute an ownership stake,[209] the Notice announces additional regulatory reforms under § 7874[210] and § 367[211] of the Code.[212] Section 7874(a)(1) provides that "[t]he taxable income of an expatriated entity for any taxable year which includes any portion of the applicable period shall in no event be less than the inversion gain of the entity for the taxable year."[213] Treasury and the IRS are cognizant that some taxpayers have been transacting with foreign corporations that possess reserves of liquid assets in order to invert

205. *See Forthcoming Regs*, *supra* note 69.

206. *See* I.R.S. Notice 2014-52, 2014-42 I.R.B. 712, 722 ("For example, after an inversion transaction, the foreign acquiring corporation may sell a portion of the stock of the domestic corporation acquired in the inversion transaction to a wholly owned CFC of the domestic corporation in exchange for property of the CFC.").

207. *Id.*; *see also supra* note 205 and accompanying text.

208. *See* Treasury Fact Sheet, *supra* note 103.

209. Ownership stake may be calculated through application of an ownership fraction. Reducing the numerator of that fraction—a result achieved by corporations using this tactic—serves to dilute one's share of ownership. *See* I.R.S. Notice 2014-52, 2014-42 I.R.B. 712, 712–13, 719.

210. I.R.C. § 7874 (2014).

211. I.R.C. § 367 (2014).

212. I.R.S. Notice 2014-52, *supra* note 175, at 712–21.

213. I.R.C. § 7874(a)(1).

and avoid the effect of § 7874.[214] In order to halt this tax-avoiding behavior, the September 2014 Treasury Notice takes several steps to make these transactions more difficult to accomplish.[215] These additional barriers include a requirement that US shareholders in an inverted firm own less than 80 percent of the new entity,[216] a limitation on the usage of passive assets[217] to evade this 80 percent rule,[218] and steps to prevent evasion of the rules by way of very large dividends prior to an inversion.[219]

Another practice that has drawn the ire of Treasury is a type of transaction known as a "spinversion."[220] In these transactions, a US company essentially inverts a share of its operations by transferring assets to a newly spawned foreign corporation, after which that foreign corporation is "spun off" to the US company's public shareholders.[221] The Notice removes the tax benefit of these transactions because the spun-off company is treated as a domestic corporation.[222] The changes to the

214. *See* I.R.S. Notice 2014-52, 2014-42 I.R.B. 712, 713.

215. *See infra* notes 216–19 and accompanying text.

216. *See* Treasury Fact Sheet, *supra* note 103. "'We've recently seen a few large corporations announce plans to exploit this loophole, undercutting businesses that act responsibly and leaving the middle class to pay the bill, and I'm glad that [Treasury Secretary Jack Lew] is exploring additional actions to help reverse this trend,' the president said in a statement." *Obama Announces US Crackdown on Inversion Tax 'Loophole,'* BBC NEWS (Sept. 23, 2014), http://www.bbc.com/news/business-29320029, *archived at* https://perma.cc/6CYL-UDK6 (alteration in original).

217. "[I]n some inversion transactions, the foreign acquirer's size is inflated by passive assets, also known as 'cash boxes,' such as cash or marketable securities. These assets are not used by the entity for daily business functions." Treasury Fact Sheet, *supra* note 103.

218. Passive assets can only account for up to 50 percent of the foreign corporation's assets. *See id.* This requirement does not apply to banks and other financial institutions. *Id.* In response to tax avoidance by inverting corporations, § 1.7874-1 provides a pair of exceptions to the Code: "the internal group restructuring exception and the loss of control exception." I.R.S. Notice 2014-52, 2014-42 I.R.B. 712, 715. "When either of these exceptions applies, stock of the foreign acquiring corporation held by members of the [expanded affiliate group] is excluded from the numerator but not the denominator of the ownership fraction." *Id.* Forthcoming regulations will appear under § 7874(c)(6) and provide that if greater than half of the gross value of all "foreign group property" is nonqualified, then a certain amount of the stock in the acquiring corporation will be withheld from the denominator when calculating ownership. *Id.* at 713. This analysis is to be performed after the acquisition and all related transactions are completed. *Id.*

219. *See* Treasury Fact Sheet, *supra* note 103. Such dividends used to reduce an ownership fraction are known as "skinny-down" dividends. *Id.* The Notice "would disregard these pre-inversion extraordinary dividends for purposes of the ownership requirement, thereby raising the U.S. entity's ownership, possibly above the 80 percent threshold." *Id.*

220. *Id.*

221. *Id.* ("This [type of] transaction takes advantage of a rule that was intended to permit purely internal restructurings by multinationals.").

222. *Id.* ("Under [the September 2014] action[s], the spun-off foreign corporation would not benefit from these internal restructuring rules with the result that the spun off company would be treated as a domestic corporation, eliminating the use of this technique for these transactions.").

implementation of § 7874 are therefore designed to recapture lost tax revenue and to make inversions less appealing for corporations that consider them in the future.[223]

Related to the changes in the construction of § 7874, the Notice also details a forthcoming modification to the regulatory interpretation of § 367[224] that will further curtail a corporation's ability to invert.[225] Section 367(a)(1) provides generally that "[i]f . . . a United States person transfers property to a foreign corporation, such foreign corporation shall not, for purposes of determining the extent to which gain shall be recognized on such transfer, be considered to be a corporation."[226] Furthermore, § 367(b)(1) specifies:

> In the case of [certain types of exchanges] in connection with which there is no transfer of property described in subsection (a)(1), a foreign corporation shall be considered to be a corporation except to the extent provided in regulations prescribed by the Secretary which are necessary or appropriate to prevent the avoidance of Federal income taxes.[227]

The IRS was concerned that inverting corporations were abusing § 367 to avoid paying income taxes when domestic entities would disburse property to prior shareholders, therefore lowering the numerator in the ownership fraction used as a threshold for tax eligibility.[228] In response to these abuses, Treasury has given notice of its intent to amend § 367(b) so that exchanging shareholders, as defined in § 1.367(b)-4(b)(1)(i)(A),[229] will be required to count such above-mentioned disbursements of assets as a deemed dividend that qualifies as income for income tax purposes, regardless of whether the conditions in § 1.367(b)-4(b)(1)(i)(B) have been met.[230] The Obama administration and the IRS hope that this change, along with the other measures implemented by the Notice,[231] will deter corporations from inverting and will make it less profitable for those which do so nonetheless.[232]

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223. *See id.*
224. I.R.C. § 367 (2014).
225. I.R.S. Notice 2014-52, 2014-42 I.R.B. 712, 720.
226. I.R.C. § 367(a)(1).
227. *Id.* § 367(b)(1).
228. *See* I.R.S. Notice 2014-52, 2014-42 I.R.B. 712, 718–20.
229. 26 C.F.R. § 1.367(b)-4(b)(1)(i)(B) (2016).
230. I.R.S. Notice 2014-52, 2014-42 I.R.B. 712, 720.
231. *See supra* notes 175–230 and accompanying text.
232. *See* McKinnon & Paletta, *supra* note 176.

IV. CRITICAL RESPONSE TO REGULATORY LIMITATION OF INVERSIONS

A. Reaction to the September 2014 Treasury Notice

Lawmakers hope that Treasury's recent efforts will serve as a disincentive for prospective inverters, even if the Notice is best understood as an interim measure in anticipation of more comprehensive reforms in the future.[233] Any idea that the Notice provides an "ultimate solution" to the perceived inversion problem would be met with warranted skepticism, considering this shift in policy within the historical context of governmental regulation of inversions.[234] However, despite sentiment that the Notice falls short of heralding the demise of inversions, the stock markets reflected an immediate investor response. One day after the September 2014 changes were announced, AstraZeneca stock fell 4.5 percent, Shire declined 1.7 percent, and Pfizer was down 0.7 percent.[235] Each of those corporations was involved in a pending inversion deal.[236] Furthermore, the Notice affected a number of deals that were pending in September 2014, including Medtronics' acquisition of Covidien, Salix Pharmaceuticals' acquisition of Cosmo Pharmaceuticals, Mylan's acquisition of part of Abbott Laboratories' business, and the merger of Chiquita with Fyffes.[237]

Treasury officials, who had previously projected about thirty new inversions in the last quarter of 2014, hoped that companies would consider the new rules, reexamine the cost of inverting, and ultimately decide that the transaction no longer made business sense.[238] Responses by politicians have predictably followed party lines, with Democrats lauding

233. *See* Treasury Fact Sheet, *supra* note 103. "Mr. Lew was the first to admit . . . the new actions are in no way a substitute for a broader reform of the U.S. corporate tax code. They are, at most, a short-term fix for one specific manifestation of the code's overall inefficiency." Editorial Board, *Mr. Obama's Action Against Corporate Tax 'Inversions' Just a Short-Term Fix*, WASH. POST (Sept. 23, 2014), https://www.washingtonpost.com/opinions/mr-obamas-action-against-corporate-tax-inversions-are-just-a-short-term-fix/2014/09/23/84ff2416-4359-11e4-9a15-137aa0153527_story.html.

234. *See supra* notes 112–27 and accompanying text.

235. Steve Schaefer, *AstraZeneca Hurt as Obama Tries to Get Tough on Tax Inversions*, FORBES (Sept. 23, 2014, 10:28 AM), http://www.forbes.com/sites/steveschaefer/2014/09/23/astrazeneca-hurt-as-obama-tries-to-get-tough-on-tax-inversions/. "Those declines may be overdoing it though. Citi analyst Andrew Baum suggested . . . that the measures . . . 'do little to negatively impact the economic benefit' of a proposed Pfizer/AstraZeneca tie-up, as Pfizer could drop its tax rate from 28% to 22% even without using the so-called 'hopscotch' loans . . . . " *Id.*

236. *Id.*

237. *See* McKinnon & Paletta, *supra* note 176. The Burger King deal may not be affected. *Id.*

238. *Id.*

the efforts of Treasury and Republicans expressing skepticism.[239] However, some experts have questioned the extent to which Treasury can further limit inversions. They speculate that legal challenges to the Notice could be possible and that enterprising firms will inevitably still find ways to circumvent the restrictions.[240] Furthermore, if the Obama administration's anti-inversion plan is effective, the cause for tax reform may, ironically, be set back.[241] For voters, little can demonstrate the need to modernize corporate tax laws better than observations of US firms expatriating to reduce their tax burden after years of benefiting from strong US infrastructure.[242] Therefore, if the Notice is as successful in blocking inversions as Obama hopes it will be, the call for larger corporate tax reform may lose momentum.[243]

In the months following the publication of the Notice, there have been signs that industry is feeling the changes, but the new rules have, as expected, failed to completely reverse the inversion trend.[244] The Medtronic-Covidien deal[245] that was pending prior to the release of the Notice provides an example. Many thought that Medtronic would try to renegotiate its $42.9 billion bid.[246] However, after making adjustments to compensate for the new rules, the deal closed in late January 2015.[247] In

239. *See id.* ("Senate Finance Committee Chairman Ron Wyden (D., Ore.) said the new policy 'reinforces the urgency for action before this growing wave of inversions erodes our nation's tax base' and suggested he would continue trying to pursue legislation to ban the practice. House Ways and Means Committee Chairman David Camp (R., Mich.) had a more barbed response. 'A few campaign style speeches and stopgap measures from Treasury won't do it,' he said. 'It hasn't worked in the past.' He didn't, however, recommend the Obama administration scrap the new rules.").

240. *See id.*; Editorial Board, *supra* note 233 ("Tax-law experts generally agree that Treasury's moves amount to an aggressive use of its existing legal authorities, not an illegitimate overextension of them, though that assessment may be tested in court.").

241. Editorial Board, *supra* note 233.

242. *Id.*

243. *See id.* "Yet if there is room for post-election agreement between Republicans and Democrats on any economic issue, it could be an overhaul of the loophole-ridden system of business taxation, the broad principles of which are recognized by leaders of both parties." *Id.*

244. *See supra* notes 130–36, 235–37 and accompanying text.

245. *See supra* notes 130–38 and accompanying text.

246. "The new rules make it more expensive for Medtronic to buy Covidien, by potentially requiring it to take out a loan instead of using cash held abroad, according to the people familiar with the matter and a Reuters analysis of the contract." Soyoung Kim, *New U.S. Tax Rules May Lead Medtronic to Redo Inversion Deal*, REUTERS (Sept. 29, 2014, 7:00 AM), http://www.reuters.com/article/us-usa-tax-inversion-medtronic-idUSKCN0HL2G920140926, *archived at* https://perma.cc/M84N-V37G. In light of the new rules, Covidien might have been asked to accept a reduced price or to receive more stock and less cash. *Id.* However, Covidien retains leverage because of a large "breakup fee," should Medtronic renege on the deal. *Id.*

247. Press Release, Medtronic, Medtronic Completes Acquisition of Covidien (Jan. 26, 2015), *available at* http://newsroom.medtronic.com/phoenix.zhtml?c=251324&p=irol-newsArticle&ID=2010595, *archived at* https://perma.cc/X3KZ-3N39.

fact, in anticipation of the deal with Medtronic, Covidien's earnings increased 28 percent on sales growth in its primary business segment.[248] Despite the Notice, this major inversion deal was ultimately consummated, although Medtronic was required to raise an additional $16 billion in debt financing in light of the new rules.[249]

Shortly after Treasury released the Notice, industry began commenting on the perceived effectiveness of the changes to the interpretation of various sections of the Code and on the possibility of circumventing the latest prohibitions.[250] The changes in the implementation of § 956(e), designed to prevent the use of hopscotch loans, will not even affect all inversion deals. For example, according to Citi analyst Andrew Baum, the inversion deal between Pfizer and AstraZeneca that was proposed in 2014 could have still transpired without use of the now-forbidden loans.[251] Furthermore, some have speculated that Treasury's revised interpretation of § 956(e) can be avoided altogether. Sam Lichtman, a Tax partner at Haynes and Boone, LLP in New York, theorized that companies could avoid the rule by having a foreign subsidiary holding substantial cash give an advance to an affiliate corporation in a lower-tax jurisdiction for inter-company goods or intellectual property under certain types of contracts.[252] Under such a transaction, these advance payments may not be treated as creating an "obligation" for the parent, which would allow for a tax advantage if the corporation were to undergo a subsequent inversion.[253]

248. Angela Chen, *Covidien Earnings Rise on Growth in Surgical Sales*, WALL ST. J. (Jan. 22, 2015, 9:30 AM), http://www.wsj.com/articles/covidien-earnings-rise-on-growth-in-surgical-sales-1421937034.

249. *Id.*

250. *See infra* notes 251–63 and accompanying text.

251. *See* Schaefer, *supra* note 235 ("U.S. cash flow of the combined Pfizer/AstraZeneca would still be sufficient—along with Pfizer's usual debt financing—to cover the approximately $4.5 billion in dividends the company would pay."). After Pfizer's deal with AstraZeneca fell apart, the pharmaceutical giant proceeded to announce what would have been the largest inversion deal in history: a $160 billion merger with Allergan. *See* Portia Crowe, *The Largest Takeover of the Year Is All About Avoiding US Taxes*, BUS. INSIDER (Nov. 23, 2015, 10:03 AM), http://www.businessinsider.com/pfizer-allergan-deal-tax-inversion-2015-10. Pfizer's deal with Allergan was called off, however, after Treasury released even more stringent anti-inversion regulations in April 2016. *See* Renae Merle & Carolyn Y. Johnson, *Pfizer, Allergan Call Off $160 Billion Merger After U.S. Moves to Block Inversions*, WASH. POST (Apr. 6, 2016), https://www.washingtonpost.com/business/economy/pfizer-allergan-call-off-160-billion-merger-after-us-moves-to-block-inversions/2016/04/06/4fd55446-fc11-11e5-80e4-c381214de1a3_story.html. The April 2016 regulations are beyond the scope of this Note.

252. *See* Patton, *supra* note 184.

253. *See id.* "Absent an inversion, these advance payments by the foreign subsidiary would be includible in income for U.S. tax purposes regardless of whether the payment is structured as a loan or deposit (giving rise to a deemed dividend) or as a business payable (giving rise to operating income)." *Id.* (quoting Sam Lichtman).

Therefore, Lichtman argues that the new rules fail to entirely remove the tax benefits associated with hopscotch loans.[254]

Furthermore, according to Lichtman, the changes related to § 7701(*l*) that are designed to prevent inverted corporations from gaining tax-free access to their foreign subsidiaries' earnings may also be ineffective.[255] He explains that the new rule would not apply when US shareholders use income from a deemed dividend as part of a de-controlling transaction.[256] Thus, the post-inversion earnings of a CFC would be available for a parent corporation without incurring US tax liability.[257] As such, Treasury's objectives under § 7701 are likewise frustrated.

Finally, there are also questions about the effectiveness of the changes under § 7874 of the Code. For example, the Notice did not impact the well-known deal between Burger King and Tim Hortons, because Burger King only gained 51 percent control of the Canadian firm that survived the merger.[258] This figure is comfortably within Treasury's new 80 percent rule.[259] In light of the recent Burger King deal,[260] and with the ownership threshold set at only 80 percent under § 7874, the new regulations may be doing less than originally hoped to reduce the incentives that motivate corporations to invert.[261] The long-term impact of these regulations from Treasury will ultimately have to be assessed after more time has passed and the market has had an opportunity to evaluate and respond to the rules. There are already several compelling reasons,[262] however, to be skeptical that the Notice will function as any sort of panacea for the shortcomings of the US corporate tax system.[263]

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254. *Id.*

255. *Id.*

256. *Id.*

257. *Id.*

258. "Moreover, its shareholders will only own 27 per cent of the company . . . . That alone already complies to [sic] the Treasury Department's new less-than-80-per cent rule . . . ." Esther Tanquintic-Misa, *Burger King, Tim Hortons Merger Still on Go Despite the New US Tax Rules, $2.25B Worth of Notes Issued to Fund Purchase*, INT'L BUS. TIMES (Sept. 25, 2014, 2:00 PM), http://www.ibtimes.com.au/burger-king-tim-hortons-merger-still-go-despite-new-us-tax-rules-225b-worth-notes-issued-fund, *archived at* https://perma.cc/AZ79-RCX8.

259. *Id.* Treasury had considered making the threshold 50 percent, but that would have required congressional approval. Glenn Brock, *Burger King Proceeds with Purchase of Tim Horton's, Despite Changes in Tax Rules*, INQUISITR (Sept. 27, 2014), http://www.inquisitr.com/1503885/burger-king-proceeds-with-purchase-of-tim-hortons-despite-changes-in-tax-rules/, *archived at* https://perma.cc/3NG7-LTWB.

260. "'This deal has always been driven by long-term growth and not by tax benefits,' the companies said in a joint statement." *Id.*

261. *See id.*

262. *See supra* notes 251–61 and accompanying text.

263. *See generally supra* notes 112–28 and accompanying text.

B. General Response to Anti-Inversion Regulatory Schemes

While the Obama administration's September 2014 move to discourage corporations from inverting is motivated by a desire to shore up the US corporate tax base[264] and to more equitably distribute the tax burden,[265] there are reasons to question whether these changes will have the desired effect. Although any new regulations are likely to temporarily stall inversions while companies take time to assess how their plans might be affected,[266] history shows that additional rules tend to serve merely as short-term patches for larger problems with the Code.[267] Furthermore, each successive round of Treasury efforts to limit inversions removes pressure from Congress to deal with the greater problem of the outdated US corporate tax structure.[268] This is especially unfortunate considering that, in more than thirty years of seeking to contain inversions, congressional and regulatory responses have tended to fall short of their desired impact because Washington has failed to anticipate how industry will respond.[269] So far, those responses have largely circumvented lawmakers' efforts to prohibit the transactions.[270] In light of the Notice, it appears that regulators have succumbed to the usual pitfall, rather than partnering with businesses and considering a more comprehensive overhaul of the Code.[271]

In addition to doubts about whether or not the new rules will have their desired effect, there are also reasons to fear that they actually provide businesses with some incentives that have negative implications for the US economy.[272] The Notice prohibits inversions through mergers where US shareholders account for 80 percent or more of the combined entity, and the Obama administration hopes that Congress will be even more restrictive by prohibiting such mergers unless the domestic parent makes

264. *See supra* note 71 and accompanying text.

265. *See supra* note 177 and accompanying text.

266. *See* McKinnon et al., *supra* note 76 ("The Obama administration's move to tighten rules on corporate inversions should discourage new deals, at least for a while, by making them harder and less profitable, tax experts said.").

267. *See* Editorial Board, *supra* note 233.

268. McKinnon et al., *supra* note 76 ("Taking regulatory action 'could take the pressure off for corporate-tax reform, which is the main thing to do,' said Sen. Charles Grassley (R., Iowa) . . . .").

269. *See* Patton, *supra* note 184 ("Legislators have often changed the . . . [C]ode . . . and projected success based on certain assumptions. What often seems to be overlooked is human behavior. In other words, though Washington may assume a static response, legislation often falls short . . . because they fail to consider how those affected by the legislation might alter their behavior.").

270. *See supra* notes 112–28 and accompanying text.

271. Patton, *supra* note 184 ("Rather than reduce the corporate tax burden, giving corporations a reason to remain in the U.S., it appears the government has taken an adversarial posture once again.").

272. *See infra* notes 273–89 and accompanying text.

up no more than half of the new firm.[273] However, such restrictions may actually incentivize nascent businesses to incorporate abroad from the outset in order to comply with the new rules, so that jobs and money are never brought to the United States to begin with.[274]

Martin Regalia, the leading economist at the US Chamber of Commerce, espouses the view that Treasury's September 2014 effort to stymie inversions will encourage companies to develop new jobs abroad.[275] Regalia criticized regulators, saying that "the administration just assured that deferred income in the once foreign subsidiary will never come back to the U.S. to help create income, jobs, and economic growth here."[276] Others have suggested that inversions actually harm the US labor force by sending jobs overseas to the countries in which expatriated corporations are reincorporating.[277] This view is mistaken, however, because inversions are strictly "paper transactions" and do not actually require corporations to move any jobs or facilities abroad.[278] Conversely, limiting the ability of corporations to invert actually does incentivize companies to send US jobs to foreign countries, because when inversions are regulated to the point of impracticality, "paper transactions" are no longer sufficient to relieve heavy tax burdens.[279]

Another way that corporations can avoid the reach of current US regulation, which also has negative implications for the economy, is by following what *Washington Post* columnist Allan Sloan has dubbed the "never-here" route.[280] Major businesses that have followed this route include formerly privately-held companies such as Seagate and Accenture.[281] Seagate, for example, started as a US company and underwent a "going private"[282] transaction in a buyout.[283] Its owners then moved it as a private company to the Cayman Islands,[284] where they

273. *See* McKinnon et al., *supra* note 76.
274. *See id.*
275. McKinnon & Paletta, *supra* note 176.
276. *Id.* (quoting Martin Regalia).
277. Sheppard, *supra* note 27, at 559.
278. *See id.*
279. *See id.* at 559–60.
280. Sloan, *supra* note 54 ("We've also got a second, related problem, which I call the 'never-heres.'").
281. *Id.*
282. "This procedure leaves only that group of insiders who direct the corporate reacquisition programs (usually the very ones who took the companies public originally) as the surviving shareholders in a now privately held enterprise. Such a program of share reacquisition is known as 'going private.'" Note, *Going Private*, 84 YALE L.J. 903, 903 (1975).
283. Sloan, *supra* note 54.
284. The Cayman Islands are a tax haven. Rosenzweig, *supra* note 166, at 961.

subsequently implemented a "going public"[285] transaction.[286] Seagate then moved as a public company from the Cayman Islands to Ireland[287] a few years later.[288] According to Sloan, "[f]irms like these can duck lots of U.S. taxes without being accused of having deserted our country because technically they were never here."[289] While these transactions do not actually qualify as inversions, never-here deals could become more commonplace as additional regulations are passed to restrict inversions. Since these transactions have the same effect of diminishing the corporate tax base, there is no reason to prefer regulations that encourage would-be inverters to follow the path taken by Seagate and Accenture rather than the traditional inversion route that has existed since the 1980s.[290]

In light of the historical ineffectiveness[291] of policies that seek to prevent corporations from expatriating to foreign countries with more advantageous tax regimes, the United States should embrace the new reality that it is but a single player on a competitive international stage. There was once a time when the United States paced the market and could charge essentially whatever tax rates it desired because there was a sense that the United States was the financial, political, and economic capital of the world.[292] This paradigm no longer applies, however, because of the increasing global influence of economies such as the European Union, Brazil, Russia, India, and China.[293] The United States is now better understood as *one* of the world's economic superpowers, not *the* economic superpower.[294] Recognizing that it is now just one country among many vying to be the home of massive multinational corporations, the United States must reposition itself to become more competitive globally.

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285. "Going public" happens when a company "mak[es] the transition from being privately owned to having shares traded and owned by public investors." Christine Hurt, *Moral Hazard and the Initial Public Offering*, 26 CARDOZO L. REV. 711, 712 (2005).

286. *See* Sloan, *supra* note 54.

287. Ireland has a corporate tax rate of about 12.5 percent. Lorenzetti, *supra* note 40.

288. Sloan, *supra* note 54.

289. *Id.*

290. *See id.* Companies' following the never-here route may undermine the tax base and further reduce the public's perception of corporations. *Id.* "[S]ome 60 U.S. companies have chosen the never-here or the inversion route, and others are lining up to leave." *Id.* Since both a corporation's choosing a typical inversion transaction and a company's utilizing the never-here route diminish the US corporate tax base, there seems to be little reason to prefer one path to the other. *See id.*

291. *See supra* notes 112–28 and accompanying text.

292. *See generally* John E. Rielly, *America Unbound: The Future of American Hegemony*, 30 VT. L. REV. 123 (2005).

293. *See generally* Mark C. Anderson, *A Tougher Row to Hoe: The European Union's Ascension as a Global Superpower Analyzed Through the American Federal Experience*, 29 SYRACUSE J. INT'L L. & COM. 83 (2001).

294. *See generally id.*

Countries compete for corporations based on the favorability of their tax rates, and the relative benefits of their infrastructure, educational institutions, financial markets, and legal systems.[295] The United States is no longer competitive on the basis of its tax laws. It can be expected, furthermore, that rival countries will continue to close the gap in other ways as more companies leave the United States or refuse to initially incorporate here because of burdensome US taxes.[296] As companies leave the United States, corporate earnings and associated tax revenues will flow into foreign countries. This allows those countries to improve their infrastructure, reducing any comparative US advantage in that respect, and further compounds the erosion of the United States' appeal as a home for multinationals.[297] Accordingly, it is imperative that the United States acknowledge that its interests are best advanced by working with businesses to give them reasons to incorporate domestically, thereby securing critical corporate revenues and jobs for the future.

As an alternative to perpetuating the cycle of reactive regulations that invariably only temporarily slow the pace of inversions,[298] the United States should implement comprehensive corporate tax reform that makes the US competitive with other industrialized nations. An improved corporate tax structure would adhere to two primary notions: "competitiveness and neutrality."[299] Placing an upper limit for corporate taxes around 25 percent and abandoning the anachronistic worldwide tax system for a territorial system would be an excellent core around which to

295. "President Clinton frequently would say that each nation is 'like a big corporation competing in the global marketplace.'" Michael S. Knoll, *The Connection Between Competitiveness and International Taxation*, 65 TAX L. REV. 349, 352 (2012); *see also* Simeon Djankov et al., *The Effect of Corporate Taxes on Investment and Entrepreneurship* app. A (Nat'l Bureau of Econ. Research, Working Paper No. 13756, 2008), *available at* http://www.nber.org/papers/w13756.pdf (finding that the United States has the third-highest five-year effective tax rate out of eighty-five countries studied, behind only Bolivia and Pakistan).

296. *See generally supra* notes 39–45 and accompanying text.

297. Bono, front man of the band U2, said the following about his homeland of Ireland: "We are a tiny little country, we don't have scale, and our version of scale is to be innovative and clever, and tax competitiveness has brought our country the only prosperity we've known." Rupert Neate, *Bono: Controversial Tax Laws Have Brought Ireland the Only Prosperity It's Ever Known*, THE GUARDIAN (Oct. 11, 2014, 7:05 PM), http://www.theguardian.com/world/2014/oct/12/bono-tax-laws-bring-ireland-prosperity-apple-google-u2 (internal quotation marks omitted).

298. *See supra* notes 112–28 and accompanying text.

299. Pomerleau & Lundeen, *supra* note 41. "A competitive tax code is a code that limits the taxation of businesses and investment. . . . A neutral tax code raises the most amount of revenue with the fewest number of economic distortions. . . . [I]t doesn't favor consumption over saving, as happens with capital gains and dividend taxes . . . ." *Id.*

base reform.[300] Such changes would remove the incentives for corporations to invert and would instead give multinationals a good reason to locate in the United States, especially considering the infrastructure, educational opportunities, financial markets, and other resources the United States has to offer. According to Tony James, President and Chief Operating Officer of Blackstone and a major supporter of Obama, the President is open to seeking a bipartisan deal on corporate taxation, if he can find support from both Democratic and Republican centrists with whom he can partner.[301] "'If that happened, the business community would be wildly enthusiastic,' James said. 'I think the economy could easily pick up another point or two of growth.'"[302] While it would certainly be a challenging process and while there would be much disagreement over the particulars of the change to be implemented, the United States would benefit greatly from politicians willing to invest the political capital required to make a meaningful difference. As the need for corporate tax reform becomes increasingly apparent in Washington, irrespective of party loyalties,[303] it seems that the time for a major reevaluation of the Code's treatment of corporate taxation is drawing near.

V. CONCLUSION

After measured consideration of the corporate tax inversions that have been taking place for the past thirty years and the inadequacy of the government's subsequent responses,[304] it is clear that the Code requires more substantive revision.[305] By taxing corporations at maximum statutory rates otherwise unheard of in the developed world[306] and claiming tax jurisdiction over corporations' worldwide earnings,[307] the United States is poorly positioned to be globally competitive as a home for businesses. While corporate tax rates have generally been declining worldwide over the past two decades, the United States has not kept pace, and—in order to compete against multinationals abroad—US businesses have crafted their own solution: corporate tax inversions.[308] After thirty years of failed

300. *See id.* This would improve US employment and wages and the domestic standard of living. *Id.*

301. *See* Warmbrodt & Prior, *supra* note 82.

302. *Id.*

303. *See supra* note 239 and accompanying text.

304. *See supra* Parts II.B–C.

305. *See supra* Part IV.

306. *See supra* notes 40–42 and accompanying text.

307. *See supra* notes 26–27 and accompanying text.

308. *See supra* Part II.B.

attempts to block companies from engaging in the practice, or to at least lessen the incentive to invert by imposing various penalties, it is time to consider a new, more permanent approach.[309]

Former President Bill Clinton may have put it best when he said that "[w]e're bailing water out of a leaky boat. . . . Either we undertake corporate tax reform, or every other country in the world says, 'We are wrong and we'll go back to the way we used to do it.'"[310] The purpose of a corporation is to maximize value for shareholders,[311] and a corporate fiduciary is obligated to make business decisions congruent with that purpose, rather than stoically defending the antiquated US tax system under the guise of "patriotism."[312] Despite the contentiousness of the issue, lawmakers on both sides of the aisle may find that there is more common ground than they had previously thought[313] on priorities such as shoring up the tax base, simplifying the Code, and ensuring that the United States remains a global leader as a home for business and trade. If momentum can be sustained, Washington may finally be ready for the first comprehensive revision of the tax code in twenty years.[314]

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309. *See supra* Parts II.D, IV.B.

310. Campbell, *supra* note 150 (internal quotation marks omitted). "This is practical economics and practical politics," said Bill Clinton. Lorenzetti, *supra* note 40 (internal quotation marks omitted).

311. Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919).

312. *See generally* Sloan, *supra* note 54. Inversions are "a new kind of American corporate exceptionalism." *Id.*; *see also supra* note 82 and accompanying text.

313. *See supra* note 90 and accompanying text.

314. The current corporate tax structure has been in place since 1993. *See* Lorenzetti, *supra* note 40.

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