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ARTICLE

TAX LAW AS FOREIGN POLICY

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The use of economic statecraft is at a high-water mark. The United States uses sanctions, tariffs, and import and export controls more than ever before. These tools

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have problems, though. They impose financial costs on domestic interests. They can induce retaliation by target states. And overuse of these tools could drive the United States from its central position in the global financial and economic system, undermining the effectiveness of U.S. economic statecraft in the long run. But there is an underappreciated tool that could perform valuable foreign policy work: tax law. We argue that tax law holds promise to advance U.S. foreign policy interests and that it is especially important to deploy tax tools now. Tax law has distinctive features that make it both a partial substitute and a partial complement to other tools of economic coercion, which means that it can extend the influence of U.S. economic power while reducing the risk of overusing other economic tools.

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UVA Law School but is now on leave to work for the U.S. government. Nothing herein should be construed to reflect the position or views of the U.S. government.

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INTRODUCTION

Less than two weeks after his inauguration, citing national security interests, President Biden reinstated a ten percent tariff on aluminum imports from the United Arab Emirates that President Trump initially imposed in 2018.¹ Whatever their other differences, Democratic and Republican administrations have had the same growing appetite for using economic tools to pursue foreign policy and national security goals. From raising tariffs to freezing assets to imposing trade restrictions, the federal government has left few stones unturned in trying to gain financial leverage over foreign states, companies, and individuals.² And yet, because of overuse and increased competition from alternative currencies and payment systems, we may be approaching the limits of these tools' effectiveness.³ According to

¹ See Proclamation No. 10144, 86 Fed. Reg. 8625 (Feb. 1, 2021); Proclamation No. 9704, 83 Fed. Reg. 11619 (Mar. 8, 2018).

² Richard N. Haass, *Economic Sanctions: Too Much of a Bad Thing*, BROOKINGS (June 1, 1998), <https://www.brookings.edu/research/economic-sanctions-too-much-of-a-bad-thing> [https://perma.cc/C5UV-54QK] (“[E]conomic sanctions are fast becoming the policy tool of choice for the United States in the post-cold war world.”).

³ See U.S. DEP’T OF TREASURY, THE TREASURY 2021 SANCTIONS REVIEW (2021); see also Daniel Flatley, *U.S. Treasury Says Crypto, Rival Currencies Risk Eroding Sanctions*, BLOOMBERG (Oct. 18, 2021), <https://www.bloomberg.com/news/articles/2021-10-18/treasury-sees-digital-local-currencies-undermining-sanctions> [https://perma.cc/N26R-NTH9].

former Treasury Secretary Jacob Lew, “[t]he outlook for U.S. economic statecraft, if it continues on its present trajectory, is bleak.”⁴ But perhaps we can change this trajectory. There is an economic tool for advancing foreign policy interests that Congress and the Executive have barely touched in recent years: the federal income tax. The time has come to reconsider what tax law can offer.

Any person within the long reach of U.S. income tax jurisdiction can be influenced to make choices that advance U.S. foreign policy.⁵ The leverage of the income tax comes from the United States’ appeal as a destination for foreign capital, its enormous consumer base, and the size and economic power of U.S. multinational corporations.⁶ Foreigners are eager to invest their wealth in U.S. assets, sell to U.S. consumers, and organize their businesses in the United States. But despite its potential as a source of foreign policy leverage, one finds only the residue of outdated foreign policy objectives in today’s income tax law.

This is not because Congress is shy about using the income tax for purposes other than revenue collection. Congress has enthusiastically used the income tax to pursue social and economic policies, such as poverty reduction,⁷ the environment,⁸ and health care.⁹ It is also not because there is no precedent for using the income tax to implement foreign policy. Tax law was used periodically in the twentieth century to favor certain foreign states,¹⁰ and the United States has more than sixty bilateral income tax treaties that

⁴ Jacob J. Lew & Richard Nephew, *The Use and Misuse of Economic Statecraft*, FOREIGN AFFS., Nov./Dec. 2018, at 139, 147.

⁵ U.S. citizens and residents are taxed on their worldwide income. *Taxpayers Living Abroad*, INTERNAL REV. SERV. (June 3, 2021), <https://www.irs.gov/individuals/international-taxpayers/taxpayers-living-abroad> [<https://perma.cc/4NSJ-CMC7>]. Foreign persons are subject to U.S. tax on income that is effectively connected with a trade or business in the United States and U.S. source income that is not connected to a U.S. trade or business. I.R.C. §§ 872(a), 881, 882. Unless otherwise indicated, all section references in this Article are to the Internal Revenue Code of 1986, as amended.

⁶ Scholars have identified six sources of U.S. economic leverage. PETER E. HARRELL & ELIZABETH ROSENBERG, *ECONOMIC DOMINANCE, FINANCIAL TECHNOLOGY, AND THE FUTURE OF U.S. ECONOMIC COERCION* 8 (2019) (“The United States’ coercive economic leverage rests on . . . the strength of the U.S. dollar, the soundness of U.S. banks, the massive size of the U.S. market, the depth of U.S. companies in global supply chains, the massive breadth of foreign investment by U.S. firms, and transparency requirements in the U.S. financial system.”).

⁷ Hilary W. Hoynes & Ankur J. Patel, *Effective Policy for Reducing Poverty and Inequality? The Earned Income Tax Credit and the Distribution of Income*, 53 J. HUM. RES. 859, 860 (2018) (stating that the earned income tax credit is “the largest antipoverty program for children in the United States”).

⁸ See, e.g., I.R.C. §§ 38(b)(8), 45 (allowing a business tax credit for electricity produced from renewable sources).

⁹ I.R.C. § 5000A (establishing a tax on those who do not maintain minimum health insurance coverage).

¹⁰ See discussion *infra* Section II.B.

advance cooperative relationships with foreign states.¹¹ But today's Internal Revenue Code (the Code) incorporates foreign policy goals in only a few limited ways. And Congress made sweeping changes to the Code in 2017¹² that undermined the effectiveness of these foreign policy provisions inadvertently and without any discussion in the legislative record.

Whatever the historical reasons for sidelining the income tax as a tool of foreign policy, recent technological innovation in the global financial system and the evolution of the United States' role in the international political and economic order should compel policymakers to reconsider tax as a tool of economic statecraft. We want to provoke that reconsideration. We show that compared with sanctions, tariffs, and other coercive economic instruments, tax law is an underappreciated foreign policy tool, particularly at the present moment.

We begin by describing the most common economic tools in use today: financial sanctions, import tariffs, and export controls. Each of these tools of economic coercion has been criticized. For example, scholars have argued that the United States often is unclear about the goals of its sanctions and that it rarely repeals sanctions, even if the targets adjust their behavior.¹³ Some criticize trade tariffs for being ineffective and for burdening U.S. consumers more than foreign targets,¹⁴ while others argue that these tariffs violate U.S. international legal obligations.¹⁵ Scholars, companies, and U.S. allies alike criticize the export control system for being "too restrictive, insufficiently restrictive, cumbersome, obsolete, inefficient, or any combinations of these descriptions."¹⁶ In short, while the United States needs economic foreign policy tools, the tools it has traditionally deployed have gaps in coverage and deficiencies in implementation.

Imperfect though they may be, the government uses these tools more than ever before. As the primary alternative to military force, the appeal of

¹¹ *Doing Business in the United States: US Tax Treaties*, PWC, <https://www.pwc.com/us/en/services/tax/us-inbound-tax/doing-business-in-the-united-states/us-tax-treaties.html> [<https://perma.cc/6zT7-MBYF>] ("The United States has in place bilateral income tax treaties with more than 60 countries.")

¹² See TAX FOUND. STAFF, PRELIMINARY DETAILS AND ANALYSIS OF THE TAX CUTS AND JOBS ACT (2017) (summarizing major changes brought about by the 2017 Tax Cuts and Jobs Act). See discussion *infra* subsection II.C.2.c for details on the impact these 2017 changes had on foreign policy provisions within the Code.

¹³ See, e.g., SaraBeth Egle, *The Learning Curve of Sanctions—Have Three Decades of Sanctions Reform Taught Us Anything?*, CURRENTS: INT'L TRADE L.J., Summer 2011, at 34.

¹⁴ See, e.g., Harry Wolff, *Unilateral Economic Sanctions: Necessary Foreign Policy Tool or Ineffective Hindrance on American Businesses?*, 6 HOUS. BUS. & TAX L.J. 329, 362-64 (2006).

¹⁵ See, e.g., Uchechukwu Nwoke, *Imposition of Trade Tariffs by the USA on China: Implications for the WTO and International Trade Law*, 19 J. INT'L TRADE L. & POL'Y 69, 75 (2020) (arguing that U.S. tariffs against China violate obligations under the General Agreement on Tariffs and Trade).

¹⁶ IAN F. FERGUSSON & PAUL K. KERR, CONG. RSCH. SERV., R41916, THE U.S. EXPORT CONTROL SYSTEM AND THE EXPORT CONTROL REFORM INITIATIVE 1 (2020).

economic coercion is obvious. But the United States' increased reliance on economic leverage raises a concern of its own: that overuse may cause foreign actors to divest from the U.S. currency, financial system, and import market. We do not argue that tax law should be the sole instrument of economic statecraft. But adding tax law to the economic toolkit makes it possible to reduce financial sanctions, tariffs, and export controls, thus reducing the risk of divestment from the U.S. financial sector and dollar as a reserve currency and thereby preserving the vitality of these other tools. More generally, each economic tool involves tradeoffs between foreign policy objectives and other goals, such as economic growth. Introducing tax law as another tool takes the pressure off the other tools and facilitates more advantageous tradeoffs.

In addition to relieving pressure on overused tools, tax law fills gaps in the existing regime. Trade sanctions affect only imports and exports of specified goods and services. Financial sanctions are often limited to specific industries and can only reach foreign targets who hold U.S.-situs assets or who use the U.S. banking system. The Committee on Foreign Investment in the United States (discussed below) covers inflows of capital into strategically important industries.¹⁷ And the Foreign Corrupt Practices Act requires compliance with U.S. anti-bribery laws to access U.S. capital markets.¹⁸ This patchwork of laws is extensive but incomplete. Tax law reaches all income earned by U.S. persons and all income arising in the United States, which increases the coverage of economic statecraft both by enlarging the set of jurisdictional contacts with foreign persons and enlarging the set of industries and economic activities that can be reached. Finally, tax law also allows for a finer calibration of economic deterrence because tax incentives can be adjusted in degrees, allowing an appropriate level of economic activity to continue rather than foreclosing that activity entirely by prohibition, as embargoes and some sanctions regimes do.

Having made the case for tax law as a tool of foreign policy, we consider crucial questions about institutional competence and administration. Because Congress makes tax laws, it is important to ensure that foreign policy enacted through tax law incorporates the expertise of the Executive and that tax laws can respond to rapidly changing conditions. We examine the existing foreign policy-related tax rules and show that Congress has already demonstrated an ability to provide the Executive with the discretion and agility it requires. Two of the most significant objections to our proposal

¹⁷ See generally *The Committee on Foreign Investment in the United States (CFIUS)*, U.S. DEP'T OF TREASURY, <https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius> [<https://perma.cc/W5B3-PTKU>].

¹⁸ See generally *Foreign Corrupt Practices Act*, U.S. DEP'T OF JUST. (Feb. 3, 2017), <https://www.justice.gov/criminal-fraud/foreign-corrupt-practices-act> [<https://perma.cc/NC6D-R4VA>].

are the additional rent seeking that it could facilitate and whether it would fall afoul of international legal obligations through the World Trade Organization. These concerns are important but not insurmountable, and we argue that the risks are worth the rewards.

In Part I, we survey economic statecraft, focusing on how coercive economic tools disrupt the normal functioning of foreign states and other foreign actors. Part II describes the history and current state of U.S. federal income tax law as a foreign policy tool. In Part III, we argue that the time is right to use tax law more aggressively to advance U.S. foreign policy goals, and we identify three areas that hold the greatest promise for doing so. In Part IV, we respond to objections to our argument and consider some important choices that must be made to ensure the most effective implementation of our proposals.

I. TOOLS OF ECONOMIC STATECRAFT

For much of its history, the United States has used economic levers of power to advance its foreign policy goals.¹⁹ Part of what constitutes “economic statecraft” reflects U.S. efforts to encourage economic development at home and abroad.²⁰ These positive tools include bilateral investment treaties; multilateral trade arrangements and free trade zones; the use of the Export–Import Bank to encourage U.S. companies to export goods and services overseas; the creation of the Development Finance Corporation to promote investments by U.S. businesses in less developed countries; the provision of loan guarantees; U.S. support for international institutions such as the World Bank and the International Monetary Fund; and the provision of foreign aid. These kinds of economic carrots are not the focus of this Article.

We focus instead on the economic sticks that the United States deploys to achieve foreign policy and national security aims. These tools are intended to coerce foreign actors to change their behavior or to deprive those actors of the ability to act. At a general level, these sticks impose restrictions or burdens upon transactions by or with a target country, its nationals, or designated groups, with the intended effect of creating dysfunction in the target’s commercial and financial transactions, in the service of specified U.S. foreign policy goals.

¹⁹ See generally Lance Davis & Stanley Engerman, *History Lessons: Sanctions: Neither War nor Peace*, 17 J. ECON. PERSPECTIVES 187, 192 (2003) (detailing the use of embargoes, tariffs, and sanctions by the United States throughout the twentieth century).

²⁰ See generally DAVID BALDWIN, *ECONOMIC STATECRAFT* 29 (2020) (defining economic statecraft as “governmental influence attempts relying primarily on resources that have a reasonable semblance of a market price in terms of money”).

This Part explores three such tools: embargoes and economic sanctions, tariffs, and export controls. We consider the history of each tool, which helps explain why the tools are more familiar to U.S. national security and foreign policy officials than taxation. We assess which targets these tools are designed to influence and which actors the U.S. government relies on to implement them. We examine the tools' underlying legal bases and the bureaucratic pathways by which they are implemented and enforced.

In addition, we consider criticisms of these tools and draw out three points. First, by their nature, these tools require the U.S. government to make tradeoffs between foreign policy goals and domestic economic interests. Second, these tools often operate as blunt instruments that, in the view of some scholars, the government uses unwisely and too frequently. Third, the government relies heavily on companies—especially U.S. companies—to implement and bear many of the costs.²¹

A. *Embargoes and Economic Sanctions*

Since its founding, the United States has periodically banned or restricted commercial transactions with foreign actors.²² In extreme cases, these restrictions take the form of total embargoes that bar trade and financial relations between the United States and the target state.²³ Today, economic sanctions tend to be better targeted than embargoes, which paint with a broad brush and therefore can impose harm on innocent participants in the target economy as well as on U.S. interests. Although sanctions, like embargoes, may target a state's leadership, the United States also directs sanctions against a range of other actors and may focus on specific sectors or activities.

²¹ Corporations act as public regulators across multiple contexts. See Rory Van Loo, *The New Gatekeepers: Private Firms as Public Enforcers*, 106 VA. L. REV. 467, 499 (2020) (stating that the administrative state uses the resources of large firms to enforce regulations). See generally Kate Klonick, *The New Governors: The People, Rules, and Processes Governing Free Speech*, 131 HARV. L. REV. 1598 (2018) (describing how online platforms serve as speech regulators).

²² Consider, for example, the U.S. embargoes on Cuba and Vietnam discussed below in the text accompanying notes 31–46.

²³ Often embargoes allow the Treasury or Commerce Departments to grant licenses for specific exceptions to the embargo, such as transactions providing food or humanitarian supplies. For information on OFAC's licensing policy for activities related to Cuba, see Cuba Sanctions, U.S. DEP'T OF TREASURY, <https://home.treasury.gov/policy-issues/financial-sanctions/sanctions-programs-and-country-information/cuba-sanctions> [<https://perma.cc/X3JQ-STFJ>].

1. Embargoes

The United States imposes total embargoes on other states to signal its condemnation of a foreign regime.²⁴ Sometimes the United States identifies specific steps that the foreign state could take to persuade the United States to lift the embargo. In exceptional cases, regime change is the only way to obtain relief. Currently, the United States has near-complete embargoes on Cuba, Iran, North Korea, and Syria.²⁵ But embargoes are costly. Because they curtail commerce between the United States and the target state, embargoes reduce market access, profits, and suppliers for U.S. companies.

a. History

Embargoes have a long history. In 1807, as the British and French harassed U.S. shipping, Congress (at President Jefferson's request)²⁶ authorized the President to restrict the passage of goods from U.S. ports to overseas destinations,²⁷ to protect U.S. sailors and goods and "starve the offending nations."²⁸ U.S. states resisted the embargo because of the harm it inflicted on their economies, rendering the embargo ineffective.²⁹ Congress then enacted the First Enforcement Act, which gave the President and Treasury Department officials broad powers to oversee ship loadings and authorize vessels to set sail.³⁰ This early example forecasts the impact of embargoes on the U.S. economy, the role and discretion of the Executive in applying such measures, and the responsibility of the Treasury Department to enforce the measures—all things that still exist today.

Although complete embargoes often arise during war, others have persisted during peacetime. For example, the United States imposed a trade embargo on North Vietnam in 1964 during the Vietnam War,³¹ but the

²⁴ See, e.g., James M. Lindsay, *Trade Sanctions as Policy Instruments: A Re-Examination*, 30 INT'L STUDS. Q. 153, 155-56, 164-66 (1986) (discussing several examples).

²⁵ See 15 C.F.R. § 746.1 (2021) (listing states).

²⁶ *Embargo of 1807*, JEFFERSON MONTICELLO, <https://www.monticello.org/site/research-and-collections/embargo-1807> [<https://perma.cc/GY8U-T7MB>].

²⁷ Act of Dec. 22, 1807, ch. 5, 2 Stat. 451 (repealed 1809); Act of Jan. 9, 1808, ch. 8, 2 Stat. 453 (Second Embargo Act); Act of Mar. 12, 1808, ch. 33, 2 Stat. 473 (Third Embargo Act) (restricting the passage of goods to the United Kingdom and France).

²⁸ Letter from President Thomas Jefferson to Albert Gallatin, Sec'y of the Treasury (Apr. 8, 1808) in 12 THE WRITINGS OF THOMAS JEFFERSON 27 (Albert Ellery Bergh ed., 1907).

²⁹ Michael Bahar, *The Presidential Intervention Principle: The Domestic Use of the Military and the Power of the Several States*, 5 HARV. NAT'L SEC. J. 537, 556-57 (2014) (describing how states refused to enforce the embargo).

³⁰ Act of Apr. 25, 1808, ch. 66, 2 Stat. 499 (assigning the President the authority to give clearance for ships conducting foreign trade).

³¹ Thomas R. Stauch, *The United States and Vietnam: Overcoming the Past and Investing in the Future*, 28 INT'L LAW. 995, 996 (1994).

embargo remained in place until 1994 when President Clinton lifted it after Vietnam made progress on recovering remains of U.S. prisoners of war.³² Perhaps the best-known embargo is the U.S. embargo on Cuba. The United States imposed the embargo in the early 1960s because Cuba nationalized several U.S.-owned oil refineries without compensating the owners.³³ The goal of the embargo was to isolate Cuba's government and bring democracy to the Cuban people by forcing Fidel Castro out of power.³⁴ President Obama loosened some restrictions on Cuba and restored diplomatic relations, but President Trump re-imposed the restrictions in 2019.³⁵

b. *Statutory Authorities and Implementation*

Congress has played a significant role in U.S. embargoes, exercising its constitutional power to regulate foreign commerce.³⁶ For example, Congress has both imposed direct restrictions on commerce with Cuba and delegated certain enforcement discretion to the Executive.³⁷ President Eisenhower's original 1960 declaration was based on the authority provided to him in the Export Control Act.³⁸ Since then, Congress has changed the law applicable to the Cuba embargo five times, passing the Foreign Assistance Act of 1961 and the so-called "Hickenlooper amendments" of 1962 and 1963, the Cuban Assets Control Regulations in 1963, the Cuban Democracy Act of 1992,³⁹ the Helms-Burton Act,⁴⁰ and the Trade Sanctions Reform Act of 2000. Many of

³² Marian Nash (Leich), *Contemporary Practice of the United States Relating to International Law*, 88 AM. J. INT'L L. 515, 521 (1994).

³³ CONG. RSCH. SERV., IF10045, CUBA: U.S. POLICY OVERVIEW (2021); see also AMNESTY INT'L, THE U.S. EMBARGO AGAINST CUBA: ITS IMPACT ON ECONOMIC AND SOCIAL RIGHTS 7 (2009).

³⁴ William M. LeoGrande, *A Policy Long Past Its Expiration Date: US Economic Sanctions Against Cuba*, 82 SOC. RSCH. 939, 946 (2015).

³⁵ Patrick Oppmann & Maegan Vazquez, *Trump Admin Imposes New Travel Restrictions on Cuba, Banning Cruise Ships*, CNN (June 4, 2019, 1:25 PM), <https://www.cnn.com/2019/06/04/politics/us-cuba-travel-restrictions/index.html> [<https://perma.cc/C6C7-V2P4>] (summarizing new restrictions on travel to Cuba imposed by the Trump Administration).

³⁶ U.S. CONST. art. I, § 8, cl. 3.

³⁷ DIANNE R. RENNACK & MARK P. SULLIVAN, CONG. RSCH. SERV., R44822, CUBA SANCTIONS: LEGISLATIVE RESTRICTIONS LIMITING THE NORMALIZATION OF RELATIONS (2018) (discussing the Cuban Democracy Act and the LIBERTAD Act).

³⁸ *Id.* at 1 n.2.

³⁹ 22 U.S.C. §§ 6001–05 (restricting the entry of vessels carrying goods in which Cuba or Cuban nationals have an interest into U.S. ports without authorization and requiring the President to establish "strict limits on remittances to Cuba").

⁴⁰ 22 U.S.C. §§ 6021–37 (strengthening the U.S. embargo against Cuba by expanding the scope and territorial application of sanctions).

these statutes allow the Executive to suspend or waive aspects of the embargo imposed by Congress after the Executive makes particular findings.⁴¹

The Helms-Burton Act, in particular, is notable because it allows U.S. nationals whose property was confiscated by the Cuban government to sue for damages from any entity that traffics in or benefits from trafficking in that property.⁴² This statute thereby discourages foreign corporations from entering into a variety of transactions with the Cuban government.⁴³ These “[s]econdary sanctions” reflect Congress’s effort to expand the embargo’s effectiveness and further harm Cuba.⁴⁴ Still, in doing so they also increase the embargo’s costs on others, burdening foreign businesses and U.S. businesses that would like to engage in commerce with Cuba. The extraterritorial aspect of the embargo has created frictions with allies, which resist the application of U.S. law to their companies when those companies lack significant jurisdictional contacts with the United States.⁴⁵ Further, the threat of these lawsuits limits the foreign companies’ activities.⁴⁶ The hostile reception by U.S. allies to secondary sanctions offers an important caution for new forms of economic statecraft that affect third parties.

⁴¹ See, e.g., 22 U.S.C. §§ 6033(b), 6064 (allowing the President to suspend prohibition on foreign aid only if he determines that a “transition government in Cuba is in power”); 22 U.S.C. § 6085(b)(1) (allowing the President to suspend Helms-Burton litigation for up to six months); 22 U.S.C. § 6007(a) (allowing the President to waive restrictions on vessels if, among other things, Cuba conducts free and fair elections and takes certain other steps to protect human rights).

⁴² Brice M. Clagett, *Title III of the Helms-Burton Act is Consistent with International Law*, 90 AM. J. INT’L L. 434, 434 (1996).

⁴³ See *id.* (describing foreign corporations as the principal traffickers and targets of the law); Cuban Liberty and Democratic Solidarity (LIBERTAD) Act of 1996, tit. III, Pub. L. No. 104-114, 110 Stat. 785 (codified in scattered titles and sections of U.S.C.).

⁴⁴ John J. Forrer & Kathleen Harrington, *The Trump Administration’s Use of Trade Tariffs as Economic Sanctions*, CESIFO F., Winter 2019, at 23, 23 (“Secondary sanctions are a tool designed to push foreign countries, companies, and individuals into halting business dealings with countries and entities on which primary economic sanctions have been imposed.” (citation omitted)).

⁴⁵ On the unpopularity of secondary sanctions enforcement, see Tom Ruys & Cedric Ryngaert, *Secondary Sanctions: A Weapon Out of Control? The International Legality of, and European Responses to, US Secondary Sanctions*, BRIT. Y.B. INT’L L. (Sept. 22, 2020), <https://academic.oup.com/bybil/advance-article/doi/10.1093/bybil/braa007/5909823> [<https://perma.cc/W6VB-8L8A>]. See also *id.* (“The Helms-Burton Act’s far-reaching private enforcement right, which threatened investments in Cuba by EU Member States, was a particular thorn in the EU’s side.”).

⁴⁶ Monroe Leigh, *The Political Consequences of Economic Embargoes*, 89 AM. J. INT’L L. 74, 75-76 (1995) (giving examples of litigation challenging application of the U.S. embargo). Section 306(b) of the Helms-Burton Act allows the Executive to suspend the application of the expropriation litigation provision. Cuban Liberty and Democratic Solidarity (LIBERTAD) Act of 1996 § 306(b).

c. *Critiques*

Complaints about the extraterritorial application of embargoes are just one of a range of critiques they face. As former U.S. State Department Legal Adviser Monroe Leigh noted,

The catalog of criticisms of economic embargoes is lengthy and substantial. We read scholarly articles proving that they seldom achieve their declared objectives; that they deny trading opportunities to enterprises in the embargo-imposing country; that they bestow windfall profits on third-country traders; that economic embargoes are inherently illegal; that they despoil the poor and enrich the wealthy; that they fail to unseat the dictatorial regimes; that they are inherently immoral; [and] that in American practice they almost always include extreme assertions of extraterritorial jurisdiction⁴⁷

Embargoes may also cast the state imposing the embargo in a bad light. If the embargo succeeds, critics may view it as draconian; if it fails, critics may view the state imposing the embargo as feckless.

2. Economic Sanctions

Compared to embargoes, targeted sanctions represent a more tailored approach to foreign targets. Sanctions can reach not only foreign governments but also foreign officials, foreign nationals, or non-state groups such as al-Qaeda and Hezbollah.⁴⁸ Sanctions commonly take the form of asset freezes, travel bans, and arms embargoes,⁴⁹ and have become a preferred policy tool because they allow states to respond to a national security threat or foreign policy challenges without necessarily resorting to military force.⁵⁰ The United States has used sanctions to promote a range of foreign policy goals, including “counterterrorism, counternarcotics, nonproliferation, democracy and human rights promotion, conflict resolution, and cybersecurity.”⁵¹

⁴⁷ Leigh, *supra* note 46, at 74.

⁴⁸ For a comprehensive list of U.S. economic sanctions, see *Sanctions Programs and Country Information*, U.S. DEP'T OF THE TREASURY, <https://www.treasury.gov/resource-center/sanctions/Programs/Pages/Programs.aspx> [<https://perma.cc/J348-BKV4>] (listing OFAC sanctions).

⁴⁹ See Jonathan Masters, *What Are Economic Sanctions?*, COUNCIL ON FOREIGN RELS., <https://www.cfr.org/background/what-are-economic-sanctions> [<https://perma.cc/A8ZH-5VM2>] (Aug. 12, 2019, 8:00 AM).

⁵⁰ Forrer & Harrington, *supra* note 44, at 23 (“Economic sanctions have become a go-to foreign policy tool to support [the Trump Administration’s] ‘America First’ foreign policy strategy.”).

⁵¹ Masters, *supra* note 49.

a. *History*

Like trade embargoes, U.S. sanctions have a long history. For example, during the Civil War, Congress “prohibited transactions with the Confederacy, [and] called for the forfeiture of goods involved in such transactions”⁵² During World War II, the Treasury’s Office of Foreign Funds Control (today, the Office of Foreign Assets Control or OFAC) helped prevent the Nazis from using the assets they seized in occupied states. Treasury also blocked enemy assets and prohibited foreign trade with the Axis Powers.⁵³ And during the Korean War, the United States froze Chinese and North Korean assets.⁵⁴

After the severe sanctions that the UN Security Council imposed on Iraq in 1990–1991,⁵⁵ states and scholars developed an interest in so-called “smart sanctions”—sanctions that are narrowly tailored to their target’s objectionable behavior and limit the collateral impact on the target country’s population.⁵⁶ As an example of the type of smart sanctions common today, consider U.S. sanctions on individuals who contributed to a spate of violence in Burundi. In a 2015 Executive Order (EO), President Obama blocked the property and entry into the United States of four individuals from Burundi, including a former Defense Minister and the sitting Minister of Public Security.⁵⁷ He also authorized the government to freeze the assets of individuals in Burundi whom the U.S. Secretaries of State and Treasury determine to be responsible for human rights abuses, acts of violence against civilians, and the use of child soldiers.⁵⁸

b. *Statutory Authorities and Implementation*

The authority for U.S. sanctions flows from Congress’s foreign Commerce Clause power. Sanctions statutes take two primary forms: general authorizing statutes such as the International Emergency Economic Powers

⁵² *OFAC Consolidated Frequently Asked Questions*, U.S. DEP’T OF THE TREASURY, <https://home.treasury.gov/policy-issues/financial-sanctions/frequently-asked-questions/ofac-consolidated-frequently-asked-questions> [https://perma.cc/BBY5-EP3E].

⁵³ *Id.*

⁵⁴ Richard T. Devane, *The United States and China: China’s Claims and Assets*, 18 *ASIAN SUR.* 1267, 1267 (1978); *see also* Proclamation No. 2914, 3 C.F.R. 71 (Supp. 1950) (proclaiming a national emergency during the Korean War).

⁵⁵ S.C. Res. 661 (Aug. 6, 1990); S.C. Res. 687 (Apr. 3, 1991).

⁵⁶ Joseph Stephanides, *Foreword*, in *SMART SANCTIONS: TARGETING ECONOMIC STATECRAFT* vii, vii (David Cortright & George A. Lopez eds., 2002) (defining smart sanctions as measures tailored to maximize a target regime’s costs of noncompliance while minimizing the suffering of that state’s population).

⁵⁷ Exec. Order No. 13,712, 3 C.F.R. 2015 Comp. 381, 384.

⁵⁸ *Id.* at 381.

Act (IEEPA)⁵⁹ and specific sanctions statutes such as the Magnitsky Act⁶⁰ and the 2017 Countering America's Adversaries Through Sanctions Act (CAATSA).⁶¹ IEEPA authorizes the President to impose sanctions when they find that a situation constitutes "any unusual and extraordinary threat, which has its source in whole or substantial part outside the United States, to the national security, foreign policy, or economy of the United States" and declare a "national emergency" to deal with that threat.⁶² After the President issues an EO making such a finding, the Treasury Department issues regulations that detail the prohibited transactions, the effects of violating those provisions, and the definitions of terms in the EO.⁶³

Although we refer to the "government" imposing sanctions, many of the actors that prevent targets from accessing assets, weapons, oil, vessels, or travel are private corporations. Because today's economic sanctions target a wide range of actors across countries and industries, many corporations must set up systems to avoid doing business with actors on the sanctions list.⁶⁴ Companies must also ensure that their supply chains and counterparties are not doing business with sanctioned targets.⁶⁵ As discussed in the next Section, these burdens impact business and investment decisions by companies that must comply with them.⁶⁶

For example, the Treasury Department's sanctions enforcement efforts have "led to many large financial institutions reassessing the value of providing correspondent banking services on a global basis."⁶⁷ Corporations now view the risk of sanctions enforcement as both a substantial cost and a potential black eye to their reputations.⁶⁸ In addition to the compliance costs that companies must incur and the fines accompanying violations, sanctions

⁵⁹ International Emergency Economic Powers Act (IEEPA), 50 U.S.C. § 1701(a).

⁶⁰ Sergei Magnitsky Rule of Law Accountability Act of 2012, Pub. L. No. 112-208, 126 Stat. 1502 (codified at 22 U.S.C. § 5811).

⁶¹ Countering America's Adversaries Through Sanctions Act, Pub. L. No. 115-44, 131 Stat. 886 (2017) (codified at 22 U.S.C. § 9401).

⁶² 50 U.S.C. § 1701(a).

⁶³ See, e.g., International Emergency Economic Powers Act Civil and Criminal Penalties, 73 Fed. Reg. 32650 (June 10, 2008) (to be codified at 31 C.F.R. pts. 535-95).

⁶⁴ See *OFAC Issues a Framework for Compliance Commitments*, U.S. DEP'T OF THE TREASURY (May 2, 2019), <https://home.treasury.gov/news/press-releases/sm680> [<https://perma.cc/2TBK-HRDG>].

⁶⁵ See Mengqi Sun, *U.S. Sanctions Compliance Fines Hit Decade High*, WALL ST. J. (July 25, 2019, 8:32 AM), <https://www.wsj.com/articles/u-s-sanctions-compliance-fines-hit-decade-high-11564057920> [<https://perma.cc/7TD7-YH59>] ("OFAC has been where the actions have been in terms of potential risk to global institutions doing transactions all over the world" (quoting Doug Davison, partner, Linklaters LLP)).

⁶⁶ See generally PIERRE-HUGUES VERDIER, *GLOBAL BANKS ON TRIAL: U.S. PROSECUTIONS AND THE REMAKING OF INTERNATIONAL FINANCE* (2020).

⁶⁷ RICHARD GORDON, MICHAEL SMYTH & TOM CORNELL, *SANCTIONS LAW* § 11.55 (2019).

⁶⁸ See Sun, *supra* note 65 (noting that OFAC issued \$1.3 billion in penalties between January and July 2019 for sanctions violations).

may deter companies from pursuing lucrative business opportunities, such as selling oil or providing shipping services to foreign actors.⁶⁹ At some point, requiring banks with a U.S. nexus to enforce U.S. sanctions may compel them to avoid the U.S. market entirely.

c. *Critiques*

Critics have identified an array of problems with both the theory and implementation of sanctions. Sanctions are only occasionally effective.⁷⁰ Part of this is because the United States sometimes imposes sanctions without understanding the dynamics of foreign economies.⁷¹ Sanctions create scarcity, which can bolster the revenues of authoritarian regimes that exert tight control over goods.⁷² Further, imposing sanctions on a foreign government offers that regime a scapegoat, allowing the regime to blame others for its troubles.⁷³ Even smart sanctions may impose costs on the general population in the target state, as when arms embargoes divert the government's spending on social services to cover the higher cost of acquiring weapons.⁷⁴ When U.S. sanctions harm local populations, it can increase anti-American sentiment in the target state.⁷⁵

Another critique is that sanctions are sometimes adopted for domestic political reasons rather than for valid foreign policy reasons. Former U.S. Deputy Treasury Secretary Stuart Eizenstat argues that congressionally driven sanctions tend to be “driven by domestic political pressures” and can be counterproductive when they lack “the flexibility needed to make

⁶⁹ See, e.g., Jonathan Saul & Parisa Hafezi, *Shipping Firms Shy Aways From Iran Despite Deal to Ease Sanctions*, REUTERS (May 28, 2014, 11:20 AM), <https://www.reuters.com/article/iran-shipping-trade/shipping-firms-shy-away-from-iran-despite-deal-to-ease-sanctions-idUSL6NoOD31H20140528> [<https://perma.cc/F66X-5XZB>].

⁷⁰ See GARY CLYDE HUFBAUER, JEFFREY J. SCHOTT, KIMBERLY ANN ELLIOTT & BARBARA OEGG, *ECONOMIC SANCTIONS RECONSIDERED* (3d ed. 2007) (discussing poor design and implementation of sanctions). Broad-based sanctions have been most effective when the goal is to destabilize a foreign regime. Financial sanctions are most effective when the goal is policy change. See generally *id.*; Jaleh Dashti-Gibson, Patricia Davis & Benjamin Radcliff, *On the Determinants of the Success of Economic Sanctions: An Empirical Analysis*, 41 AM. J. POL. SCI. 608 (1997).

⁷¹ See Daniel W. Drezner, *How Smart are Smart Sanctions?*, 5 INT'L STUDS. REV. 107, 107 (2003) (book review).

⁷² *Id.* at 108-09.

⁷³ See, e.g., *Iran Blames U.S. Sanctions for Vaccine Payment Problems*, REUTERS (Nov. 13, 2020, 10:34 AM), <https://www.reuters.com/article/us-health-coronavirus-iran/iran-blames-u-s-sanctions-for-vaccine-payment-problems-idUSKBN27T26H> [<https://perma.cc/Y6E6-ZMX8>].

⁷⁴ Drezner, *supra* note 71, at 108.

⁷⁵ See, e.g., Aresu Egbali & Asa Fitch, *On Eve of New Sanctions, Iranian Regime Whips Up Anti-American Anger*, WALL ST. J. (Nov. 4, 2018, 9:46 AM), <https://www.wsj.com/articles/on-eve-of-new-u-s-sanctions-iranian-regime-whips-up-anti-american-anger-1541342802> [<https://perma.cc/5RWJ-PJ5B>].

sanctions effective.”⁷⁶ Others note that sanctions are easier to impose than to lift, which diminishes the incentives for the targets of sanctions to change their behavior.⁷⁷

Foreign actors are not the only ones who bear the costs of sanctions. Sanctions reduce the sales revenues and business opportunities of U.S. companies. Further, as noted above, many U.S. businesses must develop costly sanctions compliance regimes, extending the compliance burden beyond financial institutions to shipping, manufacturing, and technology companies.⁷⁸ Moreover, the reach of U.S. sanctions means that not only U.S. companies but also multinational and foreign companies must worry about sanctions compliance.⁷⁹

B. National Security-Driven Tariffs

Although tariffs—taxes that a state imposes on imported foreign goods—are generally used for economic purposes such as altering the terms of trade with foreign countries, the United States also employs tariffs to advance its foreign policy and national security interests. For example, tariffs can help ensure that strategically important goods are sourced domestically, which may be necessary if relationships with trading partners deteriorate. States may also use tariffs to inflict economic harm on foreign states, creating leverage to persuade foreign states to change their policies. As with sanctions, some scholars criticize tariffs for inflicting economic harm on the United States without achieving their intended goals.⁸⁰ This critique has particular bite

⁷⁶ Stuart E. Eizenstat, Book Review, 23 J. POL'Y ANALYSIS & MGMT. 377, 380 (2004) (reviewing MEGHAN L. O'SULLIVAN, SHREWD SANCTIONS: STATECRAFT AND STATE SPONSORS OF TERRORISM (2003)); *id.* (citing as an example sanctions on India and Pakistan that hurt U.S. companies without providing benefits).

⁷⁷ One extreme example of this is the Jackson-Vanik Amendment to the Trade Act of 1974. The amendment prevented the President from waiving the unfavorable trade treatment of communist countries unless a finding was made about the emigration policies of those countries. The amendment remained applicable to Russia until 2012, more than twenty years after the collapse of the U.S.S.R. in 1991. For background, see Robert H. Bradner, *The Jackson-Vanik Amendment to the Trade Act of 1974: Soviet Progress on Emigration Reform Is Insufficient to Merit a Waiver*, 4 GEO. IMMIGR. L.J. 639, 658-59 (1990), and *The Collapse of the Soviet Union*, OFF. OF THE HISTORIAN, <https://history.state.gov/milestones/1989-1992/collapse-soviet-union> [<https://perma.cc/AU94-NBH6>].

⁷⁸ See Kristin Broughton, *U.S. Sanctions Compliance Weighs on Nonfinancial Companies*, WALL ST. J. (Nov. 19, 2019, 5:28 PM), <https://www.wsj.com/articles/u-s-sanctions-compliance-weighs-on-nonfinancial-companies-11574202523> [<https://perma.cc/WU7P-UWLF>] (discussing the impacts of sanctions on global supply chains).

⁷⁹ *Id.*

⁸⁰ See, e.g., ERICA YORK, TAX FOUND., THE IMPACT OF TRADE ON TARIFFS ON THE UNITED STATES (2018), <https://files.taxfoundation.org/20180627113002/Tax-Foundation-FF595-1.pdf> [<https://perma.cc/6S3D-NCYF>].

because tariffs are collected from U.S. importers, who often pass on their increased costs to their U.S. customers.⁸¹

1. History

In the late nineteenth and early twentieth centuries, U.S. economic policy was mercantilist, pursuing large trade surpluses that allowed it to accumulate foreign financial assets.⁸² The federal government relied heavily on tariffs both for revenue and to protect domestic industries. Thus, when Congress enacted the Smoot-Hawley Tariff Act, it focused on the purported economic benefits.⁸³ But the Smoot-Hawley tariffs proved disastrous. Domestically, the tariffs exacerbated the Great Depression and made imported goods unaffordable for most people.⁸⁴ Internationally, the tariffs prompted retaliation by other states against American exports.⁸⁵

Following World War II, U.S. economic policy moved in a liberal direction towards free movements of capital, goods, and labor. Congress enacted trade statutes authorizing the President to enter into free trade agreements and lower duties on foreign goods.⁸⁶ Internationally, the United States and other states concluded the General Agreement on Tariffs and Trade (GATT), a treaty that “removed states’ ability to discriminate against one another in an effort to protect the domestic economy.”⁸⁷ The World Trade Organization (WTO) succeeded the GATT in 1995.⁸⁸ In general, the U.S. Trade Representative today seeks to reduce trade restrictions.⁸⁹

Bucking these broader historical trends, the Trump Administration revived a range of tariffs on adversaries and allies, both for domestic economic

⁸¹ *Who Pays Trump’s Tariffs, China or U.S. Customers and Companies?*, REUTERS (May 21, 2019, 11:45 AM), <https://www.reuters.com/article/us-usa-trade-china-tariffs-explainer-idUSKCN1SR1UI> [<http://perma.cc/8P2J-4NPN>].

⁸² See Janeen M. Klingler, *Political Economy and National Security: A Primer*, in I THEORY OF WAR AND STRATEGY 235, 236-42 (J. Boone Bartholomees ed., 2008) (discussing mercantilism’s approach to improving global economic power).

⁸³ See DOUGLAS A. IRWIN, PEDDLING PROTECTIONISM: SMOOT-HAWLEY AND THE GREAT DEPRESSION 145 (2011) (describing Congress’s motivations in passing tariffs).

⁸⁴ Alan Reynolds, *The Smoot-Hawley Tariff and the Great Depression*, CATO INST. (May 7, 2016, 3:27 PM), <https://www.cato.org/blog/smoother-hawley-tariff-great-depression> [<https://perma.cc/4LMT-C39F>].

⁸⁵ IRWIN, *supra* note 83 at 183.

⁸⁶ See Kathleen Claussen, *Trade’s Security Exceptionalism*, 72 STAN. L. REV. 1097, 1112 (2020) (describing Congress’s delegation of trade negotiations to the Executive).

⁸⁷ Ari Afilalo & Dennis Patterson, *Statecraft, Trade and the Order of States*, 6 CHI. J. INT’L L. 725, 737 (2006).

⁸⁸ See Klingler, *supra* note 82, at 243 (detailing the creation of the WTO).

⁸⁹ See *Non-Tariff Barriers and Regulatory Issues*, OFF. OF THE U.S. TRADE REPRESENTATIVE, <https://ustr.gov/trade-agreements/free-trade-agreements/transatlantic-trade-and-investment-partnership-t-tip/t-tip-2> [<https://perma.cc/ST8Y-GXMF>].

purposes and as a foreign policy tool.⁹⁰ In particular, President Trump levied high-profile tariffs on China both to counteract the domestic displacement of U.S. workers⁹¹ and because China has become “our No. 1 geopolitical opponent.”⁹² This consideration of tariffs alongside targeted sanctions represented a pronounced shift from prior practice, which reflected the view that sanctions were a foreign policy tool and tariffs were not. The Trump Administration applied tariffs to historical allies too. After U.S. tensions with Iran escalated in 2019–2020, the Trump Administration “privately threatened large automobile tariffs on European countries if they didn’t call out Tehran for alleged violations of the 2015 nuclear deal that Trump ha[d] sought to dismantle.”⁹³ One European official described Trump’s effort to influence European foreign policy through tariffs as “[e]xtortion,”⁹⁴ evidencing the international political costs and reputational downside of using tariffs against foreign companies to pressure foreign governments.

2. Statutory Authorities and Implementation

Congress has delegated a range of trade authorities to the Executive. Two key U.S. statutes that the President can use to adjust tariffs accommodate national security considerations. Section 201 of the Trade Act of 1974 allows the President to impose temporary tariffs when a sudden increase in the import of a given product threatens U.S. industries; it directs the President to consider the “national security interests” of the United States when choosing what safeguards to apply.⁹⁵ Similarly, section 232 of the Trade Expansion Act of 1962 allows the President to raise tariffs on goods if those

⁹⁰ As one article noted, “The Trump administration’s enthusiasm for economic sanctions has been reflected in [its] equally passionate embrace of trade tariffs.” Forrer & Harrington, *supra* note 44, at 23; *see also id.* (describing the “re-purposing of trade tariffs as economic sanctions” as “unprecedented”).

⁹¹ Adam Behsudi & Finbarr Bermingham, *Trump Thinks Tariffs Will Add U.S. Manufacturing Jobs. Economic Reality Says They Won’t*, POLITICO (Aug. 21, 2019, 5:01 AM), <https://www.politico.com/story/2019/08/21/trump-tariffs-bikes-manufacturing-1470361> [<https://perma.cc/QG8F-Y4R3>] (“President Donald Trump had promised that his steep tariffs on Chinese goods would help bring jobs back to the U.S.”).

⁹² Keith Johnson, *Most People Don’t Know What a Tariff Is*, FOREIGN POL’Y (May 29, 2019, 4:10 PM), <https://foreignpolicy.com/2019/05/29/most-people-dont-know-what-a-tariff-is> [<https://perma.cc/T62F-FRCS>]; *see also* Geoffrey Gertz, *Did Trump’s Tariffs Benefit American Workers and National Security?*, BROOKINGS (Sept. 10, 2020), <https://www.brookings.edu/policy2020/votervital/did-trumps-tariffs-benefit-american-workers-and-national-security> [<https://perma.cc/C7VG-2PR8>].

⁹³ Anne Gearan & John Hudson, *Trump’s Strong-Arm Foreign Policy Tactics Create Tensions with U.S. Friends and Foes*, WASH. POST (Jan. 19, 2020), https://www.washingtonpost.com/politics/trumps-strong-arm-foreign-policy-tactics-create-tensions-with-both-us-friends-and-foes/2020/01/18/ddb76364-3991-11ea-bb7b-265f4554af6d_story.html [<https://perma.cc/5MG9-6BK6>].

⁹⁴ *Id.*

⁹⁵ Claussen, *supra* note 86, at 1122.

goods are “being imported into the United States in such quantities or under such circumstances as to threaten to impair the national security.”⁹⁶

Historically, presidents invoked their section 232 powers infrequently and primarily did so when they were worried about U.S. dependence on foreign oil.⁹⁷ In a few cases, however, the President invoked this authority to punish foreign governments. In 1979, President Carter used section 232 to limit oil exports from Iran to retaliate for the seizure of the U.S. hostages,⁹⁸ and in 1980 he exercised his authority under the EAA to impose a grain embargo on the U.S.S.R. to punish it for its occupation of Afghanistan.⁹⁹ The Trump Administration deployed section 232 more aggressively than its predecessors. The Department of Commerce, which initiates investigations under section 232 to determine whether imports pose a national security threat, conducted five investigations and concluded in each case that the import in question threatened U.S. national security.¹⁰⁰

If the Executive wishes to impose a discriminatory tariff today that is consistent with U.S. international obligations, it must invoke a policy exception in the GATT.¹⁰¹ Article XXI of the GATT recognizes a national security exception to its general commitment to lowering trade barriers if the state considers an action

necessary for the protection of its essential security interests

(i) relating to fissionable materials or the materials from which they are derived;

(ii) relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment; [or]

⁹⁶ 19 U.S.C. § 1862.

⁹⁷ See Linfan Zha, *The Wall on Trade: Reconsidering the Boundary of Section 232 Authority Under the Trade Expansion Act of 1962*, 29 MINN. J. INT’L L. 229, 253-54 (2020) (showing that there were only twenty-six investigations under section 232 prior to the Trump Administration); RACHEL F. FEFER, KEIGH E. HAMMOND, VIVIAN C. JONES, BRANDON J. MURRILL, MICHAELA D. PLATZER & BROCK R. WILLIAMS, CONG. RSCH. SERV., R45249, SECTION 232 INVESTIGATIONS: OVERVIEW AND ISSUES FOR CONGRESS 3 (2021) (detailing that the President took action in five cases regarding crude oil and petroleum products); *id.* at app. B (providing a complete list of section 232 investigations).

⁹⁸ Craig Anderson Lewis, *Waiting for the Big One: Principle, Policy, and the Restriction of Imports under Section 232*, 22 LAW & POL’Y INT’L BUS. 357, 389 (1991) (“President Carter imposed an embargo on oil imports from Iran in retaliation for the seizure of American hostages.”).

⁹⁹ The embargo was an economic and political failure. See generally Robert L. Paarlberg, *Lessons of the Grain Embargo*, 59 FOREIGN AFFS. 144 (1980).

¹⁰⁰ See FEFER ET AL., CONG. RSCH. SERV., *supra* note 97, at app. B, tbl. B-1 (detailing the five section 232 investigations that the Commerce Department undertook during the Trump Administration that were completed and listing two more initiated in 2020 that had not been resolved as of May 18, 2021 when the report was last updated).

¹⁰¹ See discussion *infra* Section IV.E.

(iii) taken in time of war or other emergency in international relations¹⁰²

As we discuss in Part IV, this exception will be crucial in enabling the United States to use federal income tax law for foreign policy purposes.¹⁰³

When tariffs are in place on particular goods, importers must calculate what they owe under the tariff schedules and pay the duties to U.S. Customs and Border Protection after their shipments clear customs.¹⁰⁴ The burden of the administrative processes around tariffs is thus shared between importing companies, which must keep themselves informed about current tariff rules and pay the correct tariff amounts, and the government, which sets the tariffs, processes and reviews the payments, and enforces compliance.

3. Critiques

The Trump Administration's tariffs have been criticized for multiple reasons. Critics note that U.S. companies typically pass along tariff costs to their customers or cut costs, including by reducing jobs and wages.¹⁰⁵ A study by the Federal Reserve and Columbia University found that "U.S. companies and consumers paid \$3 billion a month in additional taxes because of tariffs on Chinese goods and on aluminum and steel from around the globe."¹⁰⁶ U.S. businesses such as soybean growers lost business because of China's retaliatory tariffs.¹⁰⁷ As a legal matter, a panel of the Dispute Settlement Body of the WTO concluded that the U.S. tariffs against China violated the GATT because they did not fit into the national security exception.¹⁰⁸ In sum, tariffs are typically a blunt instrument that imposes high costs on U.S. stakeholders and that may be inconsistent with U.S. treaty obligations.

¹⁰² General Agreement on Tariffs and Trade, art. XXI, Oct. 30, 1947, 61 Stat. A11, 55 U.N.T.S. 188 [hereinafter GATT 1947].

¹⁰³ See discussion *infra* Part IV.

¹⁰⁴ See Brent Radcliffe, *The Basics of Tariffs and Trade Barriers*, INVESTOPEDIA (Apr. 27, 2021), <https://www.investopedia.com/articles/economics/08/tariff-trade-barrier-basics.asp#who-collects-a-tariff> [<https://perma.cc/B67X-K2RF>].

¹⁰⁵ See Howard Gleckman, *What Is a Tariff and Who Pays It?*, TAX POL'Y CTR. (Sept. 25, 2018), <https://www.taxpolicycenter.org/taxvox/what-tariff-and-who-pays-it> [<https://perma.cc/RFD3-4WVZ>].

¹⁰⁶ *Who Pays Trump's Tariffs, China or U.S. Customers and Companies?*, *supra* note 81.

¹⁰⁷ See *id.* ("Chinese buyers have cut billions of dollars of soybean purchases from the United States because China's tariffs have made U.S. supplies more expensive than beans from competitors such as Brazil.")

¹⁰⁸ See Panel Report, *United States—Tariff Measures on Certain Goods from China*, ¶ 7.238, WTO Doc. WT/DS543/R 64 (adopted Sept. 15, 2020) ("[T]he Panel concludes that the United States has not provided an explanation that demonstrates how the imposition of additional duties on the selected imported products contributes to the achievement of the public morals objective as invoked by the United States.").

C. Export Controls

A third way that the United States conducts economic statecraft is by regulating the export of items that may threaten national security. By controlling the sale of sensitive U.S.-made goods and services such as weapons, military training, and dual-use technologies, the United States can help ensure that hostile foreign states cannot use those goods or services against it or use those tools to perpetrate acts that the United States condemns, such as human rights violations or war crimes. Although many of these regulations have a direct connection to U.S. national security, critics variously characterize the export control regime as “too restrictive, insufficiently restrictive, cumbersome, obsolete, inefficient, or any combination of these descriptions.”¹⁰⁹

1. History

The United States has long used export controls during wartime.¹¹⁰ In the middle of the twentieth century, export controls became a peacetime undertaking, with Congress enacting the Export Control Act of 1949 (ECA) to address the need for a comprehensive peacetime export control regime.¹¹¹ The ECA authorized the President to implement export controls based on “national security, foreign policy, or for the effect of domestic exports on the national economy,” and the President imposed near-embargo levels of controls on the Soviet bloc and China.¹¹² Congress enacted a replacement statute, the Export Administration Act of 1979 (EAA), to reflect the détente in U.S.–Soviet relations, shifting the emphasis away from highly restrictive controls to promote exports, including to communist countries.¹¹³ The basic function of the EAA was to provide “the statutory authority for export controls on sensitive dual-use goods and technologies: items that have both civilian and military applications.”¹¹⁴ Export controls under the EAA also applied to the re-export of U.S.-origin items from one foreign country to another, thus extending U.S. jurisdiction to transactions that took place

¹⁰⁹ FERGUSSON & KERR, CONG. RSCH. SERV., *supra* note 16, at 1.

¹¹⁰ See generally Harold J. Berman & John R. Garson, *United States Export Controls—Past, Present, and Future*, 67 COLUM. L. REV. 791, 791 n.1 (1967) (discussing the use of export controls during both World Wars).

¹¹¹ IAN F. FERGUSSON, CONG. RSCH. SERV., RL31832, THE EXPORT ADMINISTRATION ACT: EVOLUTION, PROVISIONS, AND DEBATE 1-2 (2009); 50 U.S.C. app. §§ 2021–32.

¹¹² FERGUSSON, CONG. RSCH. SERV., *supra* note 111, at 1-2, 7.

¹¹³ Gregory W. Bowman, *A Prescription for Curing US Export Controls*, 97 MARQ. L. REV. 599, 615 (2013).

¹¹⁴ FERGUSSON, CONG. RSCH. SERV., *supra* note 111, at Summary.

abroad among non-U.S. persons.¹¹⁵ Congress did not update the EAA until 2018, when it enacted the Export Control Reform Act (ECRA).¹¹⁶ The core disagreement about reforming the EAA centered on striking the right balance between national security interests and commercial interests.¹¹⁷ In the end, the ECRA made few changes to the old regime.¹¹⁸

One prominent recent use of export controls for national security purposes involves Chinese telecommunications companies such as Huawei¹¹⁹ and ZTE. In 2016, the Commerce Department placed ZTE on its “Entity List,” which occurs when a company has engaged in “activities contrary to the national security or foreign policy interests of the United States.”¹²⁰ Sometimes known as a “death sentence,”¹²¹ being placed on the Entity List means that the Commerce Department will presumptively deny licenses to U.S. companies that seek to export goods to the listed company.¹²² In 2019, the Commerce Department added Huawei to the Entity List, citing Huawei’s involvement in violations of IEEPA and other U.S. laws in a manner contrary to U.S. national security and foreign policy.¹²³ In December 2020, the Pentagon added four Chinese companies to a list of entities judged to support the Communist Party’s People’s Liberation Army,¹²⁴ provoking claims that the United States was using national security as a cover to throttle the development of foreign industrial competition. Even more recent attempts to add Chinese companies to this blacklist have run up against court

¹¹⁵ Bowman, *supra* note 113, at 606 (“As a result, the United States is now far more inclined to assert jurisdiction extraterritorially . . .”).

¹¹⁶ Export Control Reform Act of 2018, Pub. L. No. 115-232, 132 Stat. 2208 (codified in scattered sections of 50 U.S.C.).

¹¹⁷ See Danny Vinik, *America’s Permanent Export Emergency*, POLITICO (Oct. 22, 2017, 4:22 PM), <https://www.politico.com/agenda/story/2017/08/22/america-permanent-export-emergency-000501> [<https://perma.cc/SH7M-GYYP>] (noting that export administration reform created “huge political fights between pro-business lawmakers seeking to open up new markets and defense hawks worried about permitting the sale of sensitive technologies”).

¹¹⁸ The law did provide permanent statutory authority for the Commerce Department’s export control program and its Export Administration Regulations. 50 U.S.C. § 4801.

¹¹⁹ 15 C.F.R. § 744 supp. 4 (2021).

¹²⁰ *Id.*; *id.* § 744.1(a)(1).

¹²¹ Zak Doffman, *U.S. Senators Target Huawei With ‘Death Sentence’ Law to Block Trump’s Backtrack*, FORBES (July 16, 2019, 2:33 PM), <https://www.forbes.com/sites/zakdoffman/2019/07/16/u-s-senators-introduce-huawei-death-sentence-bill-to-put-blacklisting-into-law/?sh=749c83847867> [<https://perma.cc/5BHT-25GF>].

¹²² See *Lists of Parties of Concern*, BUREAU OF INDUS. & SEC., <https://www.bis.doc.gov/index.php/policy-guidance/lists-of-parties-of-concern> [<https://perma.cc/6QAT-BGVK>].

¹²³ 15 C.F.R. § 744 supp. 4 (2021).

¹²⁴ Joe McDonald, *US Adds Chinese Chipmaker, Oil Giant to Security Blacklist*, ASSOCIATED PRESS (Dec. 4, 2020), <https://apnews.com/article/joe-biden-donald-trump-technology-beijing-china-987af9f77098906f5d71b9ef325b85f> [<https://perma.cc/7P82-GP3>].

challenges, with the D.C. District Court issuing a preliminary injunction against the listing of those companies.¹²⁵

2. Statutory Authorities and Implementation

The U.S. export control regime is a complex web of statutes and regulations. The Departments of Commerce, State, and Treasury are the primary agencies that implement, administer, and enforce export regulations.¹²⁶ Each department is responsible for a different type of export, but their jurisdiction sometimes overlaps.

The 1976 Arms Export Control Act (AECA) gives the President the power to control the export of defense articles and services.¹²⁷ The State Department administers this statute through its International Traffic in Arms Regulations (ITAR),¹²⁸ which overlaps with the U.S. sanctions regime by denying export licenses to states under UN export sanctions, state sponsors of terrorism, and states subject to a U.S. arms embargo or sanction.¹²⁹ The second key statute is the ECRA, which gives the President the power to control the “export, reexport, and in-country transfer of items subject to the jurisdiction of the United States,” whether by U.S. or foreign nationals.¹³⁰ Although the Commerce Department administers the Export Administration Regulations (EAR), U.S. companies bear primary responsibility for determining whether an export transaction requires a license.¹³¹ This determination can be difficult because of the regulations’ complexity and imperfect overlap with the U.S. sanctions regime administered by the Treasury Department.

The Committee on Foreign Investment in the United States (CFIUS) can also be understood as an export control regime, although it formally regulates inbound investments. In 1988, Congress authorized the President to suspend or prohibit certain transactions, including mergers or acquisitions, that could result in foreign control of any U.S. business, as well as certain types of real estate.¹³² Congress later broadened the statute’s coverage to extend to certain other non-controlling investments that give foreign persons

¹²⁵ Jordan Brunner, *Communist Chinese Military Companies and Section 1237: A Primer*, LAWFARE (Mar. 22, 2021, 8:01 AM), <https://www.lawfareblog.com/communist-chinese-military-companies-and-section-1237-primer> [<https://perma.cc/SDC7-KVDA>] (“[T]wo Chinese companies have filed lawsuits contesting their designation as ‘Communist Chinese military companies’”).

¹²⁶ *U.S. Export Controls*, INT’L TRADE ADMIN., <https://www.trade.gov/us-export-controls> [<https://perma.cc/RV22-9YTD>].

¹²⁷ 22 U.S.C. § 2751.

¹²⁸ 22 C.F.R. § 120 (2021).

¹²⁹ 22 C.F.R. § 126.1 (2021).

¹³⁰ 50 U.S.C. § 4812(a)(1).

¹³¹ See generally 15 C.F.R. § 732 (2021) (listing companies’ obligations under EAR).

¹³² 50 U.S.C. § 4565.

“access, rights, or involvement in certain types of U.S. businesses.”¹³³ CFIUS therefore effectively restricts the export of certain types of sensitive information to foreign actors. Through an Executive Order, the President established CFIUS, a committee of nine cabinet members from federal agencies and offices, to review covered transactions and assess their potential effect on U.S. national security.¹³⁴ If CFIUS concludes that the transaction poses a national security risk, it can request that the parties to the transaction take steps to mitigate that risk¹³⁵ or even recommend that the President block the transaction entirely.¹³⁶

As these statutes reveal, a range of federal agencies presides over the export control regime. The Departments of State, Defense, Energy, and Commerce all play roles that intersect and, in some cases, overlap. There has long been interest in trying to consolidate and simplify the export control process.¹³⁷ In 2010, then-Defense Secretary Robert Gates proposed a new export control system that would involve a single export control licensing agency; a single control list; a single enforcement structure; and a single information technology system.¹³⁸ Although the idea did not get traction, dissatisfaction with the current system remains.¹³⁹

3. Critiques

The critiques of the U.S. export control regime are both substantive and procedural. Substantively, many businesses believe that the United States imposes too many controls on U.S. exports. Others argue that because the

¹³³ *CFIUS Laws and Guidance*, U.S. DEP'T OF THE TREASURY, <https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius/cfius-laws-and-guidance> [<https://perma.cc/MA4T-9HZK>].

¹³⁴ 50 U.S.C. § 4565(b)(1); Exec. Order No. 11,858, 3 C.F.R. 990 (1971–1975), *reprinted as amended* by Exec. Order No. 13,456, 3 C.F.R. 171 (2008).

¹³⁵ Exec. Order No. 11,858, § 7, 3 C.F.R. 990 (1971–1975), *reprinted as amended* by Exec. Order No. 13,456, 3 C.F.R. 171 (2008).

¹³⁶ *Id.* § 6. Changes made in 2018 established exceptions to the process for companies with sufficient ties to “excepted foreign state[s].” 31 C.F.R. § 800.219 (2021) (implementing the Foreign Investment Risk Review Modernization Act of 2018). These states are Australia, Canada, and the United Kingdom. *CFIUS Excepted Foreign States*, U.S. DEP'T OF THE TREASURY, <https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius/cfius-expected-foreign-states> [<https://perma.cc/R56G-SVE2>]. The 2018 amendments also allow CFIUS reviews to discriminate against investors from countries of “special concern.” JAMES K. JACKSON, CONG. RSCH. SERV., RL33388, THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES (CFIUS) 2 (2019).

¹³⁷ Berman & Garson, *supra* note 110, at 794 (“[W]e do not wish to conceal our conviction . . . that our system of export controls needs a drastic revision.”).

¹³⁸ Robert M. Gates, Sec’y of Def., Address to the Business Executives for National Security on the U.S. Export Control System (Apr. 20, 2010), <https://sgp.fas.org/news/2010/04/gates-export.html> [<https://perma.cc/882D-4A68>].

¹³⁹ See Egle, *supra* note 13.

existing multilateral export control regimes are voluntary, it is easy for actors to get their hands on dangerous items from other states. Procedurally, it is hard to gainsay that the regime is unwieldy, complex, and costly for companies to comply with.

As is true with sanctions and tariffs, export controls entail a range of tradeoffs. The use of export controls to deprive a foreign state of access to a certain type of goods (such as arms or advanced lasers) might prompt the foreign government to develop its own industry. Further, export controls deprive U.S. companies of sales. Export controls can have indirect effects as well, if U.S. companies lose sales to companies in states that currently use U.S. technology but want to keep selling their products to states that the United States has blocked from receiving that technology.

Although CFIUS is a powerful tool for protecting U.S. companies and infrastructure from being purchased or controlled by foreign companies or governments in a way that could pose a threat to U.S. national security, the tool is only available for use in a narrow set of business transactions. That said, CFIUS seems to have high salience (in situations such as the Dubai Ports case),¹⁴⁰ and the trend seems to be to empower CFIUS with ever broader mandates.¹⁴¹ As with sanctions and tariffs, in those cases where CFIUS imposes risk mitigation measures or where the President bars a transaction, the affected U.S. business may suffer significant financial harm.

D. Recent Trends

Although embargoes, economic sanctions, tariffs, and export controls comprise the bulk of coercive U.S. economic statecraft, the Trump Administration employed (or contemplated using) several new tools that might serve similar purposes. The increasing range of economic tools being deployed for foreign policy purposes makes it even more puzzling that tax has not been among those tools.

One new tool is import restrictions. The United States is concerned that using Chinese products within U.S. critical infrastructure and supply chains may expose the U.S. government, citizens, and companies to Chinese government intelligence collection and hacking. In the 2019 National Defense Authorization Act, Congress prohibited executive agencies from procuring

¹⁴⁰ JACKSON, CONG. RSCH. SERV., *supra* note 136, at Summary; cf. Jon D. Michaels, *The (Willingly) Fettered Executive: Presidential Spinoffs in National Security Domains and Beyond*, 97 VA. L. REV. 801, 807 (2011) (stating that the President's significant power to block proposed foreign investment deemed detrimental to national security is closely identified with the Dubai Ports deal).

¹⁴¹ JACKSON, CONG. RSCH. SERV., *supra* note 136, at 1, 7 (describing policymakers' support for greater scrutiny by CFIUS of a range of foreign investments and the 2018 FIRRMA amendments to Exon-Florio).

telecommunications equipment or services from companies associated with or owned by the Chinese government.¹⁴² In May 2019, President Trump extended these import limitations to the private sector through an EO prohibiting U.S. actors from acquiring information and communications technology or services from designated foreign providers.¹⁴³ These efforts target companies such as Huawei, with the goals of excluding Huawei's products from the United States and adversely affecting Huawei's business. In May 2020, President Trump signed a similar EO to secure the U.S. bulk power system.¹⁴⁴

In addition to import limitations, the Executive Order also discouraged U.S. pension funds from investing in Chinese companies. The U.S. Thrift Savings Plan Board, which oversees the pension funds of U.S. government employees, had planned to increase its exposure to Chinese companies to diversify its investments and improve its rates of return.¹⁴⁵ Members of Congress and the White House criticized the Board's proposal; a letter from the National Economic Council Director and the National Security Advisor to the Board expressed "grave concerns with the planned investment on grounds of both investment risk and national security."¹⁴⁶ In response, the Board abandoned those investments.

In 2020, the Trump Administration deployed another investment-related tool to address a perceived threat to U.S. national security posed by Chinese military companies. The President issued an EO finding that China was "exploiting United States capital to resource and to enable the development and modernization of its military, intelligence, and other security apparatuses, which continues to allow the PRC to directly threaten the United States homeland and United States forces overseas."¹⁴⁷ The President prohibited transactions by U.S. persons of publicly traded securities or

¹⁴² John S. McCain National Defense Authorization Act for Fiscal Year 2019, Pub. L. No. 115-232, § 889, 132 Stat. 1636 (codified in scattered titles and sections of U.S.C.).

¹⁴³ Exec. Order No. 13,873, 84 Fed. Reg. 22,689.

¹⁴⁴ Exec. Order No. 13,920, 85 Fed. Reg. 26595 ("I further find that the unrestricted acquisition or use in the United States of bulk-power system electric equipment designed, developed, manufactured, or supplied by persons owned by, controlled by, or subject to the jurisdiction or direction of foreign adversaries augments the ability of foreign adversaries to create and exploit vulnerabilities . . .").

¹⁴⁵ Ana Swanson, *Federal Retirement Fund Halts Planned China Investment Under Pressure*, N.Y. TIMES (May 13, 2020), <https://www.nytimes.com/2020/05/13/business/economy/china-tsp-federal-retirement-fund.html> [<https://perma.cc/YQ72-KXQT>] ("[T]he plan's effort to diversify the international stock portion of the \$593.7 billion it has in assets under management has become a flash point in an increasingly contentious relationship between the United States and China.").

¹⁴⁶ Thomas Franck, *White House Directs Federal Pension Fund to Halt Investments in Chinese Stocks*, CNBC (May 12, 2020, 3:47 PM), <https://www.cnbc.com/2020/05/12/white-house-directs-federal-pension-fund-to-halt-investments-in-chinese-stocks.html> [<https://perma.cc/2BLW-X2NP>].

¹⁴⁷ Exec. Order No. 13,959, 85 Fed. Reg. 73,185.

derivatives of Chinese military companies to address this concern. On June 3, 2021, President Biden expanded the scope of that Executive Order.¹⁴⁸

* * *

These recent examples illustrate that the United States has left almost no economic stone unturned when considering how to influence the foreign policy of other states and protect U.S. national security. Each of the tools discussed in this Part has different strengths and weaknesses, though all involve some costs to the U.S. economy. Further, all rely—to some extent—on U.S. companies to enforce U.S. laws and regulations, thereby burdening those industries. Finally, no one tool is perfectly tailored to accomplish its goal, and even today’s broad collection of tools contains gaps and imperfections. But the steady increase in economic coercion over time reveals that the main alternative to economic statecraft—military force—is viewed as even worse. Thus, rather than abandon the toolkit of economic statecraft, we think that it is appropriate to make it more effective—and that tax can help.

II. TAX AND FOREIGN POLICY: PAST AND PRESENT

Envisioning the proper role of tax law in implementing foreign policy requires understanding how taxes operate on the interests of foreign actors and the costs of acting on those interests. We address these topics and then provide a brief history of how income tax law has been used in service of foreign policy. This history illustrates that the primary use of tax law has been to encourage U.S. businesses to invest in strategically important countries. There are a few other foreign policy uses of tax law, but they reflect a reactive posture in which Congress has responded to particular and temporary episodes rather than developing a comprehensive and forward-looking approach.

A. *The Effects of Taxes*

The income tax is, far and away, the single most important tax for the U.S. federal government. Individual and corporate income taxes make up fifty-seven percent of federal revenues.¹⁴⁹ Moreover, an enormous variety of activities create taxable income, so the income tax provides many points of leverage over individual and corporate actors. By contrast, tariffs and excise

¹⁴⁸ See Exec. Order No. 14,032, 86 Fed. Reg. 30,145 (expanding the scope of earlier investment prohibitions against China).

¹⁴⁹ *Briefing Book*, TAX POL’Y CTR., <https://www.taxpolicycenter.org/briefing-book/what-are-sources-revenue-federal-government> [<https://perma.cc/LWZ2-ZH8Z>].

taxes are imposed on much narrower bases: only certain specified goods and services. If there is a robust role for tax law as a tool of economic statecraft, the focus will have to be the income tax.

There are two channels through which an income tax—indeed, any tax—affects a person engaged in the taxed activity. First, to the extent that the person continues to pursue that activity and cannot pass the tax's burden to someone else through higher prices, the person must bear the burden of the tax and is made poorer. With less wealth, that person will be less able to undertake any costly activity. We call this the “wealth effect.” Second, by reducing the after-tax benefits from the activity, the tax encourages the taxpayer to spend her resources and efforts on alternative activities. We call this the “price effect.”¹⁵⁰ Both effects will generally be present, with the relative magnitudes depending on the particular activity and context. Specifically, the availability of close substitutes for the taxed activity will tend to cause the price effect to dominate.

A simple example will illustrate the dynamics of these effects. Consider a foreign investor holding a portfolio of securities that includes bonds issued both by U.S. corporations and by foreign corporations. Suppose that the bond issuers all represent similar credit risks and pay interest at an annual rate of 5% and that the interest on the foreign bonds is exempt from tax. What would be the effect of imposing a 30% tax on the interest paid to foreign persons by U.S. corporations? In general, the investor will not simply accept a 3.5% after-tax return on bonds that she was previously willing to hold with a 5% rate of return. The imposition of this tax will set in motion a series of events.

First, the U.S. corporate issuer of the debt may need to increase the interest that it pays foreign bondholders, either because of a contractual obligation or market pressure. It is common in bank credit agreements for the loan indenture to include a tax “gross-up” provision that requires the issuer to compensate bondholders for a change in tax law that reduces the after-tax return to the holders. In this case, the entire burden of the tax would be borne by the U.S. issuer, not the bondholders. The increased costs of raising capital through bond issuances will encourage the U.S. issuer to consider substitute forms of financing, such as equity investments. In the absence of a gross-up provision, the tax may motivate foreign investors to sell their U.S. bonds to holders who do not pay the tax, such as U.S. investors or tax-exempt entities. But if those investors were not willing to hold the bonds to begin with, the U.S. issuers will have to increase the interest

¹⁵⁰ These two effects are very similar to what are called the “income” and “substitution” effects in the economics literature for describing the effects of a tax on consumption. The substitution effect differs from the price effect in that the substitution effect is estimated by compensating the taxpayer for the tax paid.

payable on the bonds to attract investors. The net result will be some mixture of increased borrowing costs for U.S. companies and lower after-tax returns for foreign holders of U.S. bonds. And there will be a shift in investment capital away from U.S. corporate debt to foreign assets, U.S. equities, and other substitute investments.

This example illustrates two general consequences of income taxes: they redirect resources away from the income-producing activity being taxed (the price effect), and they extract resources from the persons who continue to engage in that activity (the wealth effect). Moreover, because the burden of a given tax may vary across taxpayers—because they are in different tax brackets or residents of different countries, for example—there are “clientele” effects, whereby taxpayers who are less burdened by the tax displace those for whom the taxed activity has become too costly. It is essential to keep these effects in mind when using the income tax to influence private actors in pursuit of foreign policy goals. If the goal is to impoverish taxpayers engaged in an activity, then one wants the wealth effects to dominate. If the aim is to discourage taxpayers from engaging in the activity, one wants the price effect to dominate.

It is worth first noting how the wealth and the price effects appear through a traditional tax policy lens. One function of the income tax is to allocate the costs of financing the government equitably. The wealth effects of taxes are the necessary consequence of paying for government, and they are generally evaluated according to some fairness criterion according to which taxpayers who have a greater ability to bear the burden of government pay more in taxes. The price effect is the change in behavior induced by the tax. This behavioral change is generally viewed as undesirable insofar as individuals’ pre-tax allocations of time and resources are efficient. Tax policy thus generally strives to have as small an effect on these allocations as possible.¹⁵¹

By contrast, a “tax sanctions” lens inverts these intuitions. A tax sanction is a tax rule specific to a country, individual, or corporate target that increases the effective tax rate on that target’s income, or on income earned by other persons from transactions with that target, in the service of specified U.S. foreign policy purposes. Rather than trying to minimize the price effect, a good tax sanction will maximize that effect, generating a very large behavioral response away from the behavior it intends to discourage. And rather than trying to make the wealth effects as small as possible—minimizing revenue needs through, for example, more efficient government—a tax sanction with large wealth effects may be desirable insofar as it weakens the capacity of its target to achieve any of its goals.

¹⁵¹ This discussion ignores certain exceptions, such as cases of externalities, public goods, and other market imperfections.

In addition to its effects on taxpayer wealth and behavior, income tax law also compels the disclosure of information about taxpayers and their economic affairs. Form 1040 and the associated schedules require U.S. individual taxpayers to disclose all sorts of information, including details about their family, investments, charitable donations, and whether they maintain health insurance. Certain persons with ownership or control rights in foreign corporations must disclose the foreign corporation's income, assets, ownership, and business activities. Certain foreign investors are exempt from a thirty percent tax on the interest they receive from U.S. debtors only if they certify under penalty of perjury that they are a foreign person and provide identifying information.¹⁵² In sum, the IRS receives an enormous amount of information about the economic activities of people within the long reach of U.S. tax jurisdiction. In most cases, that information is collected to ensure the accurate application of the tax laws but, as we discuss in Section II.C, sometimes the relationship between tax and information is reversed: collecting information is the goal and taxation is used to compel its disclosure.

B. History

Tax law was used in service of foreign policy throughout the twentieth century,¹⁵³ primarily to steer U.S. trade and investment towards strategically important countries.¹⁵⁴ The foreign policy case for this approach relies on a collection of arguments about how economic interdependencies between states reduce the risk of conflict, and how trade and investment lead to growth, democratization, and moderation, which may make foreign states friendlier to U.S. interests.¹⁵⁵

For example, in the early 1920s the U.S. tax code contained special tax exemptions for businesses operating in U.S. possessions¹⁵⁶ and tax benefits

¹⁵² I.R.C. § 871(h)(2)(B)(ii).

¹⁵³ See generally Michael J. Graetz, *The David R. Tillinghast Lecture: Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 54 TAX L. REV. 261, 307 (2001) (discussing examples).

¹⁵⁴ Encouraging investment in foreign countries may advance the United States' financial interests and spread U.S. political influence. See Robert Hellowell, *United States Income Taxation and Less Developed Countries: A Critical Appraisal*, 66 COLUM. L. REV. 1393 (1966). The earned income exclusion was also originally justified as a way to increase the presence of Americans abroad to facilitate trade. Jeffrey Evans, Note, *911: The Foreign Earned Income Exclusion—Policy and Enforcement*, 37 VA. J. INT'L L. 891, 895 (1997).

¹⁵⁵ See Alan L. Gornick, *Tax Incentives and Our National Foreign Policy*, TAX EXEC., Apr. 1955, at 3, 20 (arguing that expanded foreign trade will contribute to peace and security and deter aggression); Ruth Mason, *Efficient Management of the Wealth of Nations*, TAX NOTES, Sept. 29, 2008, at 1321, 1321 (stating that economic interdependence provides a powerful market disincentive for manipulation).

¹⁵⁶ See, e.g., Revenue Act of 1921, ch. 136, § 262, 42 Stat. 227, 271 (detailing how to determine income from sources within United States possessions).

for investing in China.¹⁵⁷ During the Cold War, several rules favored investment in less-developed countries (LDCs), particularly in Latin America. Income earned by controlled foreign corporations was treated more favorably if the income was derived from an LDC and reinvested in an LDC.¹⁵⁸ The purpose of § 931—which currently excludes income from Guam, American Samoa, and the Northern Mariana Islands—was to stimulate economic development abroad, primarily in Puerto Rico and the Philippines after they came under U.S. control following the Spanish-American War.¹⁵⁹ And the foreign tax credit rules were also more favorable for income earned in these jurisdictions.¹⁶⁰

The cost to the United States of these tax incentives was foregone revenue and redirection of private investment. During the economic boom of the 1960s, the tradeoff between tax revenue and economic growth on the one hand and foreign policy goals on the other hand favored foreign policy.¹⁶¹ But these tax incentives were repealed when oil prices rose, the stock market crashed, and the country sunk into a recession in the mid-1970s.¹⁶² The tradeoff between economic and foreign policy goals is contingent on economic conditions and geopolitical circumstances, which vary over time.

The historical use of domestic income tax law to induce taxpayers to invest in strategically important countries has shaped scholars' imaginations about what is possible. For example, Professor Graetz suggests that the foreign tax credit or transfer pricing rules could be used to increase U.S. investment in select countries.¹⁶³ Professor Brown argues that the United States should exempt income from sub-Saharan African countries for reasons having to do with both equity and foreign policy.¹⁶⁴ Daniel Lubetzky argues that the

¹⁵⁷ China Trade Act of 1922, § 26, 42 Stat. 849, 856 (describing special dividends to Chinese citizens for corporations organized under the China Trade Act).

¹⁵⁸ 26 U.S.C. § 954(b)(1) (repealed 1975).

¹⁵⁹ See S. REP. NO. 99-313, at 477-78 (1985).

¹⁶⁰ Donald R. Whittaker, *An Examination of the O.E.C.D. and U.N. Model Tax Treaties: History, Provisions and Application to U.S. Foreign Policy*, 8 N.C. J. INT'L L. & COM. REGUL. 39, 56 (1982) (describing provisions designed to encourage investment in less developed countries, including favorable foreign tax credits).

¹⁶¹ John M. Kline, *A New Federalism for United States Foreign Policy*, 41 INT'L J. 507, 511 (1986).

¹⁶² *Id.*

¹⁶³ See Graetz, *supra* note 153, at 309. Another oft-discussed benefit is a tax credit for foreign taxes even if those taxes are not paid—what are known as “tax sparing” provisions. The scholarly appraisal of tax sparing rules is mixed. See, e.g., Kim Brooks, *Tax Sparing: A Needed Incentive for Foreign Investment in Low-Income Countries or an Unnecessary Revenue Sacrifice?*, 34 QUEEN'S L.J. 505, 508 (2009) (reviewing tax sparing agreements adopted by other countries and arguing against their usefulness).

¹⁶⁴ Karen B. Brown, *Missing Africa: Should U.S. International Tax Rules Accommodate Investment in Developing Countries?*, 23 U. PA. J. INT'L ECON. L. 45, 48 (2002). For a more recent discussion of this approach, see Yariv Brauner, *The Future of Tax Incentives for Developing Countries*, in TAX, LAW AND DEVELOPMENT 25 (Yariv Brauner & Miranda Stewart eds., 2013).

United States should provide incentives such as tax credits for investment in joint ventures between Arabs and Israelis to increase regional stability and facilitate long-term peace.¹⁶⁵

Income tax treaties have been another critical tax mechanism for encouraging foreign investment.¹⁶⁶ Historically, the primary purpose of income tax treaties has been to coordinate income tax jurisdiction between two states so that nationals engaged in cross-border transactions would not be taxed by both. In this way, income tax treaties are another tool—like investment treaties and regional free trade agreements—to further economic integration. As part of its income tax treaties, the United States has generally provided nationals of the other states reduced tax rates on outbound passive income payments, such as interest and dividends.¹⁶⁷ But because tax treaties are negotiated instruments designed to advance the interests of both signatories, they provide carrots, not sticks. If the United States wants to steer economic activity away from certain states, it must do so using domestic tax law by amending the Code or the Treasury Regulations, or by issuing administrative guidance.

Although changes to the Code require congressional action, changes in statutory interpretation by the IRS can also have dramatic effects on foreign policy. An interesting episode illustrating the role of the IRS involved the growing importance of OPEC in the 1970s and the creditability of certain foreign levies on oil extraction. In a provocative article, one scholar argued that the IRS changed its position on the creditability of these levies to compel U.S. oil companies to renegotiate their contracts with the OPEC states.¹⁶⁸ By

¹⁶⁵ Daniel Lubetzky, *Incentives for Peace and Profits: Federal Legislation to Encourage U.S. Enterprises to Invest in Arab-Israeli Joint Ventures*, 15 MICH. J. INT'L L. 405, 406 (1994). Professor Dean argues that countries should move beyond simple tax information exchanges and contemplates certain countries (generally richer countries) paying others for tax information. Steven A. Dean, *The Incomplete Global Market for Tax Information*, 49 B.C. L. REV. 605, 667 (2008). For other proposals to use tax to achieve foreign policy goals, see Diane L. Fahey, *Can Tax Policy Stop Human Trafficking?*, 40 GEO. J. INT'L L. 345 (2009), proposing that tax on interest payments to residents of countries that are not working to stop human trafficking should be subject to a higher rate of tax, and Joshua A. Feinzeig, Note, *Promoting World Peace Through the Use of the "Good Book": Implementing Foreign Policy Through the Tax Code*, 40 BROOK. J. INT'L L. 953 (2015), arguing that tax law should discourage the purchase of conflict minerals from the Democratic Republic of Congo.

¹⁶⁶ AM. L. INST., FEDERAL INCOME TAX PROJECT: INTERNATIONAL ASPECTS OF UNITED STATES INCOME TAXATION II, at 1 (1992) ("The principal function of income tax treaties is to facilitate international trade and investment by removing—or preventing the erection of—tax barriers to the free international exchange of goods and services and the free international movement of capital and persons.").

¹⁶⁷ BORIS I. BITTKER & LAWRENCE LOKKEN, FUNDAMENTALS OF INTERNATIONAL TAXATION ¶ 66.3 (2001).

¹⁶⁸ Julie Hayward Biggs, *Foreign Policy Implications of the Abolition of the Foreign Tax Credit for Oil Companies*, 4 J. CORP. L. 339, 352 (1979) ("[I]t is likely that the reasoning behind the recent changes in tax policy reflect[s] political motivation.").

forcing companies to renegotiate the oil contracts, the IRS could unify the companies against the host governments, reduce the ability of OPEC members to collude, and reduce U.S. involvement in foreign oil operations.¹⁶⁹

C. Current Rules

This Section describes how domestic income tax law currently incorporates foreign policy through mandatory information reporting and by imposing penalties on taxpayers and certain tax-exempt entities that earn income from certain countries.

1. Information Reporting

We begin by considering two mandatory disclosure regimes in federal income tax law. These regimes illustrate that tax law can compel the disclosure of information relevant to foreign policy while also revealing the importance of limiting reporting obligations only to those taxpayers who have substantial jurisdictional contacts with the United States.

a. Section 999

Congress added § 999 to the Code in the 1976 Tax Reform Act in response to the Arab League's boycott of Israel.¹⁷⁰ Section 999 generally requires any person or member of a corporate group that has "operations in, or related to" a country, or with its government, companies, or nationals, to report their operations to the IRS if that country requires participation in, or cooperation with, an unsanctioned boycott as a condition of doing business.¹⁷¹ The taxpayer must also disclose if it or a member of its corporate group has either agreed, or been asked, to participate in or cooperate with such a boycott.¹⁷² An actual agreement to participate in such a boycott triggers adverse tax consequences, described in the next subsection.¹⁷³ The willful failure to report under § 999 by an officer or employee of a corporation may result in modest fines and imprisonment for up to one year.¹⁷⁴

The only boycott to which § 999 currently applies is the boycott of Israel. Each quarter, the Treasury Department publishes in the Federal Register the countries that presently require cooperation with an unsanctioned boycott as

¹⁶⁹ *Id.* at 355.

¹⁷⁰ For an excellent overview of these rules, see Richard L. Kaplan, *Income Taxes and the Arab Boycott*, 32 TAX LAW. 313, 316 (1979).

¹⁷¹ I.R.C. § 999. Section 999 applies only to transactions in tangible goods and excludes primary boycotts. *Id.* § 999(b)(4).

¹⁷² *Id.* § 999(a)(2).

¹⁷³ *Id.* § 999(b)(1).

¹⁷⁴ *Id.* § 999(f).

a condition of doing business in the country.¹⁷⁵ As of April 8, 2021, these countries are Iraq, Kuwait, Lebanon, Libya, Qatar, Saudi Arabia, Syria, and Yemen.¹⁷⁶ The United States has an interest in obtaining information about boycotts of Israel because Israel is a close ally and because a requirement to obtain information might create a chilling effect on companies that are considering doing business in boycotting countries.

By requiring annual disclosures of boycott requests, § 999 provides a way for Treasury to monitor the ebb and flow of pro-boycott attitudes, enforcement, and compliance in the target jurisdictions. In places where boycott rules are vigorously enforced or anti-Israeli sentiments are at a high-water mark, there should be an increase in the number of boycott requests. Thus, § 999 provides another vantage point for assessing on-the-ground sentiments in target states, taking advantage of the potentially broad information collection network of U.S. multinationals. The information can serve as a helpful complement to qualitative information gathering efforts by intelligence professionals and formal communications from government officials.

FIGURE 1: Boycott Requests and Agreements under § 999

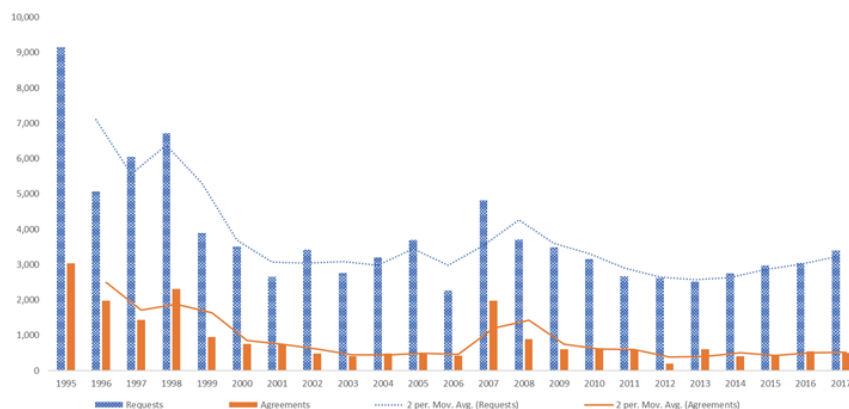


Figure 1 shows the number of requests to participate in foreign boycotts reported under § 999 between 1995 and 2017 and the number of agreements to participate in those boycotts. Both data series show a general downward trend since 1995 before increasing briefly in 2007 and then resuming the

¹⁷⁵ *Id.* § 999(a)(3)

¹⁷⁶ List of Countries Requiring Cooperation with an International Boycott, 86 Fed. Reg. 18,374 (Apr. 8, 2021).

downward trend.¹⁷⁷ The increase in requests and agreements in 2007 came from all listed countries, although for Yemen the increase first began in 2006 and in Libya the increase in requests and agreements persisted through 2010.

b. *FATCA*

The most important recent example of the use of tax law to compel information reporting is in §§ 1471–74 of the Code, which were added in 2010 by the Foreign Account Tax Compliance Act (FATCA).¹⁷⁸ The FATCA rules generally subject foreign financial institutions and other foreign entities to a thirty percent tax on certain U.S. source payments of investment income—including interest and dividends—if those entities do not disclose information to the IRS about their U.S. account holders and their accounts.¹⁷⁹

The FATCA regime was not implemented for foreign policy purposes but was a response to concerns about widespread tax evasion by U.S. persons hiding income from assets held in overseas accounts.¹⁸⁰ FATCA has been widely criticized as “unilateral and extraterritorial legislation,”¹⁸¹ with commentators arguing that it “strong arm[s] every financial institution in the world into doing the job of the IRS”¹⁸² and can require foreign banks to make disclosures that conflict with local bank secrecy laws.¹⁸³ And yet, as Professors

¹⁷⁷ Before 2007, the tabulations were based on the returns with a tax accounting period ending within the calendar year. Beginning in 2007, the tabulations include returns with accounting periods ending between July of the study year and June of the following year. We do not think that this change in accounting convention is likely to have caused the increase in reporting that we observe in 2007. For the sources of Figure 1 statistics, see *SOI Tax Stats – International Boycotts Table 1*, IRS, <https://www.irs.gov/statistics/soi-tax-stats-international-boycotts-table-1> [https://perma.cc/BTG3-A5HM]. For an early analysis of Treasury data on the anti-boycott rules, see Richard L. Kaplan, *A Critical Examination of the Treasury Department’s Report on the Arab Boycott*, 1983 U. ILL. L. REV. 23.

¹⁷⁸ Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, § 501, 124 Stat. 97 (2010) (codified as amended in scattered sections of 26 U.S.C.).

¹⁷⁹ I.R.C. § 1471.

¹⁸⁰ J. Richard (Dick) Harvey, Jr., *Offshore Accounts: Insider’s Summary of FATCA and Its Potential Future*, 57 VILL. L. REV. 471, 487 (2012) (explaining that the goal of FATCA “was to reduce the number of U.S. taxpayers using offshore accounts to hide income from the IRS”). FATCA had other consequences, too. See Lisa De Simone, Rebecca Lester & Kevin Markle, *Transparency and Tax Evasion: Evidence from the Foreign Account Tax Compliance Act (FATCA)*, 58 J. ACCT. RSCH. 105, 147 (2020) (finding evidence of increased expatriations of U.S. citizens and increased investment in assets not subject to FATCA reporting). The U.S. government has also participated in international tax projects such as the OECD’s base erosion and profit shifting project. See Ruth Mason, *The Transformation of International Tax*, 114 AM. J. INT’L L. 353, 354 (2020) (discussing the significance of base erosion and profit shifting project for international tax law).

¹⁸¹ Joshua D. Blank & Ruth Mason, *Exporting FATCA*, 142 TAX NOTES 1245, 1245 (2014).

¹⁸² Andrew F. Quinlan, *FATCA and US Fiscal Imperialism Threaten to Sink Global Economy*, DAILY CALLER (Mar. 19, 2013, 1:30 AM), <https://dailycaller.com/2013/03/19/fatca-and-us-fiscal-imperialism-threaten-to-sink-global-economy> [https://perma.cc/6AGW-P4PS].

¹⁸³ Joel Slawotsky, *US Financial Hegemony: The Digital Yuan and Risks of Dollar De-Weaponization*, 44 FORDHAM INT’L L.J. 39, 70–71 (2020). In response, the United States has entered

Mason and Blank have noted, FATCA provoked copycat legislation in foreign jurisdictions and laid the groundwork for multilateral automatic information exchanges that benefit tax compliance globally.¹⁸⁴ In the final analysis, it may be that what was initially viewed as egregious jurisdictional overreach by Congress will be viewed favorably by the international community. Professor Stephan has demonstrated how examples of apparent U.S. overreach—specifically anticartel law and the FCPA—ultimately resulted in international norms that other states adopted or with which they cooperated.¹⁸⁵

Nevertheless, the backlash to FATCA provides a cautionary tale about the use of tax penalties to coerce information disclosures by foreign institutions whose only nexus with the United States is the receipt of passive investment income. It may be difficult to draw a bright conceptual line between a foreign direct investment in the United States—such as the establishment of a branch or acquisition of a subsidiary—and a passive investment in U.S. securities. But the decision to operate an active business in the United States generally is preceded by greater research and due diligence into the legal and regulatory obligations of operating in the United States than simply making a passive investment. For this reason, we think that it is more reasonable to impose greater regulatory burdens—including compliance with U.S. foreign policy regulations—on foreigners operating an active business in the United States than on foreigners merely earning passive income.

2. Tax Sanctions

In this subsection we summarize the few ways that the income tax currently discourages U.S. persons from engaging in economic activity adverse to U.S. foreign policy goals.¹⁸⁶ We consider first the rules that apply to taxable U.S. persons and then discuss the treatment of tax-exempt entities.

into a number of intergovernmental agreements to resolve these conflicts. Robert Stack, *Myth vs. FATCA: The Truth About Treasury's Effort to Combat Offshore Tax Evasion*, U.S. DEP'T OF THE TREASURY (Sept. 20, 2013) <https://www.treasury.gov/connect/blog/Pages/Myth-vs-FATCA.aspx> [<https://perma.cc/L3DF-4JFH>] (describing intergovernmental agreements allowing for foreign bank information to be transmitted to the IRS only to the extent consented to or legally permitted under local laws).

¹⁸⁴ Blank & Mason, *supra* note 181, at 1245, 1247.

¹⁸⁵ Paul B. Stephan, *Antibribery Law* (U. of Va. Sch. of L. Pub. L. & Legal Theory Rsch. Paper Series, Paper No. 2021-30), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3870866 [<https://perma.cc/HZ5F-74PW>]. See also VERDIER, *supra* note 66, at 3, 7-8, 32 (discussing a similar phenomenon in the banking regulation context).

¹⁸⁶ In addition to those we focus on here, the § 162 deduction of business expenses is disallowed for any payment made to a government or its officials if the payment would be illegal under federal law—including sanctions law. See I.R.C. § 162(c)(2) (prohibiting deductions for any “illegal payment under any law of the United States”). The earned income exclusion generally available to U.S. taxpayers whose tax homes are outside the United States is unavailable with respect to foreign

a. *Taxable Persons*

There are two adverse tax consequences for a taxpayer who cooperates with a foreign country's unsanctioned boycott (a "§ 999 reportable country")¹⁸⁷ or who earns income from a state that the United States does not recognize, with which it does not conduct diplomatic relations, or that supports terrorism (collectively, "§ 901(j) countries").¹⁸⁸

First, foreign tax credits that would otherwise be available for income taxes paid to those countries are denied.¹⁸⁹ The net effect of denying foreign tax credits is to increase the effective tax rate on income from those sources, generating wealth effects and price effects.¹⁹⁰ To the extent that the price effect drives U.S. taxpayers from doing business in these states, it will deprive the foreign state of access to U.S. capital investment and deprive U.S. businesses of profitable business opportunities. And there is a second way that denying the foreign tax credit may advance U.S. foreign policy goals. To the extent that foreign taxes are creditable against U.S. taxes, there is a real sense in which the U.S. Treasury subsidizes the foreign regime. For each dollar of a creditable foreign income tax, foreign tax revenues increase, and U.S. tax revenues decrease. Subject to anti-abuse rules policing the foreign tax credit, the foreign government can increase its tax rate up to the level of the U.S. rate and redirect revenue from the U.S. Treasury to its own coffers.¹⁹¹ By eliminating the tax credit, the U.S. government prevents U.S. tax revenues from flowing to the foreign government.

Second, if a controlled foreign corporation (CFC) earns income in one of these countries, then that income will be deemed to have been distributed to

countries for which travel is subject to regulations promulgated under IEEPA or the Trading With the Enemy Act. § 911(d)(8)(B)(i).

¹⁸⁷ See *supra* subsection II.C.1.a.

¹⁸⁸ I.R.C. § 901(j).

¹⁸⁹ *Id.* This may not matter for companies in an excess FTC position. See Paul R. McDaniel, *The U.S. Tax Treatment of Foreign Source Income Earned in Developing Countries: A Policy Analysis*, 35 GEO. WASH. INT'L L. REV. 265 (2003). Some scholars argue that the tax credit should only be used to relieve double taxation. See, e.g., Stephen E. Shay, J. Clifton Fleming, Jr. & Robert J. Peroni, *The David R. Tillinghast Lecture, "What's Source Got to Do With It?": Source Rules and U.S. International Taxation*, 56 TAX L. REV. 81, 149 (2002) ("[T]he foreign tax credit and its associated rules for determining the source of income and deductions for purposes of limiting that credit should be aimed at providing double taxation relief . . .").

¹⁹⁰ Foreign taxes that are not creditable because of the antiboycott rules are deductible. See I.R.C. § 908(b); *id.* § 275(a)(4). But for the countries listed in § 901(j), non-creditable taxes are not deductible. Although no longer the case, for a time, foreign taxes paid to South Africa were not creditable, but they were deductible. Donald T. Williamson & Leo C. Moersen, *Taxation as a Foreign Policy Instrument: The Tax Collector as Diplomat?*, 15 INT'L TAX J. 311, 313 (1989). For § 901(j) countries, there are also separate § 904 and § 960 limitations.

¹⁹¹ If a foreign tax is contingent on the availability of a tax credit in the United States, no tax credit is available. Treas. Reg. § 1.901-2(c) (2013); Treas. Reg. § 1.903-1(b) (1983).

its shareholders and thus currently included in income by the CFC's significant U.S. shareholders.¹⁹² Historically, the active business earnings of CFCs—roughly, foreign corporations the majority of the stock of which is held by U.S. persons with stakes of at least ten percent in the company¹⁹³—were not generally subject to U.S. tax until the company distributed those earnings to its U.S. shareholders.¹⁹⁴ This meant that the U.S. tax on these earnings was deferred, often indefinitely. Not all earnings of CFCs, however, were entitled to deferral. So-called “subpart F income,”¹⁹⁵ which includes passive income such as interest and dividends, certain related party income, and income attributable to a § 999 reportable country or a § 901(j) country,¹⁹⁶ is generally taxed to the CFC's U.S. shareholders before it is distributed.¹⁹⁷

Figure 2: Tax Sanctions from § 999 Reportable Countries (\$ thousands)



¹⁹² We do not discuss them because of their minor economic significance, but there are consequences of participating in a boycott for taxpayers with a “domestic international sales corporation.” See I.R.C. § 995(b)(1)(F)(ii).

¹⁹³ *Id.* §§ 951(b), 957(a).

¹⁹⁴ *Tax Cuts and Jobs Act: A Comparison for Large Businesses and International Taxpayers*, IRS, <https://www.irs.gov/newsroom/tax-cuts-and-jobs-act-a-comparison-for-large-businesses-and-international-taxpayers> [<https://perma.cc/L3YT-KJPG>] (Aug. 27, 2021).

¹⁹⁵ I.R.C. § 952(a).

¹⁹⁶ *Id.* §§ 952(a)(3)(B), 952(a)(5).

¹⁹⁷ LB&I INT’L PRAC. SERV. CONCEPT UNIT, IRS, SUBPART F OVERVIEW (2014), https://www.irs.gov/pub/int_practice_units/DPLCUV_2_01.PDF [<https://perma.cc/25SL-LG98>].

Figure 2 shows the amount of foreign tax credits disallowed and the subpart F income included each year because of operations in § 999 reportable countries and § 901(j) countries. The two data series mostly track each other over time, which is to be expected as subpart F income inclusions generally bring with them the possibility of creditable foreign taxes paid on that income. However, there is an interesting divergence beginning in 2007, after which there is a rapid increase in subpart F income inclusions but a decline in disallowed foreign tax credits.

Some observers have sharply criticized § 999.¹⁹⁸ They argue that it does not advance the core revenue-raising purpose of the income tax.¹⁹⁹ They argue that it does not deter companies who do not benefit from the foreign tax credit or that have no net taxable income.²⁰⁰ And they argue that the tax departments of multinational corporations may not understand § 999 or be capable of ensuring compliance.²⁰¹ Nevertheless, there is evidence that § 999 has reduced the willingness of U.S. companies to participate in the Arab League boycott and so it should not be dismissed out of hand.²⁰²

For a country to be removed from the list of § 901(j) countries, the Secretary of State must make a certification to the Secretary of the Treasury.²⁰³ Thus, whether the tax sanctions associated with § 901(j) apply depends on determinations made by the department in charge of foreign relations, rather than the department in charge of tax and financial policy. The tax credit limits of § 901(j) can also be waived if the President “determines that a waiver . . . is in the national interest of the United States and will expand trade and investment opportunities for United States companies in such country,”²⁰⁴ leaving some discretion in the hands of the President while limiting the justifications for the exercise of that discretion to ones based in trade and investment policy. We think that this strikes a sensible balance, requiring reason giving from the President while providing them with the flexibility to waive the § 901(j) tax sanctions.

¹⁹⁸ See, e.g., James P. Holden & William F. Brown, *A Paradox: Why Does the Federal Tax Law Penalize United States Taxpayers Who Observe the Boycott of South Africa by United States Allies?*, 42 TAX LAW. 211, 232 (1989) (“[S]ection 999 is easily the least revenue-related measure ever made part of the Code.”).

¹⁹⁹ *Id.*

²⁰⁰ *Id.* at 231.

²⁰¹ *Id.* at 232 (“The tax department, to the extent that it understands section 999 at all, usually does not have supervisory authority over operating personnel or even the lines of communication to assert the necessity of compliance.”).

²⁰² James R. Hines, Jr., *Taxed Avoidance: American Participation in Unsanctioned International Boycotts* (Nat’l Bureau of Econ. Rsch., Working Paper No. 6116, 1997), https://www.nber.org/system/files/working_papers/w6116/w6116.pdf [<https://perma.cc/Z3FS-R9QR>].

²⁰³ I.R.C. § 901(j)(2)(B)(ii).

²⁰⁴ *Id.* § 901(j)(5)(A)(i).

b. *Tax-Exempt Entities*

Section 501 of the Code exempts certain organizations from U.S. income taxes.²⁰⁵ Best known among these organizations are those that are “organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes”—called 501(c)(3) organizations for the section of the Code in which they appear.²⁰⁶ Under § 501(p), an otherwise eligible entity’s tax exempt status (or application for such status) is suspended if it has certain connections to terrorism.²⁰⁷

Specifically, an organization’s tax exempt status is suspended if it is identified as a foreign terrorist organization (i) under the Immigration and Nationality Act, (ii) pursuant to a terrorism-related EO issued under IEEPA or the United Nations Participation Act of 1945 for the purpose of sanctioning the organization, or (iii) pursuant to an EO if the organization is identified as supporting or engaging in terrorism.²⁰⁸ By using EOs or terrorist designation under the Immigration and Nationality Act, § 501(p) delegates the decision about which entities lose tax-exempt status to the foreign policy judgment of the Executive.

Affording tax-exempt status to certain organizations can work at cross purposes with foreign policy in two ways. First, the exemption itself leaves these organizations with more resources to pursue their mission, which may conflict with U.S. security interests—i.e., the wealth effect. Second, the deductibility of contributions to such organizations increases the after-tax wealth of donors who may be more likely to engage in other activities adverse to U.S. national security interests, and it may increase the amount of contributions to such organizations by reducing the after-tax price of the contributions—i.e., the price effect. To the extent it increases the amount of such contributions, the economic effect is equivalent to the Treasury making a direct cash grant to such organizations.²⁰⁹

²⁰⁵ *Id.* § 501(a).

²⁰⁶ *Id.* § 501(c)(3).

²⁰⁷ Charitable contributions to such organizations are also nondeductible. *Id.* § 501(p)(4). Section 501(p) might be thought of as a partial codification of the “public policy doctrine,” which denies tax exempt status to otherwise eligible organizations that engage in activities contrary to a fundamental public policy. *See* *Bob Jones Univ. v. United States*, 461 U.S. 574 (1983). Professor Mirkay argues that the public policy doctrine should be used in the foreign policy context. *See* Nicholas A. Mirkay, *Globalism, Public Policy, and Tax-Exempt Status: Are U.S. Charities Adrift at Sea?*, 91 N.C. L. REV. 851, 859 (2013) (“[T]he public policy doctrine needs congressional attention . . . [but] the automatic inclusion of U.S. foreign policy and international law as components of ‘established public policy’ would be impractical and onerous . . .”).

²⁰⁸ I.R.C. § 501(p)(2).

²⁰⁹ Along these lines, David Pozen has argued that tax exemptions should be viewed as a form of foreign aid, to the extent that they apply to nonprofits that support persons overseas. David E. Pozen, *Hidden Foreign Aid*, 8 FLA. TAX REV. 641 (2007).

c. *Unintended Effects of TCJA*

The Tax Cuts and Jobs Act (TCJA) of 2017 made dramatic changes to how the United States taxes international income. Before TCJA, U.S. shareholders of CFCs enjoyed deferral of U.S. taxes on active earnings of those CFCs.²¹⁰ It was against this backdrop that denying deferral for § 999 reportable countries and § 901(j) countries operated as a tax sanction.

TCJA reduced both the availability and benefit of tax deferral for income earned by CFCs. First, the TCJA lowered the top U.S. corporate tax rate from thirty-five percent to twenty-one percent.²¹¹ The benefits of deferral—and therefore the penalty imposed by denying deferral—diminish as the U.S. corporate rate falls.²¹² By cutting the corporate tax rate, TCJA reduced the efficacy of tax sanctions. Second, it is no longer only subpart F income of CFCs that is subject to current U.S. taxation, but roughly all earnings of CFCs above a deemed rate of return on the tangible assets of the CFCs.²¹³ This so-called “GILTI” income is taxed at favorable rates,²¹⁴ so whether this new regime results in higher or lower effective U.S. tax rates on CFC earnings that would have otherwise been deferred depends on when those earnings would have been repatriated. However, given the lengthy deferrals that motivated the GILTI rules to begin with and the opportunity for multinationals to take advantage of periodic repatriation holidays that reduce the effective tax rate on foreign earnings, it is likely that the GILTI rules will increase the effective U.S. tax rate on foreign earnings. By eliminating deferral, the new GILTI rules also reduce the punitive effects of tax sanctions for income from § 999 reportable and § 901(j) countries, because the income will be taxed currently in any event.

TCJA also doubled the standard deduction and limited certain other itemized deductions. As a result, the share of taxpayers who itemize their deductions fell from 46 million in 2017 to 19 million in 2018.²¹⁵ Because only individuals who itemize their deductions benefit from the charitable contribution deduction, these reforms mean that the rules in § 501(p)

²¹⁰ See *supra* text accompanying note 194.

²¹¹ See *How Did the Tax Cuts and Jobs Act Change Business Taxes?*, TAX POL’Y CTR., <https://www.taxpolicycenter.org/briefing-book/how-did-tax-cuts-and-jobs-act-change-business-taxes> [<https://perma.cc/6GVC-MYU2>].

²¹² The value of deferring for y years the inclusion of $\$X$ of income taxed at rate t is attributable to the time value of money. If the relevant interest rate is i , then the value of deferral is $tX(1 - [1 \div (1 + i)^y])$. Clearly, if the tax rate t falls then this value also falls.

²¹³ We refer to the taxation of Global Intangible Low Taxed Income. See I.R.C. § 951A(b).

²¹⁴ *Id.* § 250(a)(1) (generally providing a deduction for fifty percent of GILTI income).

²¹⁵ Howard Gleckman, *A Last Look At the 2019 Filing Season*, TAX POL’Y CTR. (Apr. 25, 2019), <https://www.taxpolicycenter.org/taxvox/last-look-2019-filing-season> [<https://perma.cc/2LM8-KTZZ>].

denying a deduction for charitable contributions to listed organizations also become less punitive.

Collectively, TCJA undermined the already modest tax penalties that work in service of U.S. foreign policy. We do not think that this was by design. Although the economic consequences of the TCJA reforms are more important than their unintended effects on foreign policy, it does not appear that Congress even considered these foreign policy effects. Perhaps this illustrates a peril of implementing foreign policy through tax law: the interconnectedness of tax provisions makes it easy for a Congress concerned with revenue, economic growth, or inequality to make changes that inadvertently undermine tax as a tool of foreign policy. This does not have to be the case, though. The solution is to decouple foreign policy–related provisions from other tax rules, or for foreign policy to play a *greater* role in tax law, so that those undertaking tax reform are less likely to overlook those provisions. The next Part expands on this idea, arguing that there is more room for foreign policy in tax law than conventional wisdom suggests and that many of the hurdles to pursuing this approach can be overcome.

III. THE CASE FOR TAX SANCTIONS

We begin this part by describing three ways that tax sanctions can serve U.S. foreign policy goals. We then make our case for tax sanctions as a tool of foreign policy, both in general and in the present moment.

A. *Outbound and Inbound Sanctions*

For a given foreign target, our definition of tax sanctions covers two categories of rules: tax sanctions imposed on U.S. persons who transact with the foreign target (“outbound tax sanctions”), and tax sanctions imposed on foreign persons—including the foreign target—for income connected to the United States (“inbound tax sanctions”).

In the case of an outbound tax sanction, the punitive tax rule applies to U.S. persons, even though the purpose of the sanction is to change the behavior of a foreign target. For example, the loss of foreign tax credits and deferral of income of U.S. shareholders earned by CFCs in § 901(j) countries is an outbound tax sanction. The burden placed by the tax sanction on the U.S. shareholder is an indirect way of burdening the target country. The U.S. shareholder is merely a surrogate target of the tax sanction; the § 901(j) country is the real target. Fundamentally, outbound tax sanctions rely on the sensitivity of U.S. taxpayers to changes in the cost of earning income in the target state.

Outbound tax sanctions are especially helpful as part of a longer-term strategy exploiting the price effect when the goal is to redirect U.S. investment from the target state or foreign industry. The loss of U.S. portfolio investment will drive up the cost of raising capital for businesses in the target state, and the loss of U.S. direct investment reduces income and employment in the target state and—perhaps more importantly—the knowledge and technology transfers that generally accompany foreign direct investment.²¹⁶ Outbound tax sanctions are most effective when the price effect is large. That is, they work best when the burden on the surrogate target is light because the economic advantages of doing business in the target state are modest compared to the next-best alternative, and the burden to the target state of losing the business of the surrogate is large.

A natural way to increase the scope of outbound tax sanctions would be to add to the countries listed in § 901(j). Countries could be added by Congress itself or by delegating the choice of target countries to the Executive. Outbound tax sanctions could also be extended by considering mechanisms other than the foreign tax credit and the subpart F rules. For example, Congress could subject the income of CFCs in target jurisdictions to a minimum tax.²¹⁷ As discussed above, the changes made under TCJA weakened the § 901(j) regime, so changes like these may be necessary even if the list of 901(j) countries remains unchanged.

Another possibility is to discourage lending by U.S. taxpayers to target states. Professors Jayachandran and Kremer have argued that prohibiting new lending to dictators, or limiting the ability of creditors to look to the assets of successor regimes to satisfy their debts, would reduce the amount of lending to those dictatorships.²¹⁸ Such restrictions would have the benefit of targeting the dictator rather than the foreign population more generally, and prevent subsequent regimes from being burdened by debt incurred by the prior regime. Tax sanctions provide an alternative here, too. The interest income from loans extended to target states or non-state actors could be taxed at a higher rate than other interest, or foreign taxes on that income could be non-creditable, which would reduce the supply to targets of credit by banks and other lenders subject to U.S. tax jurisdiction. And the long reach of that

²¹⁶ See, e.g., Carol Newman, John Rand, Theodore Talbot & Finn Tarp, *Technology Transfers, Foreign Investment and Productivity Spillovers*, 76 EUR. ECON. REV. 168 (2015) (finding substantial technology transfers accompanying foreign direct investment in Vietnam).

²¹⁷ At the time of writing, the United States has endorsed a global minimum tax of fifteen percent on the income of certain multinational corporations. See Ruth Mason, *The Fine Print on the Global Tax Deal*, FOREIGN AFFS. (Nov. 8, 2021), <https://www.foreignaffairs.com/articles/united-states/2021-11-08/fine-print-global-tax-deal> [<https://perma.cc/FZM8-WFHQ>]. A current minimum tax of fifteen percent on corporate earnings would reduce the ability of the United States to impose tax sanctions for the same reasons as the GILTI rules discussed above.

²¹⁸ Seema Jayachandran & Michael Kremer, *Odious Debt*, 96 AM. ECON. REV. 82 (2006).

jurisdiction could allow outbound tax sanctions to operate on a large number of surrogate targets, which might reduce the need to enforce secondary sanctions—sanctions on foreign companies that do business with sanctioned companies—which have proven controversial with U.S. allies. Outbound tax sanctions might offer another advantage over traditional financial sanctions: because tax sanctions are not outright prohibitions but merely costs of doing business, they may generate less backlash.

Inbound tax sanctions apply to foreign persons who have a U.S. business or who receive payments of U.S. investment income. Inbound sanctions exploit the wealth effect to impose economic hardship on the target and so they work best when the price effect is small—that is, when it is very costly for the foreign target to substitute alternatives to the income subject to the tax. Fundamentally, inbound tax sanctions rely on the sensitivity of foreign taxpayers to changes in the cost of earning income in the United States.

An example of an inbound tax sanction would be an additional withholding tax on payments of interest, dividends, and royalties made to foreigners by banks and other “withholding agents.”²¹⁹ Inbound tax sanctions are likely to be more salient to foreigners than outbound tax sanctions. The foreign targets of inbound tax sanctions pay the tax themselves: consider the foreign investor subject to a higher rate of withholding tax. By contrast, the real foreign target of outbound sanctions only suffers the economic effects of decisions made by surrogates who are influenced by the taxes: consider the U.S. corporation that does not invest in a target country because of the tax sanction.²²⁰ The heightened salience of inbound tax sanctions may be a virtue—if it makes the foreign target more likely to change its behavior—or a vice—if it increases the likelihood of retaliation by the foreign target. And if the inbound tax sanctions are imposed on foreign surrogate targets, such as foreign corporations doing business in a target state, then the backlash could be widespread among allies as well as adversaries. The response to FATCA provides a cautionary tale about what the United States can demand from foreign persons under the threat of greater withholding taxes.²²¹ For this reason, inbound tax sanctions may be more palatable to U.S. allies when they are premised on the foreign actor having an active business in the United States through a branch or subsidiary rather than merely earning passive income from U.S. sources.

²¹⁹ I.R.C. § 1441.

²²⁰ How a tax is paid affects the perception of its burden. For a discussion of evidence of this in the property tax context, see Andrew T. Hayashi, *The Legal Salience of Taxation*, 81 U. CHI. L. REV. 1443 (2014).

²²¹ See *supra* Section II.C.

Although the purpose of sanctions is generally to compel the target to change its behavior, the reliance on surrogates for imposing tax sanctions allows tax sanctions to serve another function: encouraging taxpayers to collect and report valuable information to policymakers or national security experts. For example, the anti-boycott reporting done under § 999 provides the United States with a measure of the vitality of the Arab League boycott in any given year. As anti-Israeli sentiment waxes and wanes over time, so should the vigor with which businesses and individuals in § 999 countries demand compliance with national boycott laws. Additional reporting requirements, such as those that could shed light on the structure of terrorist financing, could also be enforced with tax sanctions.

Encouraging U.S. companies to operate in target states and report information with their tax return may be more helpful than encouraging the companies to divest from the country through an outbound tax sanction. For example, global technology companies could be required to report when foreign government clients force them to share their source codes, build in backdoors to spy on their citizens, or censor internet searches. This is information the U.S. government might be able to get through other avenues, but only piecemeal and after significant effort. Enlisting U.S. multinationals to report through the tax code could significantly add to the information available to foreign policymakers.

B. *The General Case for Tax Sanctions*

We make three independent arguments for using tax sanctions to achieve foreign policy goals. First, adding tax to the foreign policy toolkit will allow U.S. economic influence to reach more foreign targets and will involve more, and a greater variety of, actors in implementing rules that advance U.S. foreign policy goals. Second, using tax sanctions is beneficial even if they do not extend the reach of economic sanctions, because they operate on different points of leverage than existing sanctions. Because the costs of using any one tool can increase rapidly with its use, the costs of economic coercion are minimized when more tools are used.²²² Adding tax to the toolkit of economic statecraft allows policymakers to use other tools less aggressively. Third, tax

²²² One concern with increasing the number of tools is the possibility of inadequate coordination among the various departments and agencies—such as the Commerce, Treasury, and State Departments. Poor coordination could result in an aggregate of sanctions that operates effectively like an embargo or could make it difficult to communicate to targets how to obtain sanctions relief. And if Congress plays a role in imposing tax sanctions, then targets may wonder whether the sanctions are motivated by foreign policy or domestic politics, in which case they may be less inclined to think that changing their behavior will obtain relief. The National Security Council's role in coordinating these approaches and clearly communicating the conditions necessary for relief becomes more important as tools proliferate.

law may offer greater flexibility than other kinds of sanctions and may be a less salient instrument of coercion to U.S. adversaries.²²³

1. More Targets, More Enforcers

The federal income tax reaches all U.S. citizens, regardless of their place of birth or residence,²²⁴ and all individuals who are U.S. residents by virtue of having lawful permanent resident status or by being physically present in the United States for a sufficient number of days in a year.²²⁵ The income tax applies to all corporations organized in the United States, regardless of where their business operations or customers are located.²²⁶ And the income tax reaches foreign individuals and corporations too, if they either have a trade or business in the United States or have U.S. source income.²²⁷ The reach of the income tax is broad indeed.

Foreigners who have a business in the United States not only may have U.S. tax liability for the income from that business, but they also must file a U.S. tax return.²²⁸ Thus, coming within U.S. tax jurisdiction not only provides the United States with an opportunity to impose tax, but it also provides the basis for compelling information disclosures that are relevant to that U.S. liability. A foreign person who receives passive U.S. investment income does not generally need to file a tax return,²²⁹ but even in that case they still generally must disclose certain information to the payors of that income. For example, some foreign individuals who are the beneficial owners of U.S. corporate bonds must provide identifying information to be exempt from a thirty percent withholding tax that would otherwise apply.²³⁰ And, as

²²³ Some scholars argue that the use of tax law for foreign policy is “at best an awkward and indirect device,” in part because it is less salient to taxpayers. Williamson & Moersen, *supra* note 190, at 317. We think that this lack of salience may be an advantage.

²²⁴ See I.R.C. § 7701(a)(30)(A) (stating that for tax purposes, the term “United States person” includes both citizens and residents). The United States is the only country to tax its citizens wherever they reside. This is controversial. Compare Ruth Mason, *Citizenship Taxation*, 89 S. CAL. L. REV. 169, 238 (2016) (arguing that citizenship-based taxation is “inadministrable, inefficient, and often unfair”), with Michael S. Kirsch, *Taxing Citizens in a Global Economy*, 82 N.Y.U. L. REV. 443 (2007) (arguing that there is a strong justification for taxing based on U.S. citizenship). In practice, of course, only citizens with taxable income are subject to tax.

²²⁵ I.R.C. § 7701(b)(1)(A) (resident aliens include lawful permanent residents and those meeting the “substantial presence test”).

²²⁶ *Id.* § 7701(a)(4).

²²⁷ *Id.* §§ 872(a), 881, 882.

²²⁸ Foreign corporations with a U.S. trade or business must file form 1120-F. 26 C.F.R. § 1.6012-2(g)(1)(i) (2021).

²²⁹ I.R.C. § 6012(a)(8) (nonresident aliens subject only to withholding taxes generally not required to file a return).

²³⁰ *Id.* § 871(h)(2) (stating that exemption from withholding for portfolio interest requires a statement that “the beneficial owner of the obligation is not a United States person”).

discussed above, payors of U.S. source income to foreign persons have an obligation to withhold any taxes owed on the amounts paid.²³¹ This creates a strong incentive for the U.S. payor to collect the information required by law to exempt the payment from withholding.

Adding tax to the economic coercion toolkit increases the number of foreign targets that can be subject to U.S. influence and fills gaps in the coverage of existing tools. Export controls and tariffs operate only through cross-border trade in goods. Financial sanctions generally only affect those with U.S. situs assets. By contrast, U.S. taxation reaches anyone who operates a trade or business in the United States, regardless of whether that business owns real or personal property located in the United States. For example, a foreign company may have a taxable business in the United States if it is represented by an agent in the United States whose activities are imputed to the foreign company. U.S. tax jurisdiction also reaches anyone who earns passive investment income such as interest, dividends, rents, or royalties from U.S. sources.

Moreover, whereas the enforcement of financial sanctions primarily falls to banks and other financial intermediaries, federal income tax law reaches all economic activity that generates revenue with a U.S. nexus. Tax law therefore fills gaps in the coverage of economic statecraft by reaching industries and sites of nexus that are not already included. Because information reporting and tax withholding obligations can apply to anyone who makes a reportable payment, the number of parties involved in enforcing a tax rule aimed at foreign targets is also much greater. This spreads the cost of enforcing tax sanctions across many businesses and industries and shifts some of the burden to foreign entities. By contrast, the burden of enforcing travel restrictions or asset freezes generally falls on airlines and financial institutions, and defense and technology companies shoulder much of the burden for enforcing export controls.

Inbound sanctions leverage the attractiveness of U.S. markets to foreign actors to extract costly concessions from those actors in service of U.S. foreign policy. If the costs of acceding to U.S. demands exceed the benefits of U.S. market access, then targets and surrogates will not incur them. The imposition of a tax on U.S. source income is one such cost, but so are any information disclosures that foreign investors must make to the IRS. It is the sum of the two costs that matters to foreigners in deciding whether to become subject to U.S. tax jurisdiction. Seeing this makes clear both the promise and limits of tax law for influencing foreign actors. Consider a foreign manufacturer weighing whether to establish a branch in the United States. As access to U.S. markets becomes more profitable for the

²³¹ *Id.* §§ 1441, 1442.

manufacturer, more concessions can be extracted for the privilege of access.²³² Because increasing the tax rate on U.S. source income reduces the value of access to U.S. markets, it reduces the other demands that can be made on foreign actors. Conversely, reducing the tax rate creates more room to make other costly demands on foreigners, such as information disclosures or compliance with some costly regulation. We can compare the potential of tax in this context with the existing rules under export controls. Export controls merely prohibit or permit certain transfers to foreigners. A tax sanction could be used to extract information disclosures or other concessions from potential foreign investors that may be worth the added risk of undesirable technology transfers.

How can tax sanctions coerce foreign investors to change their behavior or comply with some regulatory obligation? The actor will comply only if two things are true: (1) the cost of compliance is less than the additional tax she will pay if she continues to earn income in the United States and does not comply with the regulatory obligation, and (2) the after-tax benefits of complying are less than the after-tax benefits of divesting from the United States. There are therefore two constraints on what the United States can demand by using its tax leverage. By setting the tax sanction as high as possible, the government can ensure that the taxpayer will always prefer complying to paying the tax sanction. Reducing the normal (i.e., non-sanction) level of tax increases the benefits from investing in the United States and increases the demands that can be made on the target.

2. Same Targets, Different Interests

The continued emergence of China as an economic power, the rise of alternatives to the dollar as a reserve currency,²³³ and the development of novel financial technologies such as decentralized finance, which may eventually displace the U.S. financial system as a clearing mechanism for international transactions, all raise the risk that overuse of existing sanctions will lead to foreign actors decoupling their financial affairs from U.S. banks and the U.S. dollar as a reserve.

As a result, even if everyone subject to U.S. tax jurisdiction is already required to comply with existing sanctions regimes, there would be

²³² A related issue is how easily sanctions can be evaded, something affected by whether sanctions are imposed unilaterally or multilaterally. Most early work found that unilateral sanctions were more effective, but recent evidence finds the opposite. See Navin A. Bapat & T. Clifton Morgan, *Multilateral Versus Unilateral Sanctions Reconsidered: A Test Using New Data*, 53 INT'L STUD. Q. 1075 (2009).

²³³ Gabriele Galati & Philip Wooldridge, *The Euro As a Reserve Currency: A Challenge to the Pre-eminence of the US Dollar?*, 14 INT'L J. FIN. & ECON. 1 (2009) ("The US dollar has maintained its place as the dominant reserve currency . . .").

advantages to adding tax law to the economic statecraft toolkit. This is because even if tax operates on the same actors as other tools, it operates on different interests of those actors. Targeted financial sanctions affect the foreign target's ability to use the U.S. financial system; export controls affect the ability of the target to import sensitive goods; and tariffs affect the ability of the target to sell goods into the U.S. market. By contrast, tax law affects all economic activity that generates U.S.-source revenues. Increasing the number of interests on which U.S. economic coercion operates increases the number of points of leverage. Increasing the number of economic points of leverage can reduce the strain on other levers of influence and compel costlier compliance by the target.

For example, suppose that the foreign target uses both the U.S. banking system and earns income subject to U.S. tax. Specifically, consider a foreign manufacturing corporation with a U.S. branch that earns commissions from sales made abroad in foreign currencies. If we add tax to the toolkit, then noncompliance will cause the target to both lose access to the U.S. banking system and subject the branch's income to a tax sanction.²³⁴ The target will now comply if the cost of compliance is less than the benefit of accessing the U.S. financial system plus the cost of the tax sanction, and the benefit of the U.S. financial system plus the pre-tax benefit of continuing to earn income in the United States.

Because income subject to U.S. tax is not limited to income denominated in U.S. dollars, processed through U.S. financial institutions, or earned from a U.S. source, adding tax sanctions adds another cost to the loss of banking access for noncompliance.²³⁵ It will generally be preferable to set this sanction very high, so that the limit on what can be demanded of the foreign target is limited by the total after-tax benefits of the U.S. banking system and earning income in the United States. For the sake of this example, however, assume that the tax sanction is set low enough that the target is just indifferent between paying the tax sanction and losing access to U.S. banking. In that case, introducing tax sanctions creates two options for U.S. policymakers. The first possibility is to allow the United States to extract more costly compliance from the target with its foreign policy goals than it would be able to if only financial sanctions were available.

The second possibility is to divide compliance into two parts—say, two regulations—so that compliance with the first regulation is necessary to

²³⁴ If a foreign target were denied access to the U.S. banking system and subject to a tax sanction—or regular U.S. tax—it would need an exemption or license from OFAC allowing tax payments to be processed through U.S. banks and collected by the Treasury.

²³⁵ All income, including foreign-source income that is effectively connected to a U.S. trade or business, is subject to U.S. income tax. *See* I.R.C. § 864(c)(4).

access the financial system and compliance with the second regulation is necessary to avoid the tax sanction. Dividing things up in this way will not affect the total compliance that can be demanded from targets, but it reduces the compliance costs that the target must incur to preserve access to the U.S. financial system and so the target will be more willing to incur those costs. For example, consider a foreign corporation with a U.S. subsidiary where the corporate group has profitable operations in target states *X* and *Y*. The first possibility contemplates both denying access to the U.S. financial system and imposing a tax sanction on the U.S. subsidiary unless the corporate group divests from those two target states. The second possibility might be to condition access to the U.S. financial system on divesting from country *X* and to impose a tax sanction on the subsidiary unless the group divests from country *Y*.

The greater the after-tax benefits of earning income in the United States, the higher the tax sanction can be set. This greater flexibility allows the United States to either increase the total regulatory demands that can be made on foreign targets or simply make the same costly demands but in a way that is less reliant on other sanctions.

The risks of overusing economic tools are that they will either impose intolerable costs on domestic actors or impose intolerable costs on *foreign* actors so that they disentangle themselves from the U.S. economic or financial system rather than bear those costs.²³⁶ If they do, the tools will lose their effectiveness altogether. A cautionary example of this is the case of the 1980 grain embargo that the United States imposed on the Soviet Union. Although the embargo increased the price of grain in the U.S.S.R., it failed to deter the U.S.S.R. from its engagement in Afghanistan, cost the United States \$2.3 billion, and caused U.S. farmers to permanently lose their market share in the U.S.S.R., which they never recovered because of Russian concerns about becoming vulnerable again to such an embargo.²³⁷ The goal of economic coercion is to make the targets do what the coercive state wants. However, the emergence of cheap alternatives—to U.S. grain, or financial services, for example—threatens the viability of that coercion.

The activities that create a U.S. tax nexus remain attractive to the rest of the world and therefore serve today as potentially powerful sources of leverage. First, the United States is an enormous destination for foreign goods and services. Second, U.S. persons are the owners of valuable technology that is in demand by foreign actors. Third, the productivity of

²³⁶ See Joshua P. Zoffer, *The Dollar and the United States' Exorbitant Power to Sanction*, 113 AJIL UNBOUND 152, 156 (2019) (suggesting that a recent surge of dollar-based sanctions resulted in opposition and risk of retaliation even among America's European allies).

²³⁷ Davis & Engerman, *supra* note 19, at 194.

American labor makes it an attractive destination for foreign capital. Fourth, the U.S. legal and regulatory environment makes it a favored place to incorporate or finance a business.²³⁸ Over a longer horizon, these are more durable and less substitutable than the U.S. financial system or dollar, and so these economic, legal, and regulatory assets provide a strong foundation from which to leverage the conduct of foreign actors.

3. Flexibility

Another advantage to using tax law is its built-in flexibility to modulate incentives. Tax sanctions can be adjusted by degrees, encouraging or discouraging specific activities without prohibiting them entirely.²³⁹ Why is modulation helpful? If the government's goal is to maximize compliance then it should set the tax sanction higher than the benefit from investing in the United States relative to a foreign country. Doing so allows the government to extract all of the excess profits from investing in the United States in the form of costly compliance with U.S. foreign policy regulation.

But for the target, tax sanctions and compliance costs are substitutes. Reducing the tax sanction will induce certain investors—the ones who get the greatest benefit from investing in the United States, or for whom compliance is the costliest—to pay the tax sanction rather than comply. The revenue from the sanction in this case serves as a second-best outcome to compliance with a foreign policy regulation. But sometimes the second best outcome is preferable to setting the tax sanction high enough to effectively ban investing in the United States, because a tax sanction that functions as a ban may be more likely to become politically salient and lead to reciprocal sanctions from target states.²⁴⁰ For these reasons, the government may prefer

²³⁸ For example, Delaware corporate law appears to increase firm value. Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FINANCIAL ECON. 525, 555 (2001). Increased focus on corporate governance by securities exchanges has reduced the need to incorporate in the U.S. to get regulatory benefits. Eric L. Talley, *Corporate Inversions and the Unbundling of Regulatory Competition*, 101 VA. L. REV. 1649 (2015).

²³⁹ It is true that the Treasury Department can modulate sanctions by granting licenses for transactions that would otherwise be prohibited, but these licenses do not always give sufficient comfort to those who could operate under them. See, e.g., Aziz El Yaakoubi, Jonathan Landay & Matt Spetalnick, *U.S. to Designate Yemen's Houthi Movement as Foreign Terrorist Group*, REUTERS (Jan. 10, 2021, 6:26 PM), <https://www.reuters.com/article/us-yemen-security-usa/u-s-to-designate-yemens-houthi-movement-as-foreign-terrorist-group-idUSKBN29FoP5> [<https://perma.cc/WMV9-ZNAR>] (“Relief officials have said licenses often fail to reassure banks and insurers they will not fall afoul of sanctions.”).

²⁴⁰ For an example of reciprocated sanctions, see the recent dispute between China and the United States. *China to Impose Reciprocal Sanctions Against 6 US Individuals, 1 Entity; '1st Time Anti-foreign Sanctions Law Used,'* GLOB. TIMES (July 24, 2021, 4:21 AM), <https://www.globaltimes.cn/page/202107/1229501.shtml> [<https://perma.cc/SD8A-C3T6>].

to set the tax sanction high enough to induce compliance by some, but not necessarily all, targets.

We can summarize the reasons why Congress may want to deploy tax tools as a “dimmer switch.” First, Congress could use tax sanctions when it wants to discourage U.S. companies or individuals from undertaking some—but not all—investment in certain states, such as those that are not firmly allied with the United States but are not allied with U.S. adversaries either. Allowing U.S. companies to participate in even a relatively disfavored foreign market avoids opening a void into which the companies of adversary states may step. Congress could also use tax sanctions when it wants to discourage U.S. companies from investing in one group of states (autocracies, for example). Second, it could discourage investment in some types of commercial activities but not others (favoring investment in ecotourism and solar power, but not military hardware or surveillance software, for instance) inside a single country. Third, the United States could use tax sanctions to deter investment in foreign assets without formally declaring contentious secondary economic sanctions such as those found in the Helms-Burton Act.

C. *The Case for Tax Sanctions Today*

Our arguments about the benefits of tax sanctions so far are general, but they have greater purchase now than in years past. If the benefits of using the U.S. financial system decline because the alternatives are improving, then the United States has less room to make demands on foreign targets,²⁴¹ and the additional leverage available through tax sanctions becomes more valuable. For example, the development of blockchain technology and cryptocurrencies creates risks of an alternative to the existing payment system.²⁴² Although the U.S. dollar is still the preferred international reserve currency, foreign currencies are becoming a larger share of global reserves.²⁴³ Frustration with the imposition of unilateral sanctions against Iran caused European states to band together and form an alternative special purpose vehicle to facilitate trade with Iran in a way that would not implicate the U.S. financial system.²⁴⁴ And although the U.S. market is still attractive as

²⁴¹ See generally Daniel W. Drezner, *The United States of Sanctions: The Use and Abuse of Economic Coercion*, FOREIGN AFFS., Sept./Oct. 2021, at 142 (emphasizing the United States’ decline in international power and the current inefficacy of U.S. sanctions).

²⁴² See HARRELL & ROSENBERG, *supra* note 6, at 14 (describing technological advancements such as cryptocurrency as a means for other countries to curtail sanctions, reducing the impact of U.S. economic measures).

²⁴³ See *id.* at 24 (noting the decline in the share of global reserves denominated in U.S. dollars).

²⁴⁴ Jacob J. Lew, *Preserving the Power of US Economic Statecraft* (Apr. 30, 2019), <https://sipa.columbia.edu/sites/default/files/20190430-lew-economic-statecraft.pdf> [https://perma.cc/E6WV-JJNS].

a destination for foreign exporters, the emergence of growing middle classes in China and India with disposable incomes may reduce the relative importance of the U.S. export market.²⁴⁵

All of these are reasons to be concerned about overreliance on the existing tools of economic coercion. The continued use of the U.S. dollar as a currency for clearing international transactions is mostly the result of a coordination equilibrium.²⁴⁶ It does not benefit any one party or country to enter into contracts cleared using a different currency or outside of the U.S. financial system, but if foreigners could coordinate on a simultaneous shift to another currency or clearing system, there may be very little cost to doing so. If such a dislocation were to happen, the effects on U.S. domestic interests would be rapid and severe.

The primacy of the U.S. dollar as a reserve currency depends on perceptions about the trustworthiness of U.S. institutions—specifically the Federal Reserve and the U.S. Treasury—not to engage in activities that lead to currency depreciation and volatility.²⁴⁷ It is striking that Treasury yields *fall* during periods of global financial insecurity, because U.S. government debt is viewed as the safest asset. But the United States should not take this position for granted. If divestment from the U.S. dollar were to happen—and for certain countries it has begun—it could happen very quickly and with great disruption.²⁴⁸ Moreover, recent budget and macroeconomic trends in

²⁴⁵ By one estimate, by 2027 there will be 1.2 billion Chinese consumers in the middle class, accounting for twenty-five percent of the global total. Homi Kharas & Meagan Dooley, *China's Accounting on the Global Middle Class*, in GLOBAL CHINA: THE IMPLICATIONS OF CHINA'S RISE AS A GLOBAL ACTOR 309, 311 (Tarun Chhabra, Rush Doshi, Ryan Hass & Emilie Kimball eds., 2021).

²⁴⁶ See Enea Gjoza, *Counting the Cost of Financial Warfare: Recalibrating Sanctions Policy to Preserve U.S. Financial Hegemony*, DEF. PRIORITIES (Nov. 2019), <https://www.defensepriorities.org/explainers/counting-the-cost-of-financial-warfare> [<https://perma.cc/NQ69-KYMX>] (arguing that an overuse of US financial sanctions could threaten US financial dominance); see also Zoffer, *supra* note 236, at 156 (noting that the emergence of the dollar as the world's dominant currency was "largely organic").

²⁴⁷ This also depends on deep and liquid markets for trading U.S. dollars. See Daniel W. Drezner, *Why I Am Starting to Worry About the Dollar*, WASH. POST (Nov. 15, 2018), <https://www.washingtonpost.com/outlook/2018/11/15/why-i-am-starting-worry-about-dollar> [<https://perma.cc/87QZ-YP3C>]. As of 2008, there was much debate over whether the market for the Euro was becoming sufficiently deep and liquid, raising questions about the primacy of the dollar. See Galati & Wooldridge, *supra* note 233, at 3-4 (summarizing the debate).

²⁴⁸ See Daniel McDowell, *Financial Sanctions and Political Risk in the International Currency System*, 28 REV. INT'L POL. ECON. 635, 644 (2020) (noting that U.S. sanctions accelerated Russian efforts to "significantly cut the dollar share of its foreign exchange reserves"); see also Darya Korsunskaya & Alexander Marrow, *Russian Rainy Day Fund to Get Out of All U.S. Dollar Assets*, REUTERS (June 3, 2021, 11:31 AM), <https://www.reuters.com/article/us-russia-reserves/russian-rainy-day-fund-to-get-out-of-all-u-s-dollar-assets-idUSKCN2DF1R9> [<https://perma.cc/ZFU4-5G4X>] ("Russia has been gradually reducing its dollar holdings since the imposition of Western sanctions following Moscow's annexation of Crimea in 2014, and has sought to partially decouple from the Western financial system.").

the United States may give foreigners additional reasons to rebalance their foreign currency portfolios. Higher than average inflation in the wake of the pandemic and large infrastructure and public spending legislation risks endangering the long-term stability of the U.S. dollar.

By contrast, countries would forego real economic benefits if they were to stop trading and investing with U.S. consumers and businesses. Increasing U.S. tax rates is unlikely to trigger a large, unexpected exodus of foreign firms and individuals from the United States, and because tax incentives can be modulated, it is easy to retrench if tax sanctions begin to drive foreigners out of U.S. markets. Finally, and notwithstanding a recent surge in protectionism, the project of global economic integration carries on. The integration of goods and capital markets extends the reach of U.S. tax jurisdiction still further. The benefits of adding tax law to the toolbox are greater now than ever, and the risks of not doing so are looming.

D. Other Advantages

Moving from an “on/off switch” to a “dimmer switch” approach to sanctions not only provides greater flexibility in setting incentives, but it also changes the psychological frame for evaluating the sanction. Taxing income from an activity, even at unfavorable rates, does not generally convey moral disapproval or judgment, and it is not a punishment for engaging in that conduct. Conveying moral opprobrium might be helpful in some cases, but not in others. The use of tax rules can also avoid some of the harsh perceptions that accompany sanctions (i.e., that the United States is trying to “strangle” another country’s economy or industry). Of course, the United States could communicate the reasons why certain taxpayers are being targeted, which may be helpful in providing clarity about what those targets need to do to obtain tax sanctions relief, but it may also be advantageous in certain circumstances to let the tax incentives quietly do their work with little fanfare.

Another advantage of tax sanctions, given the ability to modulate by degrees, is that it becomes possible to experiment with modest tax sanctions and collect information on the results without triggering adverse consequences. For example, foreign corporations with a U.S. nexus could be compelled to report on activities in target states affecting their business, such as rights-suppressing laws, by a tax sanction. That sanction could increase steadily over time until the point at which the foreign corporations begin to comply or actually leave U.S. jurisdiction. By contrast, the costs of using the financial system and U.S. currency to target foreign actors—in terms of increasing the risk of divestment—may be mostly invisible until the moment

they are not. As discussed above, a coordinated move by foreign countries away from the U.S. dollar or the U.S. financial system as a clearinghouse for cross-border transactions may come without much advance warning.

Finally, although we cannot be certain, we are also hopeful that putting tax law in service of foreign policy will benefit tax administration. The IRS has suffered from declining support in recent years.²⁴⁹ The fact that the IRS is the nation's tax collector would seem to necessarily make it an unpopular agency. But the IRS is tasked not only with revenue collection and law enforcement, but also with making contested and ideologically fraught judgments about things like tax-exempt status, which make it vulnerable to being perceived as politicized. In 2013, concerns that the IRS was unduly scrutinizing applications by conservative applicants for tax-exempt status created an enormous uproar.²⁵⁰ Assertions about political bias at the IRS have fueled posturing by elected officials and cuts to IRS funding, which undermine the ability of the IRS to perform its primary function: tax law enforcement.²⁵¹ This is an important lesson. When the agency's mission creeps into politically fraught areas, it can undermine its ability to perform its primary purpose. Delegating the enforcement of U.S. foreign policy to the IRS could cut in either direction. Certain aspects of foreign policy—such as anti-terrorism measures—may have broad and bipartisan popular support, while others will be divisive.

IV. OBJECTIONS AND REPLIES

In this final Part, we anticipate objections to using tax law as a tool of foreign policy and provide our replies. We start by describing tax norms and why tax sanctions are not egregious transgressions of those norms. We then turn to possible concerns about rent seeking, Congress's competence to legislate in this area, the adaptability of the Code to changing circumstances, and issues with U.S. obligations under the WTO.

²⁴⁹ See Chuck Marr & Cecile Murray, *IRS Funding Cuts Continue to Compromise Taxpayer Service and Weaken Enforcement*, CTR. ON BUDGET & POL'Y PRIORITIES (Apr. 4, 2016), <https://www.cbpp.org/sites/default/files/atoms/files/6-25-14tax.pdf> [<https://perma.cc/56EU-L7W7>] (explaining that funding cuts have required the IRS to reduce its workforce, cut training, and delay technological upgrades, weakening tax enforcement capability); see also Drew Desilver, *IRS Among Least-Popular Federal Agencies*, PEW RSCH. CTR. (May 16, 2013), <https://www.pewresearch.org/fact-tank/2013/05/16/irs-among-least-popular-federal-agencies> [<https://perma.cc/G4UY-D7SJ>] (finding that the public views the IRS as eleventh out of fourteen federal agencies in terms of performance).

²⁵⁰ See Lloyd Hitoshi Mayer, "The Better Part of Valor Is Discretion": *Should the IRS Change or Surrender Its Oversight of Tax Exempt Organizations?*, 7 COLUM. J. TAX L. 80 (2016) (noting the controversy and arguing that oversight of charitable and tax-exempt organizations should be moved outside of the IRS into alternative regulatory bodies that could handle IRS matters).

²⁵¹ Cf. Marr & Murray, *supra* note 249.

A. Tax Norms

Tax policy is guided by concerns about equity, efficiency, and administrability.²⁵² The scholarly literature on these criteria is voluminous, and its dizzying complexity need not concern us here. For our purposes, it is only necessary to observe that these criteria generally point towards a policy heuristic of neutrality, which is to say that all income should be taxed at the same rate. To do otherwise could result in two taxpayers with the same income paying different amounts of tax (making it inequitable), redirecting resources to the activity that generates favorably taxed income (making it inefficient), and requiring the tax authority to police the boundary between the activity that generates favored income and other, similar activities that do not (making it inadministrable).

There are also political reasons to favor neutrality as between different categories of income. Tax sanctions might appear to violate this neutrality norm, and for this reason we anticipate objections to using tax law for foreign policy. It is easy to contrive plausible but insincere policy reasons having to do with culture, economic growth, or indeed national security, to favor certain economic activities over others. Permitting favorable tax treatment for some kinds of income invites rent seeking dressed up as principled tax policy. Once the door is opened to using tax law to encourage desirable behaviors or make social, industrial, or foreign policy, it becomes attractive for interest groups to invest in rent-seeking behavior that is privately beneficial but socially wasteful. This behavior generally results in an undemocratic redistribution of resources and inefficient market interventions. We discuss these political economy considerations in greater detail in Section IV.B.

In practice, Congress honors the neutrality principle as much in the breach as in the observance.²⁵³ And yet the heuristic is a powerful one that drives periodic calls for “tax reform,” an evergreen source of political energy that entails broadening the tax base to become more neutral among different categories of income, thus reducing tax rates.

Neutrality heuristics have also been the dominant frame for thinking about international taxation, with capital export neutrality (CEN) being particularly influential in guiding U.S. international tax policy.²⁵⁴ CEN aims

²⁵² See Reuven S. Avi-Yonah, *The Three Goals of Taxation*, 60 TAX L. REV. 1, 1 (2006) (noting that the traditional grounds for evaluating tax policy are efficiency, equity, and administrability).

²⁵³ See Susannah Camic Tahk, *Everything Is Tax: Evaluating the Structural Transformation of U.S. Policymaking*, 50 HARV. J. LEGIS. 67, 69-73 (2013) (noting that “[t]hroughout the last quarter century, the federal government has been increasing its use of the tax code to accomplish key objectives,” including the use of tax credits to accomplish anti-poverty, sustainable energy, and health care reform goals).

²⁵⁴ Michael S. Knoll, *Reconsidering International Tax Neutrality*, 64 TAX L. REV. 99, 99 (2011). Professor Knoll argues that the term CEN in fact means different things to economists—for whom

to ensure that taxes are neutral with respect to the source of a taxpayer's income, so that U.S. taxpayers make investment decisions on the basis of pre-tax rates of return, regardless of whether those investments are in the United States or abroad.²⁵⁵

The primary mechanism for implementing CEN is the foreign tax credit, which reduces U.S. taxes on foreign-source income by the amount of foreign income taxes paid on that income.²⁵⁶ In theory, this means that U.S. persons pay the same tax rate on income, regardless of where it is earned. This form of neutrality advances global economic efficiency. But efficiency immediately loses some of its obvious appeal in the international context. Why should the United States adopt international tax rules that improve global efficiency rather than the welfare of U.S. citizens or residents?²⁵⁷ It is natural to believe, as Professor Graetz has argued, that U.S. tax policy should “give adequate priority to the goals and interests of the American people.”²⁵⁸

In the domestic context, neutrality norms serve equity, efficiency, and administrability goals. They also serve as a (leaky) bulwark against rent seeking by interest groups. Because departures from neutrality typically create competitive winners and losers in the marketplace, there are political checks against rent seeking. But the politics of international taxation are different. In the international tax context, the losers from non-neutralities may be foreigners who do not vote in U.S. elections and who are at a disadvantage when it comes to lobbying lawmakers. This suggests that the political headwinds against pursuing foreign policy through the international tax rules likely are weaker than those against implementing social policy through purely domestic tax rules. Moreover, persistent disagreement about the normative foundations of international tax policy,²⁵⁹ and the uneasy justification for international neutrality norms to begin with, make it easier for other policy considerations—such as national security—to intervene. As Professor Graetz has argued, “Only the view that the tax law is always a bad way to do things other than raise revenue—the perspective

a better term is competitive neutrality—than to lawyers—for whom it means locational neutrality. *Id.* at 100.

²⁵⁵ Diane Ring, *International Tax Relations: Theory and Implications*, 60 TAX L. REV. 83, 87 (2007) (“The basic goals other than revenue of the international tax system are the same ones generally espoused for domestic tax policy: efficiency, equity, and administrability.”).

²⁵⁶ I.R.C. § 901.

²⁵⁷ Sometimes pursuing global welfare may be helpful in achieving greater national welfare. Daniel Shaviro, *Why Worldwide Welfare as a Normative Standard in U.S. Tax Policy?*, 60 TAX L. REV. 155, 157 (2007).

²⁵⁸ Graetz, *supra* note 153, at 307.

²⁵⁹ Mason, *supra* note 180, at 354, 389-93 (describing conflicting views on economic efficiency and distributional fairness dating back to the early twentieth century).

of tax-expenditure religionists—would rule out the tax law as an implement of U.S. foreign policy.”²⁶⁰

B. *Political Economy Concerns*

Using tax incentives for non-tax policy goals attracts rent seeking. This is a downside to using carrots to steer resources to support foreign policy objectives. Moreover, it is difficult to terminate these benefits once they have become entrenched, because the benefits are concentrated but, as with all tax expenditures, the costs are widely dispersed among current taxpayers or future generations that will have to pay for the deficit-financed tax expenditure. And extraordinary tax interventions made during the 2008–2009 financial crisis illustrate the difficulty in obtaining standing to oppose favorable tax treatment for competitors.²⁶¹

The tariffs and import restrictions imposed by the Trump Administration illustrate how foreign policy can be a fig leaf for industrial policy.²⁶² As Professor Noah Feldman put it, “[T]he national security rationale has the capacity to kill free trade, a little bit at a time.”²⁶³ Departing from established neutrality norms to use tax law for foreign policy purposes, as we endorse here, creates similar risks, although we think that the risks are smaller than with tariffs and import restrictions. For example, inbound tax sanctions such as increased rates of withholding on investment income will, in theory, shelter U.S. investors from the competition of certain foreign investors. We do not think, however, that domestic politics are likely to make this form of protectionism appealing.²⁶⁴ Squeezing out foreign investors through higher rates of tax will only drive up the costs to U.S. businesses of raising capital, which will tend to reduce worker wages and employment. Contemporary

²⁶⁰ Graetz, *supra* note 153, at 309.

²⁶¹ For a discussion of some of these measures, see generally Albert H. Choi, Quinn Curtis & Andrew T. Hayashi, *Crisis-Driven Tax Law: The Case of Section 382*, 23 FLA. TAX REV. 1, 9–27 (2019) (summarizing regulatory and tax responses to the 2008 crisis, including TARP, § 382, and IRS Notice 2008-83); for a discussion of taxpayer standing, see generally Paul B. Stephan III, *Nontaxpayer Litigation of Income Tax Disputes*, 3 YALE L. & POL’Y REV. 73 (1984) (discussing purported private enforcement of tax statutes).

²⁶² It can be difficult to draw a distinction between protectionism and general national security interests. Noah Feldman, *Huawei and 5G: A Case Study in the Future of Free Trade*, BLOOMBERG (Feb. 13, 2019, 2:38 PM), <https://www.bloomberg.com/opinion/articles/2019-02-13/huawei-and-5g-a-case-study-in-the-future-of-free-trade> [<https://perma.cc/K4CC-X69M>].

²⁶³ *Id.*

²⁶⁴ These protectionist effects will also raise issues under the U.S. international legal obligations discussed *infra* Section IV.E.

protectionism is driven by concerns about jobs,²⁶⁵ so it seems unlikely that political pressures will line up behind the interests of domestic capital.

Outbound tax sanctions and increased reporting obligations impose costs, not benefits, on U.S. businesses. We would expect that U.S. businesses will generally lobby to avoid having to bear these costs. And the politics of imposing costs on a relatively narrow constituency with widely dispersed benefits in the form of improved national security suggests that there will likely be political headwinds against using tax law in this way. Thus, the risk when it comes to using tax law to increase information reporting and outbound tax sanctions is not that they will be inefficiently popular, but instead that they will not be able to overcome industry opposition.

It is possible that certain market participants will actually be in favor of these additional compliance costs. If there are economies of scale from compliance with a tax sanctions regime, then larger firms may embrace these new obligations to the extent they help deter new, smaller entrants to the marketplace. We cannot say for certain just how significant the political economy problems associated with rent seeking are likely to be. Unless the process of adopting and removing tax sanctions is insulated from political actors—and we do not think it can, or should, be—then there will be aggressive lobbying. Exactly how problematic that is will depend on institutional design details about how tax sanctions are administered, and we cannot consider all of the possibilities here. There are bound to be rent-seeking issues regardless of whether important decisions about tax sanctions are made by Congress or the Executive Branch. At the same time, we do not think that introducing tax sanctions will necessarily worsen rent-seeking behavior that already takes place under the guise of improving the competitiveness of U.S. companies, protecting American workers, and so forth.²⁶⁶

Instead, we think that the bigger concern from a political economy perspective is how politicians—rather than private industry—may respond to using tax sanctions for foreign policy. The reason is that these sanctions will tend to raise revenue, and they may be seen as politically expedient offsets to increased government spending or tax cuts. One way of dissuading Congress from succumbing to the temptation to impose excessive tax sanctions for the purpose of raising revenue would be to delegate to the Executive the ability to designate the tax sanctions targets.

Of course, the Executive is not entirely insulated from pressure, but it is further removed from lobbying by a large bureaucracy that is designed to

²⁶⁵ Adam Mordecai, *Anti-Offshoring Legislation: The New Wave of Protectionism: The Backlash Against Foreign Outsourcing of American Service Jobs*, 5 RICH. J. GLOB. L. & BUS. 85, 91 (2005).

²⁶⁶ The CFIUS regime, discussed *supra* Section I.C, is an example of an institution that has expanded beyond its initial conception as the definition of national security has grown.

make policy based on expert views and to be less directly exposed to lobbying. Why would Congress agree to delegate the power to identify targets? Because it recognizes that the Executive has greater access to relevant intelligence and a more finely tuned understanding of foreign relations. And, whatever its reasons, Congress has already made these kinds of delegations in a range of other areas, including both export controls and financial sanctions.

C. Institutional Competence

One argument against an increased reliance on tax sanctions is that the actors in Congress who would draft them are unfamiliar with foreign policy.²⁶⁷ However, various congressional committees already play significant roles in crafting financial statutes that implicate foreign policy.²⁶⁸ Adding foreign policy-related tax tools to the agenda would not impose an unduly heavy burden on the congressional committees who would help craft those tools.

In general, the Executive plays the leading role among the three branches in establishing and executing foreign policy.²⁶⁹ Some see Congress as parochial, with a much stronger institutional focus on, and expertise about, domestic issues than foreign ones.²⁷⁰ Further, as the Executive often asserts,²⁷¹ the conduct of U.S. foreign policy requires the government to react flexibly to changing circumstances overseas; statutes often fix policy at a particular point in time and thus diminish that flexibility.

That said, Congress has played a robust role in establishing sanctions regimes. As discussed in Part I, Congress has enacted statutes that empower the President to impose sanctions on human rights violators, nuclear proliferators, and the leadership of particular states. These statutes usually

²⁶⁷ We do not foresee any constitutional barriers to tax sanctions in general. Congress can likely impose tax sanctions under its taxing power or its foreign commerce power. We note that outbound tax sanctions are already employed under § 901. *See supra* notes 198–199 and accompanying text. Although Congress has not given the Executive the ability to set tax rates, some scholars argue that it could delegate more tax power than it does. *See, e.g.*, James R. Hines Jr. & Kyle D. Logue, *Delegating Tax*, 114 MICH. L. REV. 235 (2015).

²⁶⁸ For a discussion of foreign affairs in committees, see ANDRES B. SCHWARZENBERG ET AL., CONG. RSCH. SERV. R45474, INTERNATIONAL TRADE AND FINANCE: OVERVIEW AND ISSUES FOR THE 116TH CONGRESS (2020) (providing a broad overview of select topics in international trade and finance, focusing on prominent issues that have been the subject of recent discussion and debate that may come before the 116th Congress).

²⁶⁹ *See United States v. Curtiss-Wright Exp. Corp.*, 299 U.S. 304, 319–24 (1936) (noting that the President represents the government of the United States in its foreign affairs).

²⁷⁰ *E.g.*, Bryan W. Marshall & Patrick J. Haney, *The Impact of Party Conflict on Executive Ascendancy and Congressional Abdication in US Foreign Policy*, INT'L POL. (July 13, 2021), <https://doi.org/10.1057/s41311-021-00326-z> [<https://perma.cc/UE4Z-R9X4>].

²⁷¹ James M. Lindsay, *Congress and Foreign Policy: Why the Hill Matters*, 107 POL. SCI. Q. 607, 611 (1992).

accommodate the need for foreign policy expertise and flexibility by creating a framework within which the Executive can impose sanctions, while allowing the Executive to make (or not make) certain findings that actually implement the sanctions or waive their imposition.²⁷²

A range of congressional committees drafted these sanctions statutes. The Helms-Burton Act was drafted by the House International Relations, Ways and Means, Judiciary, and Banking and Financial Services Committees.²⁷³ The Senate Finance and Foreign Relations Committees, together with the House Foreign Affairs and Judiciary Committees, drafted the Global Magnitsky Act,²⁷⁴ which allows the federal government to sanction individuals accused of human rights violations. And CAATSA, which sanctioned Iran, North Korea, and Russia, was produced by the House Foreign Affairs, Intelligence, Judiciary, Oversight and Government Reform, Armed Services, Financial Services, Rules, Ways and Means, and Transportation and Infrastructure Committees.²⁷⁵ This indicates that a range of committees—beyond simply the House and Senate foreign relations committees—have periodic exposure to and opportunity to legislate on foreign affairs issues.

Beyond sanctions, the House Ways and Means and Senate Finance Committees produced the trade statutes under which the Executive has deployed tariffs for foreign policy purposes. Those committees produced the Trade Expansion Act of 1962²⁷⁶ and the Trade Act of 1974.²⁷⁷ The Senate Banking, Housing, and Urban Affairs Committee and the International Trade

²⁷² A good example of this is the regime under § 901(j) of the Code, described above in subsection I.C.2.

²⁷³ Cuban Liberty and Democratic Solidarity (LIBERTAD) Act of 1996, Pub. L. No. 104-114, 110 Stat. 785 (codified in scattered titles and sections of U.S.C.). For a full list of committee actions, see *H.R.927 - Cuban Liberty and Democratic Solidarity (LIBERTAD) Act of 1996*, CONGRESS.GOV <https://www.congress.gov/bill/104th-congress/house-bill/927/actions> [<https://perma.cc/YHR5-Q9RK>].

²⁷⁴ Global Magnitsky Human Rights Accountability Act (Global Magnitsky Act), Pub. L. No. 114-328; 130 Stat. 2000 (codified at 22 U.S.C. 2656). For a full list of committee actions, see *S.284 - Global Magnitsky Human Rights Accountability Act*, CONGRESS.GOV, <https://www.congress.gov/bill/114th-congress/senate-bill/284/all-actions?s=10&r=1> [<https://perma.cc/KS5L-ZEWH>].

²⁷⁵ Countering America's Adversaries Through Sanctions Act, Pub. L. No. 115-44, 131 Stat. 886 (2017) (codified in scattered titles and sections of U.S.C.). For a full list of committee actions, see *H.R.3364 - Countering America's Adversaries Through Sanctions Act*, CONGRESS.GOV, <https://www.congress.gov/bill/115th-congress/house-bill/3364/actions> [<https://perma.cc/7VJ7-SFFK>].

²⁷⁶ See Trade Expansion Act of 1962, Pub. L. No. 87-794, 76 Stat. 872, 877 (codified in scattered titles and sections of U.S.C.) (“[The President] shall take such action, and for such time, as he deems necessary to adjust the imports of such article and its derivatives so that such imports will not so threaten to impair the national security.”).

²⁷⁷ See *H.R.10710 - An Act to Promote the Development of an Open, Nondiscriminatory, and Fair World Economic System, to Stimulate Fair and Free Competition Between the United States and Foreign Nations, to Foster and Economic Growth of, and Full Employment in, the United States, and for Other Purposes*, CONGRESS.GOV, <https://www.congress.gov/bill/93rd-congress/house-bill/10710/actions> [<https://perma.cc/LPJ-BGNE>].

and Finance Subcommittee drafted the 1999 reauthorization of the Export Administration Act.²⁷⁸

Today, the House Ways and Means Committee drafts tax legislation²⁷⁹ consistent with the constitutional requirement that all legislation concerning taxation must originate in the House.²⁸⁰ Of course, as with many statutes, the Executive Branch may help draft the bills' language.²⁸¹ According to the Treasury Department, "[m]ost recommendations for new tax legislation come from the President," with the Treasury Department and IRS playing the primary role in preparing those recommendations.²⁸² Because members on the House Ways and Means Committee and the Senate's equivalent (the Finance Committee) are very senior, they are likely to be seasoned legislators who have been periodically exposed to foreign relations issues.²⁸³ In the House, the Speaker may refer a measure to more than one committee (either initially or seriatim) such that the Speaker can ensure that both the Ways and Means and the House International Relations Committee review a bill.²⁸⁴ Likewise, Senate Rule XVII allows the Senate majority and minority leaders jointly to refer a measure to several committees for consideration simultaneously or seriatim.²⁸⁵

In short, while it is likely that members of the congressional committees that would be responsible for initiating foreign policy-related tax bills will be less steeped in foreign relations issues than members of Congress's foreign relations committees, they may have more experience than one might assume at first glance. At the very least, they are capable of interfacing with their foreign relations committee colleagues and the Executive Branch to ensure that the bills will advance U.S. foreign policy. This interfacing should happen more when revising international tax provisions, in any event. Not doing this can lead to unintentional conflicts between U.S. domestic tax law and

²⁷⁸ *S.1712 - Export Administration Act of 1999*, CONGRESS.GOV, <https://www.congress.gov/bill/106th-congress/senate-bill/1712/all-actions> [<https://perma.cc/9MVA-R2TG>].

²⁷⁹ *Jurisdiction & Rules*, WAYS & MEANS COMM., <https://waysandmeans.house.gov/about/jurisdiction-and-rules> [<https://perma.cc/DN26-7XRX>].

²⁸⁰ U.S. CONST. art. I, § 7.

²⁸¹ See Ashley Deeks, *Statutory International Law*, 57 VA. J. INT'L L. 263 (2018) (discussing the role of the Executive Branch in suggesting language for statutes).

²⁸² *Writing and Enacting Tax Legislation*, U.S. DEP'T OF THE TREASURY, <https://www.treasury.gov/resource-center/faqs/taxes/pages/writing.aspx> [<https://perma.cc/H556-C3PG>].

²⁸³ See Emma Roller, Stephanie Stamm & National Journal, *Here Are America's Most Wanted (House Committee Chairmen)*, ATLANTIC (June 5, 2014), <https://www.theatlantic.com/politics/archive/2014/06/here-are-americas-most-wanted-house-committee-chairmen/455682> [<https://perma.cc/44R6-4PQM>] (showing the popularity and power of the Ways and Means Committee).

²⁸⁴ MARK J. OLESZEK, CONG. RSCH. SERV., R46251, COMMITTEE JURISDICTION AND REFERRAL IN THE HOUSE (2020) (describing the practice of multiple referral in the House).

²⁸⁵ *Rules of the Senate*, RULES & ADMIN., <https://www.rules.senate.gov/rules-of-the-senate> [<https://perma.cc/X9KL-UUSM>].

international treaty obligations²⁸⁶ or undermine foreign policy provisions in existing tax law, as we discussed in Part II in connection with TCJA.

D. Dynamism

An important design question is the ease with which countries or entities can be added to, or removed from, a list of actors subject to tax sanctions. A common criticism of traditional sanctions is that they are rarely rolled back, and that countries or individuals on sanctions lists stay there longer than they should.²⁸⁷ This raises questions of both fairness and effectiveness, as sanctions can only induce a change in behavior if the target believes that the change in behavior will prompt the United States to remove the sanction.²⁸⁸

One possibility is for Congress to make tax sanctions mandatory. Congress could, for example, pass a bill that disallowed foreign tax credits for income taxes paid to the government of a specified country, perhaps adding it by name to the list of countries currently covered by § 901(j). Doing so would require that it be embedded in a bill passed by the House and Senate and signed by the President. In addition to giving greater influence to Congress in the arena of foreign policy, the legislative process means that it would take longer to add new names to the list. If states and individuals are added to the list by name, then it will also take a legislative act by Congress to remove them from the list. This builds in longer delays at the back end as well. In cases where speed is important, these delays are a shortcoming of making tax sanctions mandatory and such tax sanctions will almost certainly be “stickier” and more likely to outlast their usefulness.²⁸⁹ Moreover, if revisions to the tax sanctions list were included in legislation, then those revisions could be derailed by unrelated parts of a bill.

An alternative—and we think better—approach is the one that is currently used in § 901(j). The determination of whether § 901(j) applies to a country is made by the Executive and can be implemented by Executive Order in comparatively short order.²⁹⁰ Further, allowing the Executive to add countries or other entities to the tax sanctions list would provide the Executive with

²⁸⁶ See, e.g., Richard L. Doernberg, *Legislative Override of Incomes Tax Treaties: The Branch Profits Tax and Congressional Arrogation of Authority*, 42 TAX LAW. 173, 201 (1989) (noting that the branch profits tax intentionally overrode treaty obligations).

²⁸⁷ See Haass, *supra* note 2 (“It is often difficult or impossible to build a consensus for rescinding a sanction, even if there has been some progress on the matter of concern, if the sanction has been shown to be feckless or counterproductive, or if other interests can be shown to suffer as a result.”).

²⁸⁸ See *id.* (“Sanctions tend to be easier to introduce than to lift. It is almost always more difficult to change the status quo than to continue with it.”) (emphasis removed).

²⁸⁹ See, for example, the Jackson-Vanik sanctions described *supra* note 77.

²⁹⁰ See I.R.C. § 901(j)(2)(A) (listing countries to which § 901(j) applies).

greater flexibility and responsiveness based on changing conditions in foreign countries and changing behaviors by sanctioned entities, something important in the foreign policy arena.

E. *Unilateralism and International Law*

We have not taken a position in this article about whether tax sanctions should be imposed in coordination with allies or whether they should be used on a unilateral basis. Nevertheless, we have mostly argued for increased use of tax sanctions under the assumption that they will be imposed unilaterally.

For the most part, tax sanctions do not raise novel questions about the costs and benefits of coordinating with other countries to impose sanctions on a multilateral—rather than a unilateral—basis. Traditional sanctions work best when they are imposed with broad international support.²⁹¹ Although early research seemed to indicate that unilateral sanctions could be more effective than multilateral sanctions, recent scholarship suggests otherwise.²⁹² As a theoretical matter, coordinating with allies in the imposition of tax sanctions is likely to increase the costs of the sanctions to the foreign target. To illustrate, the imposition of withholding taxes on investment income payable by all members of the OECD to the foreign target would have a much greater impact on the performance of the target's investment portfolio than the unilateral imposition of taxes. Multilateral tax sanctions thereby make it easier to reduce the wealth of the target because it is more difficult to substitute for alternative investments.

Multilateralism also reduces the costs to the United States of imposing tax sanctions. To again use the example of increased withholding taxes, if all investment income were subject to the increased tax rate for the foreign target regardless of source, then divestment from the United States would never be attractive and the target would have to choose between paying the tax sanction or changing its behavior. And there are reputational costs to the United States from imposing unilateral sanctions. For example, the U.N. General Assembly has passed 29 near-unanimous resolutions condemning U.S. sanctions on Cuba.²⁹³ On the other hand, obtaining agreement among multiple governments about the substance of tax sanctions will inevitably require that the United States compromise to reach such an agreement.

²⁹¹ Lew, *supra* note 244.

²⁹² Bapat & Morgan, *supra* note 232, at 1092.

²⁹³ Edith M. Lederer, *US Votes Against UN Resolution Condemning US Embargo on Cuba*, ASSOCIATED PRESS (June 23, 2021), <https://apnews.com/article/united-nations-united-nations-general-assembly-middle-east-cuba-business-3d55820f2daeb666e1c91eaddae5fd2c> [https://perma.cc/W8ZL-7SW9].

The most significant legal obstacles to greater use of U.S. income tax law as a stick in foreign policymaking are the U.S. obligations under international law, specifically the General Agreement on Tariffs and Trade (GATT) and General Agreement on Trade in Services (GATS) that underpin the WTO.²⁹⁴ The central problem is that negative tax treatment that turns on a foreign/domestic distinction—for example, an inbound tax sanction that increases withholding tax rates on dividends paid to persons who do business with a foreign target—is presumptively noncompliant with WTO obligations.

To impose tax sanctions and remain WTO-compliant, the United States will likely need to invoke the national security exception under Article XXI of the GATT and GATS. As Professor Voon has noted, “Significant uncertainty surrounds this provision.”²⁹⁵ The United States has taken the position that the national security exception is nonjusticiable by the WTO.²⁹⁶ This position has other supporters, including the UAE, Saudi Arabia, Egypt, and perhaps Russia, but the European Union takes the position that the state invoking the exception bears the burden of proving its applicability.

If the United States maintains its current view, then the political question about whether to impose tax sanctions and invoke the national security exception in any trade dispute arising through the WTO requires balancing the benefits of the tax sanction against the possible effects of undermining the WTO and global free trade order, which generally serves U.S. interests.²⁹⁷ Some scholars are deeply concerned about the unravelling effects that overuse of the national security exception could have on the WTO, while others believe that free trade can be sustained through a self-enforcing process among states and that the national security exception can be kept from swallowing up the general agreement through the selective, good-faith use of the exception.²⁹⁸ Aggressive use of tax sanctions through invocation of the national security exception would put these two views to the test.

²⁹⁴ Tania Voon, *Can International Trade Law Recover? The Security Exception in WTO Law: Entering a New Era*, 113 AJIL UNBOUND 45, 45 (2019) (“[T]he security exception lies at the center of multiple explosive disputes, posing a potential threat to the WTO’s very existence.”).

²⁹⁵ *Id.*

²⁹⁶ *See id.* at 47 (“The suggestion that the security exception is wholly self-judging takes on an even more extreme form in the view of the United States, which sees the exception as ‘non-justiciable.’”).

²⁹⁷ For a discussion of these issues, see Paul B. Stephan, *Sovereignty and the World Economy*, 17 U. ST. THOMAS L.J. 649, 665-66 (2021).

²⁹⁸ Compare BRANDON J. MURRILL, CONG. RSCH. SERV., LSB10223, THE “NATIONAL SECURITY EXCEPTION” AND THE WORLD TRADE ORGANIZATION 4 (2018) (“Arguably, allowing a WTO Member to take any measure it deems essential to its security interests would defeat [the objective of security and predictability in the multilateral trading system] . . .”), with Roger P. Alford, *The Self-Judging WTO Security Exception*, 2011 UTAH L. REV. 697, 758 (noting

CONCLUSION

The use of economic sanctions is at a high-water mark in the United States, but there is reason to be concerned about overreach and signs of rebellion by foreign allies and adversaries against the overuse of these sanctions. There are limits to how much the United States can exploit the primacy of the dollar and the centrality of the U.S. financial system to coerce foreign actors before they seek alternatives that do not leave them exposed to U.S. foreign policy imperatives. We need to find alternative points of economic leverage to ensure that our existing levers do not break under the strain. Tax law is a partial answer.

that generally Member States consider the security exception to be self-judging and assume it is invoked in good faith).