3-1-2015

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The Three Legislative Components Necessary to Curb Corporate Tax Inversions

I. INTRODUCTION

Wall Street bankers have played a large role in helping U.S. companies engage in tax inversions, which are transactions “whereby [a company] becomes a subsidiary of a new parent company in another country for the purpose of falling under beneficial tax laws.”1 Recently, many leading U.S. companies have been vying to move their legal address abroad through inversion transactions to escape the U.S. tax code.2 In an attempt to disincentivize companies from inverting purely for the purpose of avoiding U.S. taxes, the U.S. Treasury (“Treasury”) announced modest restrictions to reduce the tax benefits from inversion transactions.3 However, those modest steps are not sufficient to prevent companies from engaging in inversion transactions, so Congress must take action.4

There have been several proposals by members of Congress made in attempt to curb the inversion trend, and while they all differ, they contain three main policies that target common behaviors of inverted companies.5 These policies include: (1) changing the requirements for the size and location of business activity; (2) preventing earnings stripping; and (3) limiting the ability to access

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3. INTERNAL REVENUE SERV., NOTICE 2014-52, RULES REGARDING INVERSIONS AND RELATED TRANSACTIONS 1 (Sept. 22, 2014) [hereinafter NOTICE].
untaxed foreign earnings. While anti-inversion legislation that includes all three elements will temporarily halt looming inversion deals, ultimately the United States must revamp the tax code to fully remove the incentive to invert.

This Note proceeds in four parts. Part II defines tax inversion, provides an overview of the recent regulations enacted by the Treasury, and discusses the role of major financial institutions in these transactions. Part III uses recent inversion deals to illustrate some responses to the recent regulation. Part IV uses President Obama’s 2015 budget proposal (the “Budget”) and three recent legislative proposals to analyze the three major policies and explains why some are more effective than others. Lastly, Part V discusses how anti-inversion legislation impacts advisors and their clients and argues that ultimately, the United States should adopt a territorial tax system in conjunction with lowering the corporate tax rate.

II. OVERVIEW OF THE CORPORATE TAX INVERSION CRISIS

In the 1950s, one-third of the federal government’s revenue came from corporate taxation. However, over the years that number has decreased to one-tenth. U.S. companies have been able to lower their effective tax rates from the statutory tax rate by utilizing tax credits, maximizing subsidies, and employing tax minimization strategies. For example, in 2011, the total corporate federal tax rate

6. Id.
7. See infra Part II.
8. See infra Part III.
11. See infra Part IV.
12. See infra Part V.
14. Id.
fell to just 12.1% of profits earned from business activity in the United States, according to the Congressional Budget Office. Recently, several high-profile U.S. companies have been engaging in inversions in order to lower their tax bill. According to the Internal Revenue Service ("IRS"), the $3 trillion in assets held offshore costs the United States more than $70 billion annually in lost tax revenue. This section discusses: (1) what an inversion is and motivations behind inversion transactions; (2) what rules the U.S. government has issued in attempt to curb inversion transactions; and (3) what role major financial institutions play in inversion transactions.

A. What is it and Why are Companies Doing it?

A corporate inversion occurs when an American company legally moves its domicile to a foreign country with lower tax rates in order to reduce its tax burden. After the headquarters is moved, the company utilizes various U.S. tax code provisions to access overseas earnings without paying U.S. taxes. Often, tax inversions result in a much smaller foreign holding company owning a significantly larger U.S. operating company. Companies that are inverting are not likely to make any material change in business strategy, operational structure or function. Instead, the inversion is purely a paper transaction motivated by reducing U.S. tax liability. Thus, an inversion changes little other than a company’s address for tax purposes.

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22. Id.
23. Id.
24. Kyle Pomerleau, Everything You Need to Know About Corporate Inversions, TAX
With a statutory tax rate of 35%, U.S. corporations currently face one of the highest statutory corporate tax rates among countries in the Organization for Economic Cooperation and Development (“OECD”). U.S. companies identify the high U.S. corporate income tax rate as the underlying cause of the increasing popularity of inversion transactions. Another component driving companies to invert is that, unlike most countries, the United States uses a worldwide tax system, not a territorial tax system. In a territorial system, companies must only pay taxes on income earned domestically. Conversely, the United States taxes all income regardless of the country in which it is earned; however, foreign income is only taxed once it is repatriated.

Companies that invert often cite strategic business reasons in addition to tax reduction as motivation behind the deal. For instance, Burger King stated that its inversion would allow it to increase revenue through international expansion. Other U.S. companies have pointed to more agreeable “corporate governance rules and more flexible banking laws” in other countries. The U.S. government recognizes that cross-border mergers can strengthen the economy and encourages the mergers as long as the transactions are “driven by genuine business


26. Id.


28. Feyman, supra note 25.

29. “Repatriated” meaning foreign profits that are paid to the U.S. parent firm as a dividend. See Press Release, U.S. Dep’t of the Treasury, supra note 20.


strategies and economic efficiencies.” However, the U.S. government does not want these deals to be motivated by “a desire to shift the tax residence of the parent entity to a low-tax jurisdiction simply to avoid U.S. taxes.”

Under the U.S. tax code, engaging in a corporate inversion is legal. As indicated by Judge Learned Hand in 1934, “Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one’s taxes.” The Obama Administration, however, has condemned inversion practices by calling them “unpatriotic.” The President is particularly concerned about the effect on the economy, arguing inversions are sending American investment money overseas, which ultimately burdens U.S. taxpayers who are left to pick up the tab. Some have argued that U.S. companies will ultimately suffer from inversion transactions because if the United States has less money overall, interest rates will rise, making it more difficult for U.S. companies to borrow money. Inversion proponents, on the other hand, argue that there is nothing unpatriotic about cutting costs and that companies have a fiduciary duty to maximize profits for shareholders. Democrats and Republicans agree that inversions need to be addressed, but they disagree on what needs to be done. Republicans feel the only solution is a full overhaul of the tax code, which includes lowering the U.S. corporate tax rate, while Democrats feel anti-inversion legislation is necessary in the interim.

34. Id.
35. Raice, supra note 17.
40. Feyman, supra note 25.
42. Id.
Uncertainty about Congress’s ability to pass timely legislation has led the Obama Administration to issue rules in hopes of preventing looming inversion deals from closing.43

B. Summary of Issued Rules Regarding Inversions

Although inversion transactions have gained popularity recently, the concept is far from novel.44 In 2004, Congress passed the American Jobs Creation Act (“AJCA”),45 in an attempt to eliminate the incentive to invert.46 The AJCA had a limited impact between 2004 and 2007 because of the strong mergers and acquisitions market, but deals slowed down remarkably when the 2008 financial crisis hit.47 The AJCA established that if at least 80% of a company’s former U.S. shareholders maintain ownership after the inversion transaction, it would remain a U.S. domestic corporation for tax purposes.48 Additionally, if between 60% and 80% of a company’s former U.S. shareholders maintain ownership after the inversion transaction, it is subject to U.S. taxes if the company does not have “substantial foreign operations.”49

On September 22, 2014, the Treasury issued Notice 2014–52, detailing regulations intended to make it more difficult for companies to invert.50 The changes affect transactions that occur after September 22, 2014.51 The Treasury’s Notice limits how a corporation can calculate ownership under I.R.C. § 7874.52 For instance, it disallows the inclusion of passive assets53 in calculating the size of the acquiring foreign entity.54 It also disallows the payout of pre-inversion dividends
intended to reduce the size of the U.S. entity.\textsuperscript{55} Therefore, more inverted companies will be treated as if they are domestic for tax purposes.

Other new rules\textsuperscript{56} seek to limit the new foreign parent company’s access to controlled foreign corporation’s (“CFC’s”) cash after an inversion.\textsuperscript{57} The new rules contain amendments to I.R.C. § 956 that consider loans or equity U.S. property.\textsuperscript{58} For example, prior to the recent Treasury regulations, by making loans or investing in the stock of a domestic affiliate, U.S. multinationals were often able to avoid paying taxes on deferred earnings.\textsuperscript{59} Thus, the regulations restrict their ability to avoid paying taxes on deferred earnings so such loans will now be treated as U.S. property and subject to full U.S. tax, just as if the CFC had made a loan directly to the U.S. parent prior to the inversion.\textsuperscript{60}

The Treasury’s press release stated that “[f]or some companies considering mergers, today’s action will mean that inversions no longer make economic sense.”\textsuperscript{61} Since the regulations will apply to inversions that close on or after September 22, 2014, advisors working on pending transactions must evaluate how the new regulations will affect their deal.\textsuperscript{62} In fact, the new regulations have caused several pending inversion deals to fall through, such as AbbVie Inc., an Illinois-based company’s proposed $52 billion merger with Ireland’s Shire PLC.\textsuperscript{63} Similarly, Salix Pharmaceuticals Ltd., a North Carolina-based company, abandoned its planned $2.7 billion dollar merger with Italy’s Cosmo Pharmaceuticals SpA.\textsuperscript{64} While some inversion deals have unraveled since the Treasury’s announcement, with the help of top-notch bankers and attorney advisors, many companies are still proceeding as planned.\textsuperscript{65}

\begin{itemize}
\item \textsuperscript{55} Id.
\item \textsuperscript{56} Rules pertaining to I.R.C. §§ 956, 7701, and 304. NOTICE, supra note 3, at 1.
\item \textsuperscript{57} Id. at 2.
\item \textsuperscript{58} Id. at 21–22.
\item \textsuperscript{59} Id. at 21.
\item \textsuperscript{60} Id. at 21–22.
\item \textsuperscript{61} Press Release, U.S. Dep’t of the Treasury, supra note 20.
\item \textsuperscript{62} Id.
\item \textsuperscript{64} Id.
\item \textsuperscript{65} Gandel, supra note 39.
\end{itemize}
Inversions are incredibly complex tactical strategies that require expertise and substantial capital.66 As Harvard law professor Stephen E. Shay commented, “‘This is an economic game. There are no virgins anywhere.’”67 For example, JP Morgan Chase and Wells Fargo & Co. assisted Burger King in raising $9.5 billion in capital to fund the deal.68 Inverting is expensive because at the time of the transaction, shareholders may be subject to a capital gains tax.69 However, this tax is often offset because the corporation’s stock appreciates due to the lower tax bill and the prospect of future earnings.70 Bankers are profiting from tax inversions in two major ways: (1) service fees from the mergers and acquisitions themselves and (2) capital gain from stock price appreciation.71 Bankers and other advisors are able to capitalize on inversion transactions by purchasing company stock throughout the inversion process.72 They also often contribute to funding the acquisition deals.73 Thus, since they are able to anticipate the stock price appreciation, they can capitalize not only on services they offer but also from speculation.74 Investment banks have earned an estimated $1 billion in service fees from inversion deals over the last three years.75 Goldman Sachs alone has made an estimated $203 million from inversion transactions since 2011.76 JPMorgan Chase, Morgan Stanley, and Citigroup have made an estimated $185, $98, and $72 million,
respectively, since 2011.77

III. CASE STUDIES

Corporate tax inversion transactions were a sizable portion of cross-border mergers and acquisitions, constituting 66% of proposed outbound deals in 2014.78 The total value of inversion deals has already jumped from $152.14 billion in 2013 to $349.37 billion in 2014.79 Some companies planning inversions have taken notice of the Obama Administration’s push for legislation, causing pending deals to fall through.80 For instance, Walgreen Co. and Pfizer recently opted out not to relocate their headquarters to Europe.81 However, other companies are still moving forward as anticipated.82 In December 2014, Burger King acquired Tim Hortons and moved its legal address to Canada.83 Additionally, in early January 2015, Cutrale-Safra Group acquired Chiquita.84 This section highlights how various companies have been impacted by the recent regulations to varying degrees.

A. Walgreen Co. and Alliance Boots

Walgreen’s parent company, Walgreen Co., announced in August 2014, that it was abandoning a plan to change its headquarters from Illinois to Switzerland by acquiring Alliance Boots.85 In weighing its options, Walgreen confirmed that it “undertook an extensive analysis to explore the feasibility of a restructured inversion transaction that would provide the company with the customary level of confidence needed to withstand Internal Revenue Service (IRS) review and...”

77. Id.
78. Raice, supra note 17.
79. Id.
82. McCoy, supra note 4.
83. Team, supra note 31.
84. Heller, supra note 30.
85. Kaufman, supra note 81.
scrutiny.’ 86 Bloomberg estimated that the transaction would have saved Walgreen $4 billion in taxes over the next five years.87 Despite the financial incentives to invert and pressure from investors, Walgreen became concerned about the potential for litigation and consumer backlash.88 Politicians also spoke out against the deal; former Labor Secretary Robert Reich even recommended excluding the company from political lobbying circles.89

Despite its decision not to reincorporate abroad, on December 29, 2014, Walgreen shareholders approved a share purchase to combine the two companies to form “the first global pharmacy-led health and wellbeing enterprise.” 90 The new holding company, Walgreens Boots Alliance Inc., will remain domiciled in the United States.91 Approximately 97% of shareholders voted in favor of the merger but the deal was not free from criticism.92 Dieter Waizenegger, executive director of the CtW Investment Group, expressed concern that there was “inadequate disclosure about the deal’s negotiation, the plans to obtain many touted synergies, and even who will lead Walgreens Boots Alliance.” 93

B. Pfizer and AstraZeneca

Pfizer stirred up concern in Congress because of its massive proposed $122.3 billion merger with AstraZeneca.94 Pfizer, a U.S.-based company, sought to acquire AstraZeneca, a U.K.-based company

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88. Id.
89. Kaufman, supra note 81.
90. Godfrey, supra note 86.
91. Id.
92. Id.
but the deal fell through in late August 2014 after AstraZeneca rejected four separate bids.\textsuperscript{95} Although the deal fell through because of failure to agree on key deal terms, Pfizer’s financial advisors were also concerned the Obama Administration would take action.\textsuperscript{96} Furthermore, there was fierce political opposition from both European and U.S. politicians.\textsuperscript{97} Regardless, Pfizer currently holds $49 billion overseas that would be exempt from U.S. taxation if the company reincorporated abroad.\textsuperscript{98} Ian Read, Pfizer’s Chief Executive Officer, has made it clear he is still interested in lowering the company’s tax bill and is considering acquiring less risky companies, such as Dublin-based Actavis.\textsuperscript{99}

C. Burger King and Tim Hortons

On December 12, 2014, Burger King Worldwide and Tim Hortons merged into Restaurant Brands International Inc., creating the world’s third-largest fast-food restaurant group.\textsuperscript{100} Despite millions of dollars in tax savings, Burger King insists that tax savings did not motivate the deal.\textsuperscript{101} Burger King had several non-tax incentives to acquire Tim Hortons including expanding its international market and increasing menu versatility.\textsuperscript{102} The combined company is projected to have sales totaling $23 billion from over 18,000 restaurants

\textsuperscript{98} Novack & Chen, supra note 94.
\textsuperscript{102} Team, supra note 31, at 3–4.
worldwide. JP Morgan Chase and Wells Fargo & Co. were the financial advisors responsible for raising the $9.5 billion of capital necessary to fund the transaction. Interestingly, Warren Buffett, a supporter of President Obama, contributed $3 billion of preferred equity financing. The transaction will save Burger King an estimated $400 million to $1.2 billion in U.S. taxes in the next three years and each brand will continue to be managed independently.

D. Chiquita Brands International and Cutrale-Safra Group

On October 27, 2014, just three days after rejecting a deal with Dublin-based Fyffes Plc., Chiquita Brands International Inc., a North Carolina-based company, agreed to be purchased by Brazil’s Cutrale Group and Safra Group in a $1.3 billion deal. Chiquita’s financial advisors on the deal were Goldman Sachs Group Inc. and Wells Fargo & Co. The acquirer’s financial advisor was Credit Suisse Group AG. Joseph Safra, the world’s richest banker, contributed to the initial offer.

In addition to future tax savings, Chiquita cited other reasons for the deal including increasing its farming, processing, logistics, distribution, technology, sourcing, and marketing knowledge.

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103. Id. at 1.
104. Id. at 2.
110. Id.
112. Id.
Lonergan, Chiquita’s Chief Executive Officer, stated that the deal “demonstrates our Board’s commitment to maximizing shareholder value and underscores the significant progress Chiquita has achieved over the past couple of years in our financial and operational performance.” The deal closed in early January 2015; shortly thereafter it was announced that Chiquita Brands International would close its corporate headquarters in Charlotte, North Carolina.

IV. THREE CRITICAL ELEMENTS LEGISLATION NEEDS TO INCLUDE TO EFFECTIVELY PREVENT INVERSIONS

In response to the new wave of companies engaging in inversions, numerous anti-inversion legislative proposals have been made, but Congress has yet to pass anti-inversion legislation. Since the Treasury’s regulatory authority is limited, Treasury Secretary Jacob Lew is pressuring Congress to pass legislation. Opponents of anti-inversion legislation argue that comprehensive corporate tax reform is the only solution. However, the argument that comprehensive corporate tax reform is a reason against enacting anti-inversion legislation falls short. Although corporations blame the high corporate tax rate for their desire to invert, corporations have not been paying the official statutory tax rate for decades. For example, between 2008 and 2012, the average federal income tax rate for Fortune 500 companies was just 19.4%.

116. See Young & Costello, supra note 5, at 1.
117. Id. at 3–4.
118. Krugman, supra note 13.
119. Id. (explaining that comprehensive tax reform will likely not occur for a number of years).
tax rate alone will have little effect because other countries will still have lower tax rates, making them tax havens.122

The political climate indicates that the ongoing struggle to implement comprehensive tax reform will not end any time soon.123 Meanwhile, the Joint Commission on Taxation ("JCT") estimates that anti-inversion legislation could save the U.S. tax base $33 billion in the subsequent ten years.124 Although the prospect for imminent legislation is grim, legislative proposals center around three policies that are influencing policymakers as they discuss how to make inversions less economically attractive.125 These policies are: (1) changing the requirements for the size and location of business activity; (2) preventing earnings stripping; and (3) limiting the ability to access untaxed foreign earnings.126 The most effective anti-inversion legislation would include provisions addressing all three.

A. Changing Requirements for the Size and Location of Business Activity Under I.R.C. § 7874

Section 7874 of the Internal Revenue Code ("IRC") was added in 2004 when Congress passed the AJCA in an attempt to eliminate tax benefits for companies that inverted but did not restructure.127 In the Budget, the Obama administration proposed broadening the definition of an inversion under § 7874.128 On May 20, 2014, Senator Levin presented the Stop Corporate Inversions Act of 2014.129 Similar to the Budget proposal, Senator Levin proposed requiring foreign shareholders to own at least 50% of the combined company, an increase from the

122. Id.
125. Young & Costello, supra note 5, at 1.
126. Id.
20% currently required. Additionally, the company would be subject to U.S. taxes if the combined company has “substantial business activities” in the United States or is primarily managed or controlled in the United States and either 25% of its employees, sales, or assets are located in the United States.

Increasing the number of required foreign shareholders to 50% would impact many pending deals, since most involve larger U.S. companies hoping to merge with smaller foreign companies. The increased percentage ownership requirement should be implemented because it is a more accurate measure of the legislative intent, which is to target companies inverting solely to escape paying U.S. taxes. President Obama stated that “There is no policy reason to permit a domestic entity to engage in an inversion transaction when its owners retain a controlling interest in the resulting entity, only minimal operational changes are expected, and there is significant potential for substantial erosion of the U.S. tax base.” Furthermore, Secretary Lew brought to light that many of the corporations practicing inversion still receive all of the privileges of doing business with the United States, only with a less substantial tax burden. This free-riding problem raises concerns regarding ethics and fairness. The newly merged foreign company still has the same access to the U.S. legal system, educational institutions, research-and-development capabilities, entrepreneurial culture, infrastructure, and skilled workforce, as does a U.S-based company paying U.S. taxes. The United States relies on its taxpayers, most importantly its corporations, to fund vital components of its society. To allow corporations to dodge this

130. Id.; Budget, supra note 9.
136. Id.
137. Id.
responsibility sends a message to the public that tax avoidance is an acceptable practice that will be tolerated.

Increasing the number of required foreign shareholders to 50% makes intuitive sense; if the majority of shareholders are located in the United States and the company engages in most of its business there, a company should not be formally located elsewhere. While these proposed changes will not completely stop inversions, they will affect many of the U.S. companies “masquerading” as foreign entities.138 Furthermore, if these changes are made, the JCT estimates $33 billion in additional tax revenue over the next ten years.139

B. Preventing Earnings Stripping Under I.R.C. § 163(j)

An inverted company may employ “earnings stripping” to reduce its overall taxable income in the United States.140 The essence of this strategy is shifting income-producing activities to the foreign parent company and transferring debt to the U.S. subsidiary.141 Often, the foreign parent company will lend money to its U.S. subsidiary.142 Any interest paid by the U.S. subsidiary on the loan can then be deducted from its profits to reduce its overall taxable income.143 For instance, if the foreign parent company loans its U.S. subsidiary $10 million at 10% interest, the U.S. subsidiary can “strip” $1 million from its taxable income.144

The Budget145 and three recent legislative proposals discussed in this Note include some form of earning stripping restrictions.146 These proposals are Congressman Levin’s discussion draft, “Stop Corporate

138. Id.
139. Barthold, supra note 124.
140. Mann, supra note 19, at 531.
143. Mann, supra note 19, at 531.
144. Id.
145. Budget, supra note 9.
Earnings Stripping Act” released on July 31, 2014, and the “Tax Reform Act of 2014” proposed by House Ways and Means Chairman Dave Camp as a comprehensive tax reform plan.\textsuperscript{147} Current law limits all companies from deducting more than 50\% of their adjusted taxable income through interest payment deductions.\textsuperscript{148} The Budget and Levin’s proposal will reduce the limit to 25\%.\textsuperscript{149} President Obama set forth the framework for Levin’s proposed legislation, though his proposal is not quite as far-reaching because it applies to only inverted companies as opposed to all corporations.\textsuperscript{150} Camp’s proposal will apply to all corporations, but is less restrictive in terms of the percentage of deductions that corporations may take, limiting deductions to 40\% of adjusted taxable income.\textsuperscript{151} The JCT estimated that Camp’s changes would raise $2.6 billion from corporate income tax revenue over the next decade.\textsuperscript{152}

Limiting a corporation’s ability to take interest deductions will certainly make inverting less appealing, but policymakers need to explore how easily these limitations can be implemented and enforced. For instance, if legislation is applicable to only “inverted” companies, then the question arises as to how to determine if a company is inverted. Burger King’s merger with Tim Horton’s exemplifies how unclear it can be to determine what transactions constitute inversions.\textsuperscript{153} Thus, there should be tighter limits on the amount of debt U.S. entities of multinationals may take.

C. Limiting the Ability to Access Untaxed Foreign Earnings under I.R.C. § 956

Under the U.S. tax code, foreign earnings of U.S. companies are taxed; however, U.S. multinationals do not owe U.S. tax on the profits

\textsuperscript{147} Id.

\textsuperscript{148} I.R.C. § 163(j) (2014).

\textsuperscript{149} Budget, supra note 9, at 65 (2014); Young & Costello, supra note 5.

\textsuperscript{150} Budget, supra note 9, at 65 (2014); Young & Costello, supra note 5.

\textsuperscript{151} Tax Reform Act of 2014, 113th Cong. § 3704 (Discussion Draft Feb. 21, 2014).

\textsuperscript{152} Brumbaugh, supra note 142, at 8.

\textsuperscript{153} See Anupreeta Das & Liz Hoffman, Berkshire, Burger King Deal Draws Criticism over Taxes, WALL ST. J. (Aug. 26, 2014), http://online.wsj.com/articles/berkshire-to-pay-u-s-tax-rate-on-burger-king-investment-1409057047 (stating Burger King executives said the deal was motivated by growth opportunities yet legislators and the Obama administration condemned the deal as an inversion).
of their CFCs until those profits are repatriated to the U.S. parent firm, typically in the form of a dividend.\textsuperscript{154} “Deferred earnings” are foreign profits that have not yet been repatriated.\textsuperscript{155} If a CFC tries to avoid this taxation by investing the deferred earnings in certain U.S. property—such as making loans or investing in the U.S. parent company—the U.S. parent company is treated as if it received a taxable dividend from the CFC and the transaction is subject to U.S. taxes.\textsuperscript{156} However, to skirt this provision, some inverted companies have the CFC make a loan to the new foreign parent company, instead of its former U.S. parent.\textsuperscript{157} This is referred to as a “hopscotch loan.”\textsuperscript{158} A hopscotch loan “is not currently considered U.S. property and is therefore not taxed as a dividend.”\textsuperscript{159}

Congressman Levin’s “Stop Corporate Earnings Stripping Act” seeks to prevent inverted companies from accessing untaxed foreign cash through hopscotch loans by expanding the definition of “foreign group property.”\textsuperscript{160} The proposed new definition is “any stock or obligation of any foreign person which is not a controlled foreign corporation.”\textsuperscript{161} The proposal would be highly effective because it would remove a pivotal reason to invert—escaping the dividend tax.\textsuperscript{162} However, it may also discourage multinational corporations from bringing profits back to the United States. Additionally, the proposed change would have a broad effect because it would apply retroactively to all inverted corporations, not just companies that have recently inverted.\textsuperscript{163}

U.S. corporations currently hold 20\% of profits offshore and these practices cost the government one-third of its expected tax

\textsuperscript{154} Press Release, U.S. Dep’t of the Treasury, supra note 20.
\textsuperscript{155} Id.
\textsuperscript{156} Id.
\textsuperscript{157} Id.
\textsuperscript{158} Id.
\textsuperscript{159} Id.
\textsuperscript{161} Id. (internal quotation marks omitted).
\textsuperscript{163} Cope, supra note 161.
If access to untaxed foreign cash is not limited, there is a strong likelihood that those profits will escape U.S. taxation, costing the government billions of dollars. While this proposal may not disincentivize U.S. companies from moving cash offshore, it will certainly disincentivize U.S. companies from inverting.

V. CONCLUSION

With the attention of the media, the White House, the Treasury, and the IRS, the debate over corporate inversions is front and center. Financial advisors must be prepared for the issuance of further rules and regulations that target tax inversions. Ultimately, the United States should adopt a territorial tax system and lower the corporate tax rate to effectively prevent U.S. corporations from inverting.

A. Uncertain Political Climate and Resulting Impact on Client Interaction

Since the Treasury announced new regulations, Wall Street dealmakers have noticed a reduction in the number of companies seeking to invert. Chris Ventresca, the Co-Head of Global Mergers and Acquisitions at JPMorgan Chase, stated “Uncertainty plays big in any M&A deal and the new rules are adding to it.” Although inverting is still legal, financial advisors must be careful to disclose all material risks of inverting to its clients.

Since each client’s priorities and values are different, there is certainly no correct answer about whether to invert. Clients should be made aware of the Treasury’s intention to issue further regulations, such as regulations that will modify earnings stripping rules under I.R.C. § 163(j). Clients should also know the prospect of potential legislation

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164. Eskow, supra note 120.
168. Id. (describing how Fortune magazine criticized inversion deals as “positively un-American tax dodges” and described inverted companies as “corporate deserters”).
and how that could affect inversion deals. Advisors should consider the possibility of adding contingencies in agreements that would allow their clients to back out of deals if Congress passes regulatory legislation. Furthermore, they should advise clients to consider the risk of negative publicity.169

B. Long-term Solution: Adopting a Territorial System and Lowering the Corporate Tax Rate

The United States should adopt a territorial tax system and lower the corporate tax rate to effectively thwart inversions. The recent wave of inversions indicates that the U.S. corporate tax rate has become severely uncompetitive.170 The United States has one of the highest corporate tax rates among the thirty-four members of the OECD.171 In 1986, the United States took the lead by slashing its corporate tax rate from 46% to 34%, but many countries have since lowered their corporate tax rates even further.172 Specifically, cutting the corporate tax rate from 35% will reduce the incentive for earnings stripping.173 Furthermore, if the corporate tax rate were lowered from its current percentage, U.S. companies would be at less of a competitive disadvantage.174

The current tax system discourages U.S. companies from returning profits to the United States.175 The United States is an outlier among developed countries by utilizing a worldwide tax system that imposes a tax on foreign earnings once repatriated at a potential rate of 35%.176 It is estimated that U.S. companies are holding nearly $1.7 trillion in profits offshore.177 A territorial tax system would remove a

169. Id.
171. How to Stop the Inversion Perversion, supra note 2.
172. De Rugy, supra note 170.
173. Id.
175. How to Stop the Inversion Perversion, supra note 2.
176. Twenty-eight out of the thirty-four countries in the Organization for Economic Co-operation and Development utilize a “territorial” tax system. Politi, supra note 27.
177. Id.
key incentive for U.S. multinationals to keep foreign profits offshore, allowing profits to be reinvested domestically.\textsuperscript{178} Politicians are concerned that without safeguards against moving profits to foreign countries, paying the U.S. corporate tax could become elective.\textsuperscript{179} However, U.S. corporations are already obtaining the benefits of a territorial system by accessing untaxed foreign cash after inverting.\textsuperscript{180} The worldwide tax system discourages investment into the United States, placing an undue burden on the economy.\textsuperscript{181} The U.S. tax system was implemented long before the technological advances that have made global economies so interconnected.\textsuperscript{182} Canada, Japan, and the U.K. are among those nations that have recently reformed their tax systems to improve their economic performance in response to globalization.\textsuperscript{183} The U.S. tax code has not been significantly reformed since 1986.\textsuperscript{184} The United States must prioritize revamping the tax code in order to foster economic growth and maximize the competitiveness of American companies.\textsuperscript{185} There is growing bipartisan support for reforming our current system to make the United States a more attractive place to do business and invest.\textsuperscript{186} During tax reform discussions, politicians should seriously consider joining the majority of the developed world by adopting a territorial system and reducing the corporate tax rate.

Sarah A. Wahl

\textsuperscript{178} Id.
\textsuperscript{180} Id.
\textsuperscript{181} How to Stop the Inversion Perversion, supra note 2.
\textsuperscript{183} Id.
\textsuperscript{184} Just the Facts: The Case for International Tax Reform, supra note 182.