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## Articles

### IS UNITED STATES CORPORATE TAX POLICY OUTSOURCING AMERICA? A CRITICAL ANALYSIS OF THE PROPOSED TAX HOLIDAY FOR TRAPPED CFC EARNINGS

ROBERT BLOINK

#### I. INTRODUCTION

THE debate about how best to reform U.S. corporate tax policy has focused almost exclusively on making U.S. corporations more competitive globally.<sup>1</sup> But the debate often glosses over tax policy's effect on the ultimate beneficiaries of corporate success and failure—U.S. corporate stakeholders. The assumption often has been that healthy, competitive U.S. corporations equal healthy stakeholders—including shareholders, employees, and the U.S. populace as a whole. However, recent economic research has brought the assumption of “trickle down” success into question.<sup>2</sup>

Economists examining the United States' comparative advantage in relation to its international trading partners suggest that making U.S. multinationals more competitive globally does not necessarily translate into a net increase in domestic investments in plants, property, and equipment or American jobs.<sup>3</sup>

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1. See John D. McKinnon, *Business Group Backs Overhaul of Tax Code*, WALL ST. J., Jan. 21, 2011, at A5, available at <http://online.wsj.com/article/SB10001424052748704881304576094311480595224.html> (discussing necessity of overhauling U.S. tax code and difficulties associated with it); see also JASON J. FICHTNER, JOINT ECON. COMM., REFORMING THE U.S. CORPORATE TAX SYSTEM TO INCREASE TAX COMPETITIVENESS 1 (2005), available at <http://www.house.gov/jec/CorporateTaxReform.pdf> (“The existing U.S. corporate tax laws have grown into a patchwork of overly complex, inefficient and unfair provisions that impose large costs on corporate business. U.S. corporations seeking to minimize the costs imposed by the counterproductive provisions in the U.S. corporate tax system have adopted strategies to reduce overall tax exposure and increase profits. Such strategies include moving operations overseas, corporate inversions, transfer pricing, earnings stripping, and complex leasing arrangements, all to minimize taxation.”).

The Committee's report acknowledges that “[c]orporations are not people. They are legal entities involving employees, shareholders, creditors, etc., each with their own individual wealth and income characteristics.” *Id.* at 2. However, it does not specify how recommended changes to U.S. corporate tax policy would affect corporate stakeholders like shareholders and employees.

2. See Kamel Mellahi & Geoffrey Wood, *The Role and Potential of Stakeholders in “Hollow Participation”: Conventional Stakeholder Theory and Institutional Alternatives*, 108 BUS. & SOC'Y REV. 183, 192 (2003) (citing sweatshop model as evidence of decline in trickle down success).

3. See KIMBERLY CLAUSING, *International Taxation*, in TAX POLICY CTR., THE TAX POLICY BRIEFING BOOK: A CITIZENS' GUIDE FOR THE 2008 ELECTION AND BEYOND, at

The disconnect between stakeholder interests and corporate competitiveness is nowhere more evident than in the area of United States international tax policy—which tends to incentivize U.S. multinationals to sock profits away overseas rather than repatriating them into the United States.<sup>4</sup> The controlled foreign corporations (CFC) regime, in particular, creates a tax disincentive for U.S. multinationals to reinvest in domestic operations.<sup>5</sup>

Congress acknowledged the disincentive to repatriation created by U.S. tax policy, enacting a tax holiday in 2004 that many believed would motivate multinational corporations (MNCs) to repatriate billions in overseas profits into the United States, providing a needed bump to the U.S. economy.<sup>6</sup> But tax breaks like the 2004 holiday cost the federal government billions in revenue and prove to be only a blunt policy tool having only a limited impact on domestic stakeholders of U.S. multinationals. Similarly, other proposals—like slashing the U.S. corporate tax rate or transitioning to a territorial system of corporate taxation—would drastically reduce the amount of U.S. taxes collected from multinationals and have a dubious positive impact on corporate stakeholders.<sup>7</sup>

This Article suggests an alternate path focused on enhancing the competitiveness of U.S. MNCs in the global economy while enhancing the welfare of U.S. corporate stakeholders. The Article concludes by suggesting an incremental reform to the current Subpart F regime that would allow U.S. MNCs to repatriate assets currently trapped in CFCs at a low tax cost in exchange for targeted domestic re-investment commitments. This normative solution would have a substantially lower net federal budgetary cost to implement than other proposals currently circulating.

## II. PERMANENT DEFERRAL AND SUBPART F

The United States taxes all U.S. persons, including both individuals and business entities incorporated in the United States, on their worldwide income “from whatever source derived.”<sup>8</sup> A U.S. corporation, for in-

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II-15-1, 15-8 (2007), available at <http://www.taxpolicycenter.org/upload/Elements/II-15KEYELEMENTS-InternationalTaxation.final.pdf> (examining impact of tax system on U.S. competitiveness).

4. See *id.* at II-15-5 (examining consequences of U.S. international tax system).

5. See OFFICE OF TAX POLICY, U.S. DEP'T OF TREASURY, THE DEFERRAL OF INCOME EARNED THROUGH U.S. CONTROLLED FOREIGN CORPORATIONS: A POLICY STUDY, at xii (2000), available at <http://www.treasury.gov/resource-center/tax-policy/Documents/subpartf.pdf> (discussing CFCs).

6. See CHUCK MARR & BRIAN HIGHSMITH, CTR. ON BUDGET & POL'Y PRIORITIES, TAX HOLIDAY FOR OVERSEAS CORPORATE PROFITS WOULD INCREASE DEFICITS, FAIL TO BOOST THE ECONOMY, AND ULTIMATELY SHIFT MORE INVESTMENT AND JOBS OVERSEAS 2 (2011), available at <http://www.cbpp.org/files/4-8-11tax.pdf> (discussing failure of 2004 tax holiday and danger of enacting another tax holiday).

7. See Michael J. Graetz & Michael M. O'Hear, *The “Original Intent” of U.S. International Taxation*, 46 DUKE L.J. 1021, 1026-27 (1997) (discussing U.S. system of taxation for international income).

8. I.R.C. § 61(a) (2006).

stance, that owns both a U.S. manufacturer and a French manufacturer will be taxed on its U.S. and its French income. In contrast to the U.S. system, some of our trading partners (e.g., Hong Kong and Singapore) use a pure territorial system of taxation, under which individuals and companies based in the jurisdiction are taxed only on income earned in the jurisdiction; there is no tax on foreign-sourced income.

#### A. *Capital Export Neutrality and Capital Import Neutrality*

The U.S. system of international taxation was adopted with the goal of maintaining capital export neutrality (CEN). Under CEN, a company's earnings—whether earned domestically or abroad—are taxed at the same rate, with a credit for foreign taxes paid.<sup>9</sup> One of the goals of the United States in generally adopting the principle of CEN was to “maximize global economic welfare”<sup>10</sup> by ensuring that U.S. taxation does not incentivize taxpayers to invest their income in domestic or foreign investments.<sup>11</sup>

In contrast to the principle of CEN, under the economic principle of capital import neutrality (CIN), MNCs and foreign companies that operate in the same market are taxed at the same rates.<sup>12</sup> The idea behind CIN is that all investments in a jurisdiction are subject to the same tax rate regardless of where the taxpayer resides.<sup>13</sup> Under a system using the prin-

9. See OFFICE OF TAX POLICY, *supra* note 5, at 17 n.21 (noting Kennedy Administration's focus on capital export neutrality); ROBERT J. SHAPIRO & APARNA MATHUR, THE ECONOMIC BENEFITS OF PROVISIONS ALLOWING U.S. MULTINATIONAL COMPANIES TO DEFER U.S. CORPORATE TAX ON THEIR FOREIGN EARNINGS AND THE COSTS TO THE U.S. ECONOMY OF REPEALING DEFERRAL 8 (2009), available at [http://www.sonecon.com/docs/studies/Shapiro-Mathur\\_June\\_2009\\_Economic\\_Benefits\\_of\\_Deferral.pdf](http://www.sonecon.com/docs/studies/Shapiro-Mathur_June_2009_Economic_Benefits_of_Deferral.pdf) (defining international tax systems as either worldwide or territorial); Kristen Fullenkamp, *International Tax Reform: Oscillating Between Capital Import and Capital Export Neutrality*, 2 PULSE, no. 3, (2005), available at <http://www.baylor.edu/Pulse/index.php?id=27753> (describing philosophy underlying CEN and CIN); Michael J. Graetz, *Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 26 BROOK. J. INT'L L. 1357, 1363-65 (2001) (defining capital export neutrality).

10. OFFICE OF TAX POLICY, *supra* note 5, at 36; see Robert J. Peroni, *Deferral of U.S. Tax on International Income: End It, Don't Mend It—Why Should We Be Stuck in the Middle with Subpart F?*, 79 TEX. L. REV. 1609, 1609 n.5 (2001) (“[T]he literature on optimal taxation of foreign direct investment income suggests that, when the goal is to maximize global economic welfare, capital export neutrality is probably the best policy.” (quoting OFFICE OF TAX POLICY, *supra* note 5, at 36)).

11. OFFICE OF TAX POLICY, *supra*, note 5, at 23 (discussing system for taxing foreign investment).

12. See SHAPIRO & MATHUR, *supra* note 9, at 8 (contrasting CEN and CIN in context of foreign tax equality structures); Fullenkamp, *supra* note 10 (discussing U.S. stance on international taxation in section entitled “Underlying Philosophies”).

13. See OFFICE OF TAX POLICY, *supra* note 5, at 31 (detailing Thomas Horst's criticism of standard analysis); Michael S. Knoll, *Reconsidering International Tax Neutrality* 3 (Univ. of Pa. Inst. for Law & Econ., Research Paper Series No. 09-16, 2009), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1407198](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1407198) (arguing for more precise definition of CIN).

principle of CIN, if a company earned foreign income, that income would not be taxed at domestic rates; rather, it would be taxed at foreign rates.<sup>14</sup> CIN takes shape in the territorial system of taxation, where taxation depends on the source of the income.<sup>15</sup>

### B. *World Wide Taxation, and Exceptions Thereto*

To an extent, CEN takes shape in the U.S. system of international taxation, but most countries do not have either a pure worldwide tax system or a pure territorial tax system; the majority of countries—including the United States—use a system combining elements of both.<sup>16</sup>

The United States has the authority to tax U.S. individuals on their worldwide income; as a result, U.S. residents—both individual and corporate—can be taxed regardless of where they are located.<sup>17</sup> The United States uses a “current taxation of worldwide income” method, under which U.S. residents are taxed on foreign-source income when earned.<sup>18</sup>

But the United States gives U.S. taxpayers a foreign tax credit to prevent double-taxation—meaning foreign-source income is not taxed domestically if it has already been taxed abroad.<sup>19</sup>

### C. *United States Taxation of Branches and Subsidiaries of U.S. Corporations*

Under the worldwide taxation system, a U.S. corporation is required to include all income and losses from foreign branches in its taxable income.<sup>20</sup> In contrast, income earned by foreign subsidiaries of U.S. corporations generally is not taxed by the United States until that income is sent back to the U.S. parent company via a distribution.<sup>21</sup> This allows those

14. See OFFICE OF TAX POLICY, *supra* note 5, at 119 (discussing Kennedy Administration’s conception of tax neutrality systems); Knoll, *supra* note 13, at 5-6 (defining CIN by describing tax relationship between United States and European Union).

15. See Fullenkamp, *supra* note 9 (discussing underlying philosophies of U.S. international tax system stance).

16. See OFFICE OF TAX POLICY, *supra* note 5, at xi (noting few countries utilize either pure worldwide or pure territorial taxation); see also Patrick Rush & Michael Mincieli, *Are U.S. Taxes Causing a Global Disadvantage?*, FIN. EXEC., June 2010, at 34, available at <http://www.financialexecutives.org/KenticoCMS/Financial-Executive-Magazine/201006/Cover-Story—June-2010.aspx> (discussing use of worldwide and territorial tax systems in foreign countries).

17. See Keith Engel, *Tax Neutrality to the Left, International Competitiveness to the Right, Stuck in the Middle with Subpart F*, 79 TEX. L. REV. 1525, 1529 (2001) (discussing jurisdiction of taxation by United States).

18. See OFFICE OF TAX POLICY, *supra* note 5, at x-xi (describing “current taxation of worldwide income” method of taxation).

19. See Diane M. Ring, *Risk-Shifting Within a Multinational Corporation: The Incoherence of the U.S. Tax Regime*, 38 B.C. L. REV. 667, 667-70 (1997) (discussing foreign tax credits for U.S. taxpayers).

20. See Engel, *supra* note 17, at 1529 (discussing jurisdiction of U.S. taxation).

21. See *id.* at 1530 (“Due to international jurisdictional limitations, the United States lacks the power to tax a foreign corporation on its foreign income, even if its stock is completely owned by one or more U.S. persons. The United States instead

corporations to defer U.S. tax on income of foreign subsidiaries until the U.S. parent elects to repatriate the income.<sup>22</sup> U.S. tax on multinationals' foreign income can be deferred indefinitely if the income is permanently reinvested in a foreign country.<sup>23</sup> Like the foreign tax credit, the option of permanent deferral of foreign income gives the U.S. international tax system some of the elements of a territorial system.<sup>24</sup>

#### D. *The Need for Subpart F*

From the inception of the Internal Revenue Code, domestic taxpayers who wanted to invest abroad have had the option of investing through either a foreign branch or a foreign subsidiary.<sup>25</sup> From 1913 to 1937, the United States did not tax U.S. parent companies on their foreign subsidiaries' income.<sup>26</sup> Income of foreign subsidiaries was taxed only when it was repatriated back into the United States.<sup>27</sup>

As a result, U.S. persons could form tax-haven subsidiaries that held passive investments like stocks and bonds and avoid U.S. tax on income

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taxes the income of a foreign subsidiary only when it actually repatriates, or is deemed to repatriate, its profits to the United States (this delayed method of taxation is known as 'deferral')." (footnote omitted).

22. See SHAPIRO & MATHUR, *supra* note 9, at 9 (discussing hybrid nature of tax system and noting "U.S. companies are not liable for U.S. tax on all of most of their foreign-source earnings until they receive those earnings through some form of distribution"); Seth Hanlon, *Tax Expenditure of the Week: Offshore Tax Deferral*, CTR. FOR AM. PROGRESS (Mar. 16, 2011), [http://www.americanprogress.org/issues/2011/03/te\\_031611.html](http://www.americanprogress.org/issues/2011/03/te_031611.html) (describing U.S. tax system and noting there is no federal income tax on multinational income as long as company keeps profits offshore).

23. See OFFICE OF TAX POLICY, *supra* note 5, at x (discussing tax avoidance by long-term foreign investment without repatriation and potential for return of foreign investment to outstrip deferred tax liability); *Tax Accounting Considerations of Obama Administration's International Tax Proposals*, U.S. TAX ALERT (Deloitte LLP), June 10, 2009, at 3, available at [http://www.deloitte.com/assets/Dcom-United States/Local%20Assets/Documents/us\\_tax\\_alert061009.pdf](http://www.deloitte.com/assets/Dcom-United States/Local%20Assets/Documents/us_tax_alert061009.pdf) (discussing indefinite avoidance of tax liability by overseas reinvestment of foreign income).

24. See SHAPIRO & MATHUR, *supra* note 9, at 9 (noting impact of deferral provisions in creating hybrid of strict worldwide and territorial tax regimes); *WTO's Extraterritorial Income Decision: Hearing Before the H. Comm. on Ways and Means*, 107th Cong. 67-68 (2002) (statement of Stephen E. Shay, Partner, Ropes & Gray LLP), available at <http://www.gpo.gov/fdsys/pkg/CHRG-107hhr79971/pdf/CHRG-107hhr79971.pdf> (discussing permanent deferral in section of prepared statement entitled "Reform of the Current U.S. Tax System of Worldwide Taxation with Deferral").

25. See Engel, *supra* note 17, at 1532 (discussing availability of foreign branch and foreign subsidiary investment options).

26. See *id.* at 1527, 1533-34, 1533 n.26 (noting assessment of tax on foreign subsidiaries under 1913 regime only when income was repatriated to United States until anti-avoidance measures were adopted with Foreign Personal Holding Company regime under Revenue Act of 1937).

27. See Revenue Act of 1921, Pub. L. No. 67-98, § 238(a), 42 Stat. 227, 258 ("[I]n the case of a domestic corporation the tax imposed by this title . . . shall be credited with the amount of any income . . . and excess-profits taxes paid during the Same taxable year to any foreign country . . .").

from those investments.<sup>28</sup> But in 1937, Congress stepped in and imposed the Foreign Personal Holding Company (FPHC) regime under which the income of foreign subsidiaries of U.S. persons was taxed to those persons directly—as if their foreign subsidiaries did not exist.<sup>29</sup>

The FPHC rules were severely limited in application. A foreign subsidiary was classified as a FPHC only if: (1) it was owned, directly or indirectly, by five or fewer U.S. individuals, and (2) at least sixty percent of the subsidiary's foreign gross income came from certain passive investments.<sup>30</sup> By definition, then, the FPHC rules did not apply to U.S. public companies, but only the smallest closely held companies.

In the 1960s, the U.S. economy was declining; it had a growing deficit that many experts attributed to the U.S. international tax policy that permitted MNCs to invest in foreign subsidiaries without U.S. tax liability.<sup>31</sup> Believing it needed to stop domestic companies from sidestepping U.S. taxes by moving their income to foreign tax havens, Congress moved to modernize the U.S. international tax regime.<sup>32</sup> Anti-deferral regimes were borne from the need to stop corporations from bypassing the U.S. tax rules.<sup>33</sup>

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28. See MICHAEL MAZEROV, CTR. ON BUDGET AND POL'Y PRIORITIES, STATE CORPORATE TAX SHELTERS AND THE NEED FOR "COMBINED REPORTING" 2 (2007), available at <http://www.cbpp.org/files/10-26-07sfp.pdf> (discussing mechanics of shifting taxable profits to tax haven subsidiaries for tax avoidance); OFFICE OF TAX POLICY, *supra* note 5, at xii (discussing avoidance of profit shifting to tax-haven domiciled subsidiaries as impetus for Subpart F regime); see also Engel, *supra* note 17, at 1532-33 (discussing historic use of foreign subsidiaries as "incorporated pocketbooks" to hold income-producing assets beyond reach of U.S. tax regime).

29. See OFFICE OF TAX POLICY, *supra* note 5, at 107-09 (discussing passage of Foreign Personal Holding Company Act and statement by President Roosevelt that Joint Committee's 1937 Report "reveals efforts at avoidance and evasion of tax liability so widespread and so amazing both in their boldness and their ingenuity that further action without delay seems imperative" (citation omitted)).

30. See *id.* at 7 ("Pursuant to the recommendation of the Joint Committee, the U.S. shareholders were required to take into income, on a current basis, their pro rata share of the undistributed net income of the foreign personal holding company.").

31. See 145 CONG. REC. 3985, 4025 (1999) (discussing development of tax policy regarding CFCs and acceptance of deferral of tax on foreign-earned income); Engel, *supra* note 26, at 1538 (discussing changes in political and economic climate leading to view of foreign subsidiary investment as leading to or exacerbating growing deficit).

32. See OFFICE OF TAX POLICY, *supra* note 5, at 23 (noting need for Subpart F to prevent companies from shifting income to foreign tax-haven countries from non-tax-haven countries like United States). See generally 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 (2005) (discussing need for anti-deferral regimes to prevent deferral of U.S. taxation through use of foreign subsidiaries).

33. See OFFICE OF TAX POLICY, *supra* note 5, at 3 (noting uniformity of taxation across national sources of income removes incentive for foreign investment); Kirsch, *supra* note 32 (discussing need for anti-deferral regimes to lessen ability of domestic corporations to defer U.S. tax liability on foreign income through foreign subsidiaries).

Prior to settling on the Subpart F regime, the Kennedy Administration initially proposed a system of international taxation that closely approximated a pure worldwide system.<sup>34</sup> The Administration proposed to end all tax deferral for U.S. corporate investments in low-tax developed countries like Switzerland and to restrict deferral for investments in low-tax jurisdictions—so-called tax havens.<sup>35</sup> The Republican-controlled Congress favored a territorial system that would have taxed U.S.-based corporations on only their U.S.-sourced earnings.<sup>36</sup>

Congress split the Kennedy Administration's proposal, implementing only the second part. The Administration's initial proposal to completely eliminate deferral for foreign subsidiaries operating within economically developed countries did not pass,<sup>37</sup> and a more generalized approach was adopted. This anti-deferral approach, or the Subpart F regime, was enacted in 1962<sup>38</sup> to prevent domestic taxpayers from receiving tax-deferral on passive income earned through offshore subsidiaries located in tax havens.<sup>39</sup> The Subpart F regime was only one of many anti-deferral regimes passed that year.<sup>40</sup>

Subpart F is an exception to the general rules permitting permanent deferral of tax on income earned by foreign subsidiaries of a U.S. corpora-

34. See Cynthia Ram Sweitzer, *Analyzing Subpart F in Light of Check-the-Box*, 20 AKRON TAX J. 1, 1 (2005) (discussing Kennedy's approach to prevent "further erosion of the [U.S.] tax base" by taxing all foreign and domestic income sources).

35. See OFFICE OF TAX POLICY, *supra* note 5, at 9 ("[T]he main thrust of the tax avoidance techniques which led to the enactment of subpart F was the 'deflection' of income to low-tax jurisdictions, not only from the United States, but also from foreign high-tax developed countries where the principal value-adding activity took place.").

36. See Sweitzer, *supra* note 34, at 1 (discussing Republican opposition to worldwide taxation system).

37. See Engel, *supra* note 17, at 1539 (describing strong opposition to "outright elimination of deferral for foreign subsidiaries operating within economically developed countries").

38. See OFFICE OF TAX POLICY, *supra* note 5, at 61 (discussing expanding relevance of concerns compelling 1962 adoption of Subpart F regime); Engel, *supra* note 17, at 1530 (discussing purpose of Subpart F to prevent U.S. taxpayers from benefiting from foreign subsidiary deferrals); *ABATax 2001 Top Simplifications: Subpart F*, AM. BAR ASS'N (Feb. 2001), [http://www.americanbar.org/groups/taxation/policy/public\\_policy/14.html](http://www.americanbar.org/groups/taxation/policy/public_policy/14.html) (noting original purpose of Subpart F regime as taxation of passive and "readily moveable" income).

39. See DAVID L. BRUMBAUGH, CONG. RESEARCH SERV., RL 32125, TAX EXEMPTION FOR REPATRIATED FOREIGN EARNINGS: PROPOSALS AND ANALYSIS 2 (2006), *available at* [http://assets.opencrs.com/rpts/RL32125\\_20060427.pdf](http://assets.opencrs.com/rpts/RL32125_20060427.pdf) (discussing Subpart F disincentive from accumulating "tax-deferred income" from passive investments in tax haven subsidiaries); Engel, *supra* note 17, at 1541-42 (discussing types of income that frequently comprise Subpart F income including "liquid passive investments").

40. See STAFF OF JOINT COMM. ON TAXATION, 106TH CONG., OVERVIEW OF PRESENT-LAW RULES AND ECONOMIC ISSUES IN INTERNATIONAL TAXATION (Comm. Print 1999), *available at* [http://www.jct.gov/jct\\_html/x-13-99.htm](http://www.jct.gov/jct_html/x-13-99.htm) (discussing anti-deferral regimes in section entitled "Foreign operations conducted through a foreign corporation"); OFFICE OF TAX POLICY, *supra* note 5, at 1.



tion. Subpart F income that is earned by a CFC must be included in a U.S. corporate shareholder's income, whether or not those earnings are repatriated—sent back—to the United States.<sup>41</sup> Subpart F income generally includes only passive income;<sup>42</sup> active income of foreign subsidiary business operations is not Subpart F income, and that active income can be continuously reinvested in the foreign country without being subject to U.S. taxation.

Because of Subpart F's limited applicability, the U.S. tax system still permits U.S. MNCs to permanently defer most types of income earned by foreign subsidiaries.<sup>43</sup> U.S. multinationals can opt to defer domestic taxes on profits earned by their CFCs until the profits are actually transferred to the parent company, such as by dividend distributions.<sup>44</sup> These rules allow a U.S. MNC to indefinitely defer U.S. taxation, creating a tax incentive to keep foreign profits offshore.<sup>45</sup>

Although the tax effect of investing in a subsidiary instead of a branch has changed over time, the taxation of foreign subsidiaries of U.S. corporations has always been, and continues to be, a glaring gap in the U.S. system of international taxation. These permanent deferral mechanisms have allowed U.S. MNCs to defer U.S. taxation on billions of dollars in foreign-source, active-business income.<sup>46</sup>

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41. See Rodney P. Mock & Andreas Simon, *Permanently Reinvested Earnings: Priceless*, 121 TAX NOTES 835, 837-39 (2008) (discussing deferral and repatriation of shareholder income in section entitled "deferring taxes, shifting profits, and paying less").

42. See *id.*

43. See SHAPIRO & MATHUR, *supra* note 9, at 9 (discussing use of deferral to avoid U.S. tax on income that is not acquired through passive investments in financial instruments or other portfolio investments).

44. See *First in Series on Tax Code Simplification: Hearing Before the Subcomm. on Oversight and Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means*, 107th Cong. 109-10 (2001) (statement of American Bankers Association) (noting that where income is derived from active conduct deferral can be used), available at <http://www.gpo.gov/fdsys/pkg/CHRG-107hhr75055/pdf/CHRG-107hhr75055.pdf>; SHAPIRO & MATHUR, *supra* note 9, at 9.

45. See SHAPIRO & MATHUR, *supra* note 9, at 9 (discussing deferral of tax on CFC profits until returned to parent company as dividend); MARR & HIGHSMITH, *supra* note 6, at 2 (stating that dividend repatriation tax holiday "effectively allows such firms to defer payment of the U.S. corporate income tax on their overseas profits indefinitely, even though they may obtain an immediate tax deduction for many expenses incurred in supporting the same overseas investments"); see also Robert Carroll, *The Importance of Tax Deferral and a Lower Corporate Tax Rate*, SPECIAL REPORT (Tax Found., Washington, D.C.), Feb. 2010, available at <http://www.taxfoundation.org/files/sr174.pdf> (discussing use of deferral by United States companies operating abroad).

46. See Mock & Simon, *supra* note 41, at 837-39 (discussing permanent deferral in section entitled "deferring taxes, shifting profits, and paying less").

### III. REPATRIATION TAX HOLIDAYS

#### A. Introduction

There is no dispute that U.S. MNCs have hundreds of billions of dollars trapped offshore as a result of U.S. tax policy;<sup>47</sup> but there is little agreement about what to do about it. Some commentators have called for permanent elimination of the repatriation tax—which would allow U.S. MNCs to earn unlimited dollars overseas in low-tax jurisdictions and return those funds to the United States without an additional U.S. tax burden.<sup>48</sup> The repatriation tax could be eliminated without otherwise reforming the U.S. international tax system; or the U.S. system could be reconstituted from the ground up as a territorial system.<sup>49</sup> Others take a position at the opposite extreme, advocating a pure worldwide system of taxation—where U.S. MNCs are taxed on all their foreign income, regardless of whether the income is earned through a branch or a subsidiary.<sup>50</sup>

The most popular proposal is to enact a temporary repatriation tax holiday that would offer U.S. corporations a severely reduced tax rate—about five percent—on funds brought back into the United States from overseas. Proponents of a repatriation holiday believe it will significantly boost U.S. tax revenue and increase domestic hiring at a time of record unemployment and a stagnating recovery.<sup>51</sup> They claim that a repatria-

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47. See ROLF EICKE, *TAX PLANNING WITH HOLDING COMPANIES—REPATRIATION OF US PROFITS FROM EUROPE: CONCEPTS, STRATEGIES, STRUCTURES* 17 (2009) (“[T]ax deferral is one of the most-popular tax planning techniques of US MNCs.” (quoting KIMBERLY A. CLAUSING & REUVEN S. AVI-YONAH, *HAMILTON PROJECT, REFORMING CORPORATE TAXATION IN A GLOBAL ECONOMY: A PROPOSAL TO ADOPT FORMULARY APPORTIONMENT* 6 (2007), available at [http://www.brookings.edu/~media/Files/rc/papers/2007/06corporatetaxes\\_clausing/200706clausing\\_aviyonah.pdf](http://www.brookings.edu/~media/Files/rc/papers/2007/06corporatetaxes_clausing/200706clausing_aviyonah.pdf))).

48. See Saj Karsan, *Time to End the Repatriation Tax?*, *SEEKING ALPHA* (Feb. 23, 2011), <http://seekingalpha.com/article/254531-time-to-end-the-repatriation-tax> (explaining benefit of “relaxation of repatriation taxes”).

49. See STAFF OF JOINT COMM. ON TAXATION, 109TH CONG., *OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES* 186-96 (Comm. Print 2005), available at <http://www.jct.gov/publications.html?func=startdown&id=1524> (discussing proposed change from present “deferral system” to “dividend exemption system” and effects on corporations’ foreign-source income); PRESIDENT’S ADVISORY PANEL ON FED. TAX REFORM, *SIMPLE, FAIR, & PRO-GROWTH: PROPOSALS TO FIX AMERICA’S TAX SYSTEM* 124-26 (2005), available at <http://govinfo.library.unt.edu/taxreformpanel/final-report/index.html> (describing how panel’s first plan, entitled “Simplified Income Tax Plan,” affects corporations). See generally J. Clifton Fleming, Jr. et al., *Worse than Exemption*, 59 *EMORY L.J.* 79 (2009).

50. See Bob McIntyre & Steve Wamhoff, *Congress Should End “Deferral” Rather than Adopt a “Territorial” Tax System*, *REPORT* (Citizens for Tax Justice, Washington, D.C.), Mar. 23, 2011, available at <http://www.ctj.org/pdf/internationalcorptax2011.pdf> (outlining how “pure worldwide system” is best option for reforming America’s corporate tax regime because it does not encourage corporations to “shift jobs or profits abroad”).

51. See BRUMBAUGH, *supra* note 39, at 1, 5 (discussing arguments for temporary tax cut for repatriations and economic effect on corporate international income).

tion holiday would bring an additional \$1 trillion back into the United States.<sup>52</sup> And the claim has been made that every billion dollars brought into the United States will create 15,000 to 20,000 jobs—for a total of 15 to 20 million new jobs.<sup>53</sup> A previous repatriation holiday gives us the numbers to empirically test these claims.

### B. *The American Jobs Creation Act Repatriation Holiday*

On October 22, 2004, Congress passed the American Jobs Creation Act (or Act), which introduced a temporary repatriation tax holiday.<sup>54</sup> Under the law, U.S. corporations were permitted to deduct 85% of qualifying cash dividends received from foreign subsidiaries.<sup>55</sup> With a top corporate income tax rate of 35%, corporations were effectively taxed at a 5.25% rate on repatriated profits.<sup>56</sup> The holiday lasted from October 22, 2004, through October 22, 2006.<sup>57</sup> Most companies that took advantage of the holiday claimed the deduction for tax year 2005.<sup>58</sup>

#### 1. *The Domestic Reinvestment Requirement*

As with the current push for a holiday, proponents of the 2004 holiday hoped it would boost the U.S. economy and motivate U.S. multinationals to hire U.S. workers. To that end, the law provided for certain restrictions on the use of repatriated funds to meet the program's goals.

52. See James Pethokoukis, *Why We Need a Tax Holiday for Overseas Earnings*, REUTERS (June 20, 2011), <http://blogs.reuters.com/james-pethokoukis/2011/06/20/why-we-need-a-tax-holiday-for-overseas-earnings/> (“In the short term, the measure could generate tens of billions in tax revenues as companies transfer money that would otherwise remain abroad, and it could help ease the huge budget deficit.” (citation omitted)).

53. See David Kocieniewski, *Companies Push for Tax Break on Foreign Cash*, N.Y. TIMES, June 20, 2011, at A1 (quoting Jim Rogers, chief of Duke Energy), available at [http://www.nytimes.com/2011/06/20/business/20tax.html?\\_r=1&pagewanted=all](http://www.nytimes.com/2011/06/20/business/20tax.html?_r=1&pagewanted=all). As of November 2011, there are about 13.3 million unemployed. See *Employment Situation Summary*, BUREAU OF LABOR STATISTICS, [http://www.bls.gov/news.release/archives/empsit\\_12022011.pdf](http://www.bls.gov/news.release/archives/empsit_12022011.pdf) (providing nationwide unemployment information for November 2011).

54. See American Jobs Creation Act, H.R. 4520, 108th Cong. § 422 (2004) (outlining temporary tax deduction for corporations' foreign-source income).

55. See *id.* (describing details of tax holiday); see also I.R.S. Notice 2005-10, 2005-1 C.B. 474, available at 2005 WL 66835 (setting forth details of domestic reinvestment plan).

56. See Fullenkamp, *supra* note 9 (discussing economic results from Act's provisions calling for “85% dividends-received deduction” from corporations, “repatriation of earnings at 5.25% for one year,” and taxing highest corporate bracket).

57. See Mock & Simon, *supra* note 41, at 835 n.7 (describing length of tax repatriation holiday).

58. See *id.* (noting that “[o]ut of the 81 firms . . . tested . . . , 13 repatriated in their tax year 2006, 67 in 2005, and 1 in 2004”).

The law required corporations to reinvest repatriated funds according to an *approved domestic reinvestment plan*.<sup>59</sup>

First, the amount of funds that could be repatriated under the holiday was restricted to the larger of (1) \$500 million, (2) the amount of “earnings permanently reinvested outside the United States,” and (3) where the company’s financial statement does not show such an amount, but does show an amount of tax liability attributable to earnings reinvested outside the United States, that amount divided by 35%.<sup>60</sup>

Reinvestment plans were required to use the funds as “a source for the funding of worker hiring and training, infrastructure, research and development, capital investments, or the financial stabilization of the corporation for the purposes of job retention or creation.”<sup>61</sup> Under Notice 2005-10, the first guidance issued by the IRS on the repatriation holiday, “financial stabilization” included repayment of debt, qualified plan funding, and other investments.<sup>62</sup> Permitted investments also included some acquisitions of interests in domestic or foreign business entities, advertising and marketing expenses, and expenditures to purchase or license rights to intangible property.<sup>63</sup>

Although some of the allowed investments—e.g., research and investment—had the potential to immediately create jobs, many others, like debt reduction and advertising and marketing, at best set the stage for future job creation. Other investments, like acquisitions, could lead to layoffs since acquired businesses are typically consolidated to reduce overhead and other costs.

## 2. *The Fungibility Problem*

The American Jobs Creation Act included substantial restrictions on uses of repatriated funds.<sup>64</sup> So how did firms manage to use repatriated funds for prohibited purposes like stock buy-backs and dividends? Money is fungible. As Representative Doggett (D-TX) explained when talks about a second repatriation holiday surfaced: “Money is fungible and efforts to

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59. See I.R.S. Notice 2005-10, *supra* note 55, at 476 (describing general requirements of “domestic reinvestment plan”).

60. See I.R.S. Notice 2005-38, 2005-1 C.B. 1100, 1101, *available at* 2005 WL 1090135 (outlining maximum amount of corporate funds eligible for tax repatriation holiday).

61. *Id.* at 1102.

62. See I.R.S. Notice 2005-10, *supra* note 55, at 478-79 (discussing expenditures qualifying as “permitted investments” under tax holiday).

63. See *id.* at 479-80 (enumerating expenditures qualifying as permitted expenses).

64. See American Jobs Creation Act, H.R. 4520, 108th Cong. § 422 (2004) (establishing restrictions on “temporary dividends received reduction” in section entitled “limitations”); McIntyre & Wamhoff, *supra* note 50, at 8 (“[T]he 2004 repatriation holiday legislation did technically ‘require’ that repatriated profits had to be used ‘for the funding of worker hiring and training, infrastructure, research and development, capital investments, or the financial stabilization of the corporation for the purposes of job retention or creation.’”).

tie repatriated funds to new investment and hiring failed. The evidence shows that the corporate tax holiday was mainly used for stock repurchases and dividends—uses expressly prohibited by the legislation.”<sup>65</sup> One dollar is one dollar, regardless of whether it comes from retained earnings or a repatriation tax break. As a result, corporations were able to sidestep the conditions on the previous tax holiday. “Permitted investments” were too broadly defined by the American Jobs Creation Act, with the result that repatriated funds could be used to pay already planned expenses that fit into the categories of permitted investments, and then cash that would have been earmarked for those expenses could be used to pay executive compensation or dividends or to buy-back stock.<sup>66</sup> For instance, if, prior to the repatriation holiday, a corporation had planned a \$30 million acquisition that qualified as a permitted investment under the Act, the corporation could follow through on the acquisition claiming repatriated funds were used to make the acquisition. Then, a \$30 million dividend could be paid to shareholders without running afoul of the conditions imposed on the tax break. Tracing the arc of individuals’ dollars is difficult if not impossible, especially for a multi-billion dollar MNC.

### 3. 2004 Repatriation Holiday Data

The 2004 repatriation holiday netted a 266% increase in repatriations from 2004 to 2005.<sup>67</sup> About 800 companies took advantage of the holiday, bringing \$320 billion in previously deferred income back into the United States.<sup>68</sup> About \$17 billion of additional income tax revenue came into the U.S. Treasury as a result—tax revenue that likely would have been held overseas indefinitely but for the holiday.<sup>69</sup>

Despite the tax holiday’s relative success at bringing profits back into the United States, its effect on the investing behavior of corporations

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65. See Rep. Lloyd Doggett on the Republican Corporate Tax Holiday Plan: To Republicans, Deficits Only Matter When Asking Seniors and Students to Sacrifice, DOGGETT.HOUSE.GOV. (May 11, 2011), [http://doggett.house.gov/index.php?option=com\\_content&view=article&id=258:jctreport&catid=49:latest-news&Itemid=149](http://doggett.house.gov/index.php?option=com_content&view=article&id=258:jctreport&catid=49:latest-news&Itemid=149) (discussing repatriation tax holiday failure to create jobs).

66. See Stewart Berger, *Repatriated Dividends Encouraged Under the American Jobs Creation Act*, 76 CPA J. Jan. 2006, at 40, available at [http://www.nysscpa.org/print\\_versions/cpaj/2006/106/p40.htm](http://www.nysscpa.org/print_versions/cpaj/2006/106/p40.htm); see also I.R.C. § 965 (2011) (codifying repatriation tax holiday).

67. See DONALD J. MARPLES & JANE G. GRAVELLE, CONG. RESEARCH SERV., R40178, TAX CUTS ON REPARATION EARNINGS AS ECONOMIC STIMULUS: AN ECONOMIC ANALYSIS 4 (2011), available at [www.ctj.org/pdf/crs\\_repatriationholiday.pdf](http://www.ctj.org/pdf/crs_repatriationholiday.pdf) (noting 266% repatriation increase in year following American Jobs Creation Act, resulting in “a large ‘spike’ in repatriations” compared to rest of decade).

68. See Grover Norquist, *It’s Time for Another Repatriation Holiday*, DAILY CALLER, (Mar. 7, 2011), <http://dailycaller.com/2011/03/07/its-time-for-another-repatriation-holiday/> (describing economic result of repatriation holiday).

69. See *id.* (“The money was used to fund pension plans, raise wages, create jobs, and invest in new plants and equipment.”).

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utilizing the holiday was minimal.<sup>70</sup> Proponents of a second tax holiday claim that a repatriation holiday will motivate U.S. corporations to boost hiring in the United States, but the biggest beneficiaries of the 2004 tax holiday reduced their domestic work force after taking the tax break—reducing their aggregate workforce by more than 100,000 jobs in the two years following repatriation. And jobs were not the only claimed benefit that failed to materialize following repatriation. “[R]epatriations under the HIA are not associated with increased domestic investment, employment, or R&D activity . . . .”<sup>71</sup>

Repatriated funds clearly were not used to hire U.S. workers, so what were they used for? Empirical studies found that repatriated earnings were not used as Congress intended: to motivate domestic investment, employment, and R&D. Instead, sixty to ninety percent of all repatriated funds were distributed to shareholders, mostly in the form of stock buy-backs.<sup>72</sup> Although the domestic reinvestment requirement on which the tax break was premised forbade those uses, the fungibility of money (discussed previously) allowed corporations to circumvent those requirements and shift repatriated capital to prohibited uses.

	<b>Dollars Repatriated</b>	<b>Layoffs 2005-2006</b>
<b>Pfizer</b>	\$37 billion	10,000
<b>Merck</b>	\$15.9 billion	7,000
<b>Hewlett-Packard</b>	\$14.5 billion	14,500
<b>Honeywell</b>	\$2.7 billion	2,000
<b>Ford</b>	\$900 million	30,000
<b>Colgate-Palmolive</b>	\$800 million	30,000
<b>TOTAL</b>	<b>\$1.7701 billion</b>	<b>93,500</b>

That MNCs repatriated capital but did not invest it in their domestic operations suggests that access to internal capital was not a predominating

70. See AVIVA ARON-DINE, CTR. ON BUDGET AND POL’Y PRIORITIES, REPATRIATION MEASURE UNLIKELY TO STIMULATE THE U.S. ECONOMY OR BOOST INVESTMENT—BUT WILL PROMOTE INVESTMENT IN TAX HAVENS AND UNDERMINE THE CORPORATE INCOME TAX 1 (2008), available at <http://www.cbpp.org/files/1-30-08tax.pdf> (noting repatriation measures generally suffer “the same basic problem that plagues most other business tax breaks offered as stimulus measures: it would infuse cash into large, profitable corporations unlikely to spend it quickly, and so would have little effect in stimulating the economy in the near term”).

71. Dhammika Dharmapala et al., *Watch What I Do, Not What I Say: The Unintended Consequences of the Homeland Investment Act*, 66 J. OF FIN. 753, 775 (2011).

72. See *id.* at 755 (“[E]very dollar of repatriated cash was associated with an increase of \$0.60-\$0.92 in payouts to shareholders, largely in the form of share repurchases.”). See generally Roy Clemons & Michael R. Kinney, *An Analysis of the Tax Holiday for Repatriations Under the Jobs Act*, 120 TAX NOTES 759 (2008) (examining repatriation of approximately \$283 billion by 364 firms under American Jobs Creation Act).

factor in their unwillingness to increase their domestic operations. As a result, if tax policy hopes to satisfy the objective of increasing domestic investment by U.S. MNCs, forces motivating desirable reinvestment behavior must be ascertained.

#### 4. *Failing of the First Holiday—Internal Rate of Return*

The American Jobs Creation Act failed to live up to its name because it motivated repatriation of offshore funds without constraining the use of repatriated funds to domestic investment or job creation.<sup>73</sup> Congress hoped to force domestic investment of repatriated funds by imposing a domestic reinvestment requirement on the holiday, but it failed to recognize that the fungibility of money eliminated the efficacy of those requirements. The expansive universe of possible domestic reinvestment plans gave MNCs enough space to maneuver around the requirements and wholly circumvent the restrictions.

The conditions did not achieve their stated purpose because they did not change the economics of domestic reinvestment or hiring for companies taking advantage of the tax break; they only encouraged repatriation. Generally, U.S. MNCs have access to capital (e.g., through loans), so an infusion of capital alone does not necessarily motivate domestic investment or incentivize hiring. If domestic investment were economically more advantageous than overseas investments, presumably those MNC would have invested domestically with or without the tax incentive.

Corporations generally attribute a cost of capital to internal capital, in the same way they do with borrowed capital. And, as with borrowed capital, if the rate of return on investment of internal capital does not exceed the cost of capital, the corporation generally will not make the investment. Although a repatriation holiday does not change the rate of return on domestic investment, it does significantly reduce the cost of bringing capital back into the United States from overseas. The result is that capital is repatriated, but because domestic investment is not economically desirable, repatriated capital is put to other uses.

Analysis of data from the prior repatriation tax holiday suggests that the default choice for use of excess domestic capital is to use the funds to keep shareholders happy in a tough economic environment. As a result, MNCs that repatriate offshore capital under the reinvestment program are well-positioned to funnel cash to their return savers—i.e., stock and bond holders. The siphoning of repatriated cash to stockholders results in a windfall to shareholders since the tax cost of repatriating offshore funds is already built into share price.

If Congress moves forward on another repatriation holiday, it must clearly define its purpose. According to Cisco CEO and Chairma John Chambers, another repatriation holiday would “put more than two million

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73. See MARR & HIGHSMITH, *supra* note 6, at 3 (suggesting American Jobs Creation Act primarily benefited corporate owners and shareholders).

Americans back to work at no cost to the government or American taxpayers.”<sup>74</sup> But if jobs growth is the political rationale for the holiday, Congress needs to recognize the tax break for what it is: a subsidy. And it is necessary to explicitly identify who we are subsidizing: U.S. shareholders or U.S. workers. Trust the words of corporate leaders like John Chambers, but verify that jobs are created as a consequence of the subsidy.

The conditions put on the 2004 holiday left very few strings attached to repatriated funds, leaving MNCs free to spend the funds as they saw fit. Any future subsidy must tie the tax break to jobs creation in a meaningful way. To motivate domestic investment, it must incentivize domestic hiring by positioning the break as a jobs subsidy. The 2004 domestic reinvestment requirement was a nod toward jobs growth, but the program had no teeth.

### C. *A Model for Repatriation: The EB-5 Visa Program*

#### 1. *Introduction*

The American Jobs Creation Act repatriation holiday had the stated policy objective of boosting the U.S. economy and increasing domestic employment. But the tax break failed to fulfill those objectives when the tax break was typically funneled to shareholders through stock buy-backs and dividends. If the objective of a repatriation holiday is to directly subsidize the creation of U.S. jobs, we need to look further afield for an analogous program. The American Jobs Creation Act went through the motions of requiring U.S. MNCs to reinvest repatriated funds and create jobs, but the program failed to ensure that investments were made in new projects. If the objective of any new repatriation program is to directly subsidize investment in U.S. jobs, Congress should look to an analogous program—the EB-5 Immigrant Investor Program—for a blueprint that requires job creation and includes mechanisms to ensure that created jobs are new jobs that would not have been created but for program investments.

The EB-5 visa program is an immigration initiative that was created to “stimulate the U.S. economy through job creation and capital investment by foreign investors.”<sup>75</sup> It conditions fast-track U.S. immigration on investment in the United States, and includes a definably high standard for satisfying the program’s jobs creation requirements. If immigrant investors can be held to this high standard, why not apply similarly rigorous requirements to MNCs who take advantage of a future repatriation holiday?

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74. John Chambers & Safra Catz, *The Overseas Profits Elephant in the Room*, WALL ST. J., Oct. 20, 2010, at A19, available at <http://online.wsj.com/article/SB10001424052748704469004575533880328930598.html>.

75. *EB-5 Immigrant Investor*, U.S. CITIZENSHIP AND IMMIGRATION SERVS., <http://www.uscis.gov/portal/site/uscis/menuitem.eb1d4c2a3e5b9ac89243c6a7543f6d1a/?vgnnextoid=fac83453d4a3210VgnVCM100000b92ca60aRCRD&vgnnextchannel=fac83453d4a3210VgnVCM100000b92ca60aRCRD> (last updated Dec. 6, 2011).



## 2. *EB-5 Participation Requirements*

Unlike the American Jobs Creation Act, which conditioned the 2004 repatriation program on vague, overbroad domestic investment requirements that were easily circumvented, the EB-5 program has specific criteria that EB-5 investors must satisfy to receive permanent residency status. To qualify for a green card under the EB-5 program, foreign nationals must invest a threshold amount of capital in the United States and create at least ten jobs.<sup>76</sup> In general, \$1 million must be invested in the United States to qualify for the program, but the threshold is reduced to \$500,000 if the foreign national invests in “certain qualified investments or regional centers with high unemployment rates.”<sup>77</sup>

EB-5 investors must invest in a “new commercial enterprise,” which is a for-profit commercial enterprise:

- Established after Nov. 29, 1990, or
- Established on or before Nov. 29, 1990, that is:
  1. Purchased and the existing business is restructured or reorganized in such a way that a new commercial enterprise results, or
  2. Expanded through the investment so that a 40-percent increase in the net worth or number of employees occurs.<sup>78</sup>

The enterprise must “create or preserve” ten or more full-time jobs for “qualifying United States workers.”<sup>79</sup> The jobs-creation requirement must be satisfied within two years of the immigrant’s entry into the United States as a “Conditional Permanent Resident.”<sup>80</sup> Jobs created as a result of an EB-5 investment must last until the immigrant investor’s conditions are removed and they are granted an unconditional green card.<sup>81</sup>

76. See Departments of State, Justice, and Commerce, the Judiciary and Related Agencies Appropriations Act, § 610, Pub. L. No. 102-395, 106 Stat. 1828 (1992) (establishing visa pilot program); Immigrant Investor Pilot Program, 59 Fed. Reg. 17920, 17920-21 (April 15, 1994) (codified at 8 C.F.R. §§ 103, 204 (2011)) (outlining program requirements); 9 FAM § 42.32(e) (2011) (setting forth relevant provisions for employment-based immigration visa program (citing Immigration and Nationality Act, 8 U.S.C. § 1153(b)(5) (2006))).

77. Andrew Frascone, *The EB-5 Visa*, EON-EB5 ELITE GRP. (Apr. 10, 2010), <http://eon-eb5.com/?cat=6>.

78. See *EB-5 Immigrant Investor*, *supra* note 75 (citing examples of commercial enterprises, including sole proprietorships, partnerships, holding companies, joint ventures, corporations, business trusts, or other entities).

79. See *id.* (explaining that wholly owned subsidiaries of holding companies engaged in for-profit activity are included in definition of commercial enterprise).

80. See *id.* (indicating jobs qualifying for program)

81. See 8 C.F.R. § 204.6 (2011) (describing qualifying employees as those who work a minimum of thirty-five hours per week and allowing for job-share agreements to fulfill this requirement); see also *Green Card*, CHICAGOLAND FOREIGN INV. GROUP, LLC, [http://www.chicagoeb5.com/?page\\_id=52#3](http://www.chicagoeb5.com/?page_id=52#3) (last visited Aug. 7, 2011) (discussing difference between conditional and unconditional green cards).

### 3. Documenting Compliance with EB-5 Program Requirements

Unlike the 2004 repatriation program, the EB-5 visa program has very specific requirements for use of invested funds and rigorous verification procedures.<sup>82</sup> The immigrant investor must provide substantial documentation—sometimes approaching 2,000 pages in length—to immigration authorities both prior to and after being approved for the program.<sup>83</sup>

First, to receive approval for participation in the EB-5 program, applicants include a detailed business plan with their petition for participation in the program.<sup>84</sup> The business plan must include detailed economic analyses showing specifically how the immigrant investor's initial investment will create at least ten U.S. jobs.<sup>85</sup>

After their petition is approved, the immigrant investor is given a two-year conditional green card.<sup>86</sup> To have the conditions removed from their green card after two years, the immigrant must provide substantial documentation of his or her compliance with program requirements, including the jobs creation requirement.<sup>87</sup> "The capital investment must be fully infused into the job creating enterprise most closely responsible for the capital investment activities that will create the jobs."<sup>88</sup> To successfully complete the program and have restrictions removed from a green card, the program participant must provide documentation demonstrating that

82. See generally 8 C.F.R. § 204.6 (requiring foreign business registration records, tax records, and comprehensive business plans, among other forms of verification).

83. See generally *id.* (outlining requirement for continued program participation).

84. See 8 U.S.C. § 1153(b)(5) (2006 & Supp. IV 2010); 8 C.F.R. § 204.6(j)(4)(i)(B) (2011) (requiring submission of comprehensive business plan); see also U.S. CITIZENSHIP & IMMIGRATION SERVS., DEP'T OF HOMELAND SEC., OMB No. 1615-0026, INSTRUCTIONS FOR FORM I-526: IMMIGRANT PETITION BY ALIEN ENTREPRENEUR 2 (2010) [hereinafter FORM I-526 INSTRUCTIONS], available at <http://www.uscis.gov/files/form/i-526instr.pdf> (mandating submission of certain evidence as part of petition).

85. See 8 U.S.C. § 1153(b)(5) (determining compliance under § 203(b)(5)(A)(iii) of the Immigration and Nationality Act); 8 C.F.R. § 204.6(j)(4)(i)(B) (providing required showings to be included in mandated business plan); see also FORM I-526 INSTRUCTIONS, *supra* note 84, at 2 (indicating requirements of minimum investment and job creation for participation in visa program).

86. See 8 U.S.C. § 1186b(a)-(b) (presenting procedural steps involved in conditional green card receipt); *Green Card*, *supra* note 81 (outlining difference between conditional and unconditional green cards).

87. See 8 U.S.C. § 1186b(d)(1) (requiring proof that, among other things, alien invested or is in process of investing requisite capital); *Immigration Procedure*, CHICAGOLAND FOREIGN INV. GRP, LLC, [http://www.chicagoeb5.com/?page\\_id=33](http://www.chicagoeb5.com/?page_id=33) (last visited Aug. 7, 2011) (providing chart explaining documentation and procedures for obtaining green card).

88. U.S. CITIZENSHIP & IMMIGRATION SERVS., QUESTIONS AND ANSWERS: USCIS QUARTERLY EB-5 STAKEHOLDERS MEETING 3 (June 30, 2011), available at <http://eb-5center.com/files/EB-5%20June%202011%20Stakeholder%20Meeting%20QA.pdf>.

the jobs were indeed created.<sup>89</sup> Evidence of the number of full-time employees created by the investment includes the following: (1) payroll records; (2) relevant tax documents; and (3) Form I-9s.<sup>90</sup> Records from both the time the investment was made and the end of the two-year term must be submitted to verify that the requisite number of jobs was created during the two-year period.<sup>91</sup>

The EB-5 program demands concrete data demonstrating that an applicant's investment has created the required number of jobs.<sup>92</sup> By tightening its requirements, the program ensures that the program satisfies the policy objectives for which it was formed. If, as trumpeted by supporters in Washington and industry, the primary purpose for passing a new repatriation tax break is to create U.S. jobs, MNCs should be held to standards at least as rigorous as those applied to immigrant investors seeking residency in the United States.

#### D. *Solving the Trapped Earnings Puzzle*

##### 1. *Introduction*

Rather than solve the trapped earnings problem through a wholesale rewriting of Subpart F, I propose a simpler solution borrowing from the American Jobs Creation Act repatriation holiday. But this solution cannot be a simple rehashing of the previous holiday, which, as illustrated above, failed to achieve its stated objectives because it failed to recognize the fungibility of money and the impossibility of enforcing that program's broad domestic reinvestment requirements.

First, any new repatriation holiday must have more discretely defined objectives—i.e., a subsidy of MNC balance sheets, MNC shareholders, or simply domestic employment. Jobs creation is preferable because it is an easily verifiable and administrable benchmark, unlike a broadly defined domestic reinvestment requirement. The holiday also must include “trust through verification” mechanics and reporting requirements to verify that its objectives are satisfied. And where an MNC fails to reinvest repatriated funds as required, a mechanism for clawing back tax savings must be implemented to put the company back in the tax position it would have been in had it never repatriated the funds. These rigorous verification require-

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89. See 8 C.F.R. § 204.6(j)(4)(iii), (m)(7)(ii) (requiring showing that investment will create, directly or indirectly, ten jobs and allowing “reasonable methodologies” to show jobs were created indirectly, including “multiplier tables, feasibility studies, analyses of foreign and domestic markets . . . , and other forecasting devices”).

90. See § 204.6(j)(4)(i)(A) (approving certain documents to demonstrate job creation requirements).

91. See § 204.6(j)(4) (establishing the initial evidence an EB-5 applicant must submit with an EB-5 petition); § 216.6 (establishing the procedure an EB-5 investor must follow to remove the conditional basis of his or her green card after the two-year ).

92. See § 204.6(j)(4)(i)(A)-(B) (calling for comprehensive business plan, tax documents, payroll information).

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ments will level the playing field for labor investments and allow American labor to compete with other labor markets for U.S. capital. And not only is jobs creation desirable and verifiable, it also results in multiple tax revenue streams to the United States. Repatriated funds are subject to U.S. income tax, a second source of tax revenue—albeit at a significantly reduced rate—and individuals employed as a result of the investment of repatriated funds will pay income tax on their wages.

Second, any normative solution to the problems of repatriation must change the internal rate of return for domestic investments. Rather than just reducing the cost of repatriating foreign earnings into the United States, the program must incentivize—or subsidize—domestic investment, making domestic investment of repatriated funds an economic imperative for participating corporations.

I recommend looking to the EB-5 Immigrant Investor Program for an example of a targeted investment program that works, while satisfying the requirements outlined above.

## 2. *Verification Procedure*

The repatriation program cannot rely on simple self-reporting of the use of repatriated funds to verify compliance with program requirements. Participants should document their compliance with the terms of the program and show how they have created the requisite number of jobs under the program.<sup>93</sup>

Unlike the broad domestic reinvestment criteria of the first repatriation holiday, jobs creation can be specifically verified. The threshold number of U.S. jobs at a corporation participating in the tax holiday must be established at the time the company makes a tax-discounted repatriation. Then, at the close of the reporting period—whether two years or otherwise—a second assessment must be made to ascertain whether jobs have been created at the corporation. There is a ready mechanism for calculating jobs at large MNCs. Large corporations must electronically report their payroll tax liability. Those records can be used to verify that jobs have indeed been created at the company.

## 3. *Clawback*<sup>94</sup>

There are two options for recapturing deductions or credits from corporations that fail to utilize the repatriation holiday or fail to satisfy jobs

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93. See *EB-5 Immigrant Investor*, *supra* note 75 (noting spouses, sons, daughters, and foreign nationals not authorized to work in United States are not qualifying employees).

94. For general information on clawback policies under the Dodd-Frank Wall Street Reform and Consumer Protection Act, see Deborah Lifshey, *Summary of Clawback Policies Under Dodd-Frank Reform Act*, BOARDMEMBER.COM, <http://www.boardmember.com/summary-of-clawback-policies-under-dodd-frank-reform-act.aspx> (last visited Jan. 19, 2012) (suggesting Dodd-Frank Act expanded mandatory recoupment policies by precluding exemptions granted by SEC and national

creation requirements: total clawback or pro rata clawback. Under total clawback, a corporation that fails to satisfy the repatriation holiday's jobs creation requirement must repay the repatriation deduction or credit in full if the company fails to create the requisite number of jobs—even if they miss the mark by only one job.

A less severe clawback option would require participants to pay back only a pro rata portion of the deduction or credit. Each job would be assigned a pro rata portion of the credit. For example, if the repatriation program calls for ten jobs to be created for every \$1 million repatriated under the program, then an MNC that repatriates \$100 million under the program must create 1,000 jobs to satisfy program requirements. If the company creates only 500 jobs, it will be forced to repay the tax break on \$50 million of the repatriated amount.

#### 4. *Clawback Amount*

After determining how much of the credit will be clawed back if an MNC fails to meet program requirements, Congress will need to wrestle with the penalty and interest consequences of repatriation default. Without interest and penalty provisions, MNCs could be motivated to sign up for the repatriation program for tax deferral purposes without ever intending to create U.S. jobs. For instance, if an MNC repatriates \$100 million but fails to create the mandatory 1,000 jobs after a two-year period, the MNC will be required to repay the deduction or credit allowed on the repatriation. If the MNC paid only \$5 million in income tax on the repatriated amount, but would have paid \$35 million but for the holiday, the MNC will repay \$30 million to the federal government. In that situation, the MNC has essentially taken a \$30 million interest-free loan from the federal government. The company had the benefit of \$30 million for two years, earning a return on that amount during that time.

The first component of the recapture is an interest component. If the MNC, of the previous example, defaults on its repatriation program requirements, it will be required to pay interest on the deferred amount. If the rate charged to a company that fails to satisfy repatriation program requirements is, for example, six percent, the MNC will be required to repay the \$30 million plus about \$4 million in interest if it fails to create the requisite number of jobs.

But the interest component will not ensure good-faith participation in the program. In a low-interest rate environment, MNCs may find opportunities that produce profits exceeding the underpayment interest rate. So, if an MNC believes it can generate \$5 million in additional revenue each year by investing repatriated funds overseas, knowing it will only pay about \$4 million in interest on the deferred amount, the MNC generally will participate in the program without ever intending to create U.S. jobs.

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securities exchanges, requiring clawbacks regardless of executive wrongdoing, and imposing penalties for non-compliance).

Because of the potential for abuse, the repatriation program will need to include penalties in addition to interest charges on the holiday tax savings.

#### 5. *Clawback Mechanics*

There are two distinct options for clawing back tax savings from MNCs that fail to create the requisite number of jobs following repatriation. The first option is to require a defaulting MNC to amend its income tax return for the year when it took the repatriation tax break, using the ordinary dividend rate (35%) instead of the holiday's reduced dividend rate (5.25% under the 2004 holiday).<sup>95</sup> Both the IRS and large corporations already have mechanisms in place to amend their past years' returns—for instance, when carrying back net operating losses—so implementing this version of the clawback will not create an undue burden on either side.

Another option for recapturing repatriation tax savings is to require the MNC to include the dividend income that was effectively exempted from taxation under the holiday in the current year's income—the year when the MNC fails to satisfy its job creation obligation. A variation on the second variety of clawback would be to reverse the tax savings under the repatriation by including the tax savings amount in income on the MNC's tax return as an addition to tax in the year the MNC fails to satisfy program requirements.

This clawback mechanism is akin to the first-time homebuyer clawback applicable to individuals who take the first time homebuyer credit but move out of the home within three years of the purchase. Those taxpayers are required to repay the full amount of the credit (about \$8,000) in the year that they move out of the home. As with the first-time homebuyer credit, clawback of the repatriation deduction can be accomplished by adding a single line to the taxpayer's tax return, where the repatriation deduction is added back into the corporation's gross income in the year the MNC fails to satisfy the requirements of the repatriation program.

Interest and penalties would be applied to the recaptured amount regardless of the clawback mechanism used to remove any incentive to participate in the program in bad faith.

### IV. CONCLUSION

As recovery from the worst recession since the Great Depression falters, corporate leaders and congressmen are calling for a repeat of the 2004 American Jobs Creation Act repatriation tax holiday. They claim that if U.S. MNCs are allowed to repatriate offshore earnings at a low tax cost,

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95. See Fullenkamp, *supra* note 9 (outlining recourse suggested by American Jobs Creation Act of 2004).

the companies will reinvest the funds in the United States and increase their domestic workforce.

To ensure domestic reinvestment of repatriated earnings, advocates of a second holiday propose attaching a domestic reinvestment requirement to the tax break—as was done with the first holiday. But the reinvestment requirements of the first holiday were precatory at best. As we saw with the 2004 holiday, jobs creation—and economic revitalization in general—are not a foregone conclusion of repatriation.

Without a substantial domestic reinvestment requirement, a repatriation holiday does nothing to boost domestic investment by U.S. MNCs. On its own, a repatriation holiday only encourages repatriation of offshore revenue into the United States; it does not encourage domestic reinvestment or jobs creation. The reason that repatriation does not work as intended is that repatriation alone does not change the economics of domestic investment. As a result, U.S. MNCs respond to the tax holiday by repatriating foreign income. But once the revenue is here, domestic investment is no more attractive than it was prior to the holiday, and the corporations put the funds to other uses. In tough economic times, the logical choice for excess funds is to funnel them to shareholders—and that is exactly what MNCs did during the 2004 holiday. The repatriation holiday then disproportionately benefits shareholders. And because the tax cost of repatriating offshore earnings has already been discounted into their share price, the shareholder payout is an undue windfall.

If domestic reinvestment and jobs creation are its goal, a repatriation holiday will be effective only if criteria for participation in the holiday are verifiable and easily administrable. Requiring domestic reinvestment in the last holiday proved to be only a meaningless exercise, because the fungibility of money allowed MNCs to divert repatriated earnings to their shareholders. To satisfy its policy objectives, a repatriation holiday must be recognized as what it is: a corporate subsidy. Being a subsidy, we must craft tax policy with a clear idea of which corporate stakeholders we are trying to subsidize—shareholders or U.S. employees.

Instead of using an amorphous domestic reinvestment requirement, any new tax holiday should not just encourage repatriation of tax-deferred earnings from multinationals' CFCs, but also place more specific conditions on spending the repatriated funds necessary to garner the tax benefit. Generalized domestic reinvestment requirements will do nothing to encourage investment in the United States. Instead, the program should use employment numbers to ensure that repatriated funds are used for domestic reinvestment.

Employment is an easily verifiable and administrable measurement tool. Domestic employment at an MNC both at the time of repatriation and then at the close of the investment period is easily verifiable, providing a ready criterion for compliance with the domestic reinvestment requirement for the repatriation tax break. In addition to being easily

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verifiable, using jobs as a measuring stick for domestic reinvestment lowers the cost of the repatriation to the U.S. government. Not only will the MNC pay income tax on the repatriated funds at the reduced repatriation rate (e.g., 5.25%), employees hired using repatriated funds will pay income tax on their wages at ordinary income rates.

A second repatriation holiday would be an effective, straightforward way to encourage U.S. investment by MNCs and reduce domestic unemployment. And a holiday would have the secondary effect of increasing tax revenue, as a result of both the tax on repatriated earnings that would not have been taxed but for the holiday, and the income and employment taxes levied on employees added as a result of the subsidy.



