The University of the Pacific Law Review

Volume 47
Issue 2 *Symposium: The Promise and Perils of an International Law of Property*

Article 16

1-1-2016

Corporate Tax Inversions: Battling the "Corporate Benedict Arnolds" by Means of Analogizing to an Individual Taxing Regime

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Corporate Tax Inversions: Battling the "Corporate Benedict Arnolds" by Means of Analogizing to an Individual Taxing Regime

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I. INTRODUCTION

Corporate tax inversions are a common form of tax avoidance whereby U.S. companies incorporate in a new country and do not have to pay U.S. taxes on all

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of their income.[1] Fruit of the Loom, Jazz Pharmaceuticals, and Burger King are a few of the many companies that have taken advantage of tax inversions.[2] Legislation in 2004 only remedied part of the problem.[3] The number of large companies taking advantage of this form of tax reduction has magnified the issue in the public eye.[4]

In 1998, Fruit of the Loom was one of the first companies to take advantage of tax inversions.[5] The company moved its financial base to the Cayman Islands.[6] At the time, the Kentucky-based company faced serious financial problems and used the Cayman Islands' lack of corporate income tax as an advantageous way to save the company.[7] Although unsuccessful, moving to the Cayman Islands, allowed Fruit of the Loom to continue its control and operations in the United States while still avoiding U.S. income tax.[8]

Jazz Pharmaceuticals also took advantage of this tax loophole.[9] Jazz Pharmaceuticals merged with Azur Pharma, a privately held pharmaceutical company headquartered in Ireland.[10] Pharmaceutical company mergers and acquisitions make up a large number of inversions in the United States.[11] Following the Patent Cliff Era,[12] companies are using tax inversions in their

1. *Definition of Tax Inversion*, FIN. TIMES, http://lexicon.ft.com/Term?term=tax-inversion (last visited June 22, 2015) (on file with *The University of the Pacific Law Review*).

2. *Grassley Highlights Corporate Loophole Closers in New Tax Bill*, U.S. SEN. COMM. ON FIN. (June 22, 2015), http://www.finance.senate.gov/newsroom/chairman/release/?id=0226539a-1c0d-4b69-96e3-5094c8 923f32 (on file with *The University of the Pacific Law Review*); David Ingold et al., *Corporate Expatriates: See the Data*, TRACKING TAX RUNAWAYS (Sept. 18, 2014), http://www.bloomberg.com/infographics/2014-09-18/tax-runaways-tracking-inversions.html (on file with *The University of the Pacific Law Review*).

3. DONALD J. MARPLES & JANE G. GRAVELLE, CORPORATE EXPATRIATION, INVERSIONS, AND MERGERS: TAX ISSUES 6 (2015).

4. Zachary R. Mider, *Tax Inversion How U.S. Companies Buy Tax Breaks*, BLOOMBERG QUICKTAKE (Oct. 24, 2014), http://www.bloombergview.com/quicktake/tax-inversion (on file with *The University of the Pacific Law Review*); U.S. SEN. COMM. ON FINANCE, *supra* note 2.

5. Amanda Vincent, *Ex-Fruit of the Loom CEO Defends Company's Move*, DAILY NEWS (Mar. 19, 2012), http://www.bgdailynews.com/ex-fruit-of-the-loom-ceo-defends-company-s-move/article_3d87088e-3b14-5c6b-a135-546b1b9fdc22.html?mode=jqm (on file with *The University of the Pacific Law Review*); *Fruit of the Loom to Lay Off 5,100 Workers at 7 Plants*, N.Y. TIMES (Aug. 8, 1997), http://www.nytimes.com/1997/08/08/business/fruit-of-the-loom-to-lay-off-5100-workers-at-7-plants.html (on file with *The University of the Pacific Law Review*).

6. Vincent, *supra* note 5, *Fruit of the Loom to Lay Off 5,100 Workers at 7 Plants*, *supra* note 5.

7. Vincent, *supra* note 5.

8. *Id.*; *Fruit of the Loom & Corporate Taxes*, WARRENBUFFETT.COM (Sept. 16, 2014), http://www.warren buffett.com/fruit-of-the-loom-corporate-taxes/ (on file with *The University of the Pacific Law Review*).

9. *Jazz Pharmaceuticals and Azur Pharma Agree to Combine to Form Jazz Pharmaceuticals plc*, PR NEWSWIRE, http://www.prnewswire.com/news-releases/jazz-pharmaceuticals-and-azur-pharma-agree-to-combine-to-form-jazz-pharmaceuticals-plc-130140748.html (last visited Feb. 1, 2015) (on file with *The University of the Pacific Law Review*).

10. *Id.*

11. Katie Thomas, *Generic Drug Makers See a Drought Ahead*, N.Y. TIMES (Dec. 3, 2012), http://www.nytimes.com/2012/12/04/business/generic-drug-makers-facing-squeeze-on-revenue.html?page wanted=all (on file with *The University of the Pacific Law Review*).

12. The "Patent Cliff Era" is a time period when established products lose their patents, which allows these products to be replicated by generic brands and sold at cheaper prices. 2012–2014 is seen as a Patent Cliff

pursuit of profit.[13] Recent attempts at merging the U.S.-based drug maker Pfizer and United Kingdom-based AstraZeneca failed.[14] There is, however, speculation that the deal might go through in the future depending on the tax inversion solution that will be enacted.[15]

The most recent and most notorious inversion was the merger between Burger King and Tim Hortons.[16] In August 2014, the companies discussed a merger. Tim Hortons and Burger King decided to merge and set up their headquarters in Ontario, Canada in order to take advantage of the tax inversion strategy.[17] Canada uses a territorial tax system, taxing only domestically produced income.[18] Burger King's reincorporation would save the company a large sum of money by creating access to foreign profits that were previously subject to U.S. tax.[19] With so many U.S. companies reincorporating in foreign countries to lower U.S. income tax, the United States must develop a tax strategy to deter corporations from expatriating.[20] Analogizing Section 877 of the Internal Revenue Code—a tax on individual expatriates—to corporations will deter corporations from expatriating.[21]

Part II of this Comment will examine the taxing structure and history of tax inversions.[22] It will demonstrate the tax inversion advantages and why companies would naturally be inclined to seek a lower tax rate.[23] This Comment will

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Era. Therefore, pharmaceutical companies are utilizing all business strategies to increase revenue including mergers and acquisitions. *Id.*

13. Richard Rubin et al., *Pfizer Seeking Inversions Shows Companies Unfazed by Lew*, BLOOMBERG (Sept. 24, 2014), http://www.bloomberg.com/news/2014-09-24/pfizer-pursuing-inversions-shows-companies-undeterred-by-lew.html (on file with *The University of the Pacific Law Review*).

14. Arash Massoudi et al., *Pfizer's AstraZeneca Pursuit Knocked by Shire Deal Collapse*, PHARMACEUTICALS (Oct. 17, 2014), http://www.ft.com/intl/cms/s/0/d4581c70-563c-11e4-bbd6-00144feab7de.html#axzz3QWxASzO1 (on file with *The University of the Pacific Law Review*).

15. *Id.*

16. *Long-awaited Burger King-Tim Hortons Merger Completed Analyst Blog*, NASDAQ (Dec. 15, 2014), http://www.nasdaq.com/article/long-awaited-burger-king-tim-hortons-merger-completed-analyst-blog-cm423414 (on file with *The University of the Pacific Law Review*). Tim Hortons is a quick-serve coffee and doughnut giant headquartered in Canada. Judy McKinnon, *Tim Hortons Profit Dips on Proposed Merger Costs Adjusted Results Beat Expectations*, WALL ST. J. (Nov. 5, 2014), http://online.wsj.com/articles/tim-hortons-profit-dips-on-costs-related-to-proposed-merger-with-burger-king-1415200313?KEYWORDS=tim+hortons (on file with *The University of the Pacific Law Review*); Trefis Team, *Burger King–Tim Hortons Cross-Border Merger Much More Than Tax Inversion*, FORBES (Aug. 29, 2014), http://www.forbes.com/sites/great speculations/2014/08/29/burger-king-tim-hortons-cross-border-merger-much-more-than-tax-inversion/ (on file with *The University of the Pacific Law Review*).

17. *See supra* note 16.

18. *Burger King–Tim Hortons Cross-Border Merger Much More Than Tax Inversion*, *supra* note 16; *Territorial vs. Worldwide Taxation*, SEN. REPUBLICAN POL'Y COMM. (Sept. 19, 2012), http://www.rpc.senate.gov/policy-papers/territorial-vs-worldwide-taxation (on file with *The University of the Pacific Law Review*).

19. Trefis Team, *supra* note 16.

20. MARPLES & GRAVELLE, *supra* note 3, at 1.

21. *See id.* at 11 (suggesting that a change in corporate taxation may motivate corporations to stay in the United States).

22. *Infra* Part II.A.

23. *Id.*

describe the different types of inversions and the various corporate structures available through inversions.[24] Part II will also discuss the U.S. federal government's attempt to solve the problem in 2004 and its repercussions,[25] as well as the government's current proposal.[26] Part III of this Comment will examine a solution that was used to prevent individuals from expatriating and analogize it to show its effectiveness when applied to corporations.[27] Part IV will show that the 1966 version of the Expatriate Act would be more effective to tax corporations' U.S. income than the current amended version of the Act.[28] Finally, Part V recommends and reiterates that the U.S. government should implement Internal Revenue Code Section 877—the Expatriate Act—on corporations as a solution.[29]

II. BACKGROUND

In order to understand why companies utilize tax inversions, one must understand the taxing structure the United States employs in comparison to other countries. Section A discusses the current taxing structure in the United States.[30] Section B describes the types of inversions companies employ.[31] Section C discusses an attempted solution in 2004 to one forms of inversions.[32] Sections D and E describe proposed solutions by President Barack Obama.[33]

A. Taxing Structure of the United States

Unlike most other countries, the United States has a worldwide tax system.[34] Therefore, a U.S. company is taxed on all its income, both within and outside the United States, at rates up to thirty-five percent.[35] Many countries only tax corporations on domestically derived profits in the form of a territorial tax.[36] Territorial tax obligates a corporation to pay taxes on domestic income and

24. *Infra* Part II.B.
25. *Infra* Part II.C.
26. *Infra* Part II.D.
27. *Infra* Part III.A–B.
28. *Infra* Part IV.A–B.
29. *Infra* Part V.
30. *Infra* Part I.A.
31. *Infra* Part I.B.
32. *Infra* Part I.C.
33. *Infra* Part I.D–E.
34. MARPLES & GRAVELLE, *supra* note 3, at 12. A worldwide tax system means that income is taxed at the U.S. rate no matter where the income is generated—at home or abroad. *Id.*
35. *Id.* at 2. Countries such as the Cayman Islands, Ireland, and Canada have average corporate tax rates of zero percent, 12.5 percent, and 26.5 percent respectively. *Corporate Tax Rates Table*, KPMG, http://www.kpmg.com/global/en/services/tax/tax-tools-and-resources/pages/corporate-tax-rates-table.aspx (last visited Nov. 6, 2014) (on file with *The University of the Pacific Law Review*).
36. SEN. REPUBLICAN POL'Y COMM., *supra* note 18.

exempts it from paying taxes on foreign income.[37] Furthermore, the United States taxes its corporations at over thirty-five percent—one of the highest rates in the world.[38] Judge Learned Hand expressed, "[a]nyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one's taxes."[39] Naturally, companies will relocate to a country that taxes corporations at a lower rate and that only taxes domestic profits.[40] A corporation is naturally inclined to take advantage of this tax strategy by restructuring so that the parent corporation is a foreign entity.[41] Tax inversions are simply the process of relocating a company to another country for the tax benefits.[42]

Many criticize this move as unpatriotic, but from a business perspective, it would be foolish not to reincorporate—failing to do so may forgo the opportunity for business growth and maximization of profits.[43] Corporate officials are not to blame for the United States' loss of corporate tax; rather, the loss is because of the inherent flaw in the tax structure.[44] The corporate tax rate of more than "twice the average rate in Europe" and worldwide income taxes are to blame for U.S. corporations leaving the country.[45] Revamping the entire corporate tax structure may be impossible and any drastic changes may not completely solve the problem.[46] Congress must create a quick and effective solution to keep corporations from leaving the United States. Tax inversions create concerns of an "erosion of the U.S. tax base, a cost advantage for foreign-controlled companies, and a reduction in perceived fairness of the [U.S.] tax system."[47]

B. Types of Tax Inversions

There are three distinct ways a company can change its residence to take advantage of another nations' more favorable tax structure.[48] The first type of inversion is a "naked" inversion,[49] which occurs when a corporation has

37. *Id.*

38. Ingold et al., *supra* note 2.

39. N. Gregory Mankiw, *One Way to Fix the Corporate Tax: Repeal It*, N.Y. TIMES (Aug. 23, 2014), http://www.nytimes.com/2014/08/24/upshot/one-way-to-fix-the-corporate-tax-repeal- it.html?_r=1&abt=0002&abg=0 (on file with *The University of the Pacific Law Review*).

40. MARPLES & GRAVELLE, *supra* note 3, at 3.

41. James Mann, Note, *Corporate Inversions: A Symptom of a Larger Problem, the Corporate Income Tax*, 78 S. CAL. L. REV. 521, 524 (2004).

42. *Id.*

43. Mankiw, *supra* note 39.

44. *Id.*

45. *Id.*; MARPLES & GRAVELLE, *supra* note 3, at 12.

46. MARPLES & GRAVELLE, *supra* note 3, at 11–13.

47. *Id.* at 6.

48. *Id.* at 4.

49. *Id.* at 3.

substantial business in a foreign country that allows it to create a foreign subsidiary.[50] Through the exchange of stocks, the foreign corporation now has a U.S. subsidiary.[51] This type of inversion is particularly advantageous because it does not require the company to alter the corporation's control center.[52]

The second type of inversion occurs when a larger foreign corporation acquires a U.S. corporation.[53] Such an acquisition allows the company to increase its international business and lower its taxes.[54] Once the U.S. shareholders own a minority share of the company, the merger allows the company to be controlled outside of U.S. borders.[55] Controlling the company outside of U.S. borders limits its tax responsibility to profits made in the United States because the U.S. Government does not tax international profits.[56]

Finally, the last type of inversion occurs when a U.S. corporation acquires a smaller foreign company.[57] This allows the company to increase its foreign operations while continuing to control the foreign company within the United States.[58]

Inversions do not avoid taxation by the U.S. government, but they reduce the company's taxable income to income that is generated within the United States—the remaining income is left untouched by the U.S. government.[59] As a result, different companies utilize the different forms of inversions in order to maximize their profits and follow the structure they find most advantageous.[60]

C. Attempted Solution to Tax Inversions: 2004

In 2002, the Treasury Department realized that tax savings were the primary goal of inversions. In response, it implemented the American Jobs Creation Action of 2004 (AJCA), which created two alternative taxing regimes applicable to corporate tax inversions.[61] Under the first regime, an inverted foreign company is treated as a domestic corporation if at least eighty percent of the former company's stockholders own it.[62] In other words, if an inversion occurred where a

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50. *Id.* at 3–4.
51. *Id.*
52. MARPLES & GRAVELLE*, supra* note 3, at 4.
53. *Id.*
54. *Id.*
55. *Id.*
56. Mider, *supra* note 4; *Grassley Highlights Corporate Loophole Closers in New Tax Bill*, *supra* note 2.
57. MARPLES & GRAVELLE, *supra* note 3, at 4.
58. *Id.*
59. Mider, *supra* note 4.
60. *See* MARPLES & GRAVELLE, *supra* note 3 (describing the reasons behind each type of inversion and the benefits for particular types of corporations).
61. AMERICAN JOBS CREATION ACT OF 2004, 108 Pub. L. No. 357, 118 Stat. 1418 (2004); MARPLES & GRAVELLE, *supra* note 3, at 5–6.
62. AMERICAN JOBS CREATION ACT OF 2004; MARPLES & GRAVELLE, *supra* note 3, at 5–6.

U.S. corporation acquired a smaller foreign corporation making up less than twenty percent of its company, it is not considered a foreign corporation for tax purposes, and, therefore, will not benefit from the reincorporation.[63] The second regime applies "if there is at least sixty percent continuity of ownership but less than eighty percent."[64] In this situation, the new foreign company is not taxed like a domestic company, but rather, any gains that would apply to the transfer cannot not offset the net operating losses or foreign tax credits.[65] This change, however, did not apply to corporations that had "substantial economic activity in the foreign country."[66] The Internal Revenue Service increased this safe harbor for what was considered substantial business from ten percent to twenty-five percent.[67]

The AJCA successfully reduced naked inversions.[68] By treating a corporation as domestic under the two alternative tax regimes and increasing the safe harbor, the AJCA only prevented companies from inverting by exchanging stock with a foreign subsidiary in a foreign country.[69] However, a corporation could still shift its headquarters and retain control in the United States if there were substantial economic operations in the foreign country.[70] The AJCA did not deter U.S. corporations from acquiring larger foreign corporations or from merging with smaller foreign corporations making up more than twenty percent of the resulting companies—the latter two types of inversions.[71] As a result, corporate inversions continued despite the legislative action and, this time, in countries where a substantial part of the corporation's business existed and in countries where the tax was territorial or lower in rate.[72]

D. The Proposed 2012 Presidential Solution

In 2012, the Treasury Department and the Internal Revenue Service intended to change the regulatory scheme, thereby making it more difficult to invert and to reduce the tax benefits of corporate inversions.[73] President Barack Obama included five elements in his business tax reform plan: (1) eliminate tax loopholes and lower the corporate tax rate to spur growth in America; (2) strengthen manufacturing and development in America; (3) create incentives for

63. AMERICAN JOBS CREATION ACT OF 2004; MARPLES & GRAVELLE, *supra* note 3, at 5–6.
64. AMERICAN JOBS CREATION ACT OF 2004; MARPLES & GRAVELLE, *supra* note 3, at 5–6.
65. MARPLES & GRAVELLE, *supra* note 3, at 6.
66. *Id.*
67. *Id.* at 7.
68. *Id.* at 6.
69. *Id.*
70. *Id.*
71. *Id.*
72. *Id.* at 6–7.
73. WHITE HOUSE & DEP'T OF THE TREASURY, THE PRESIDENT'S FRAMEWORK FOR BUSINESS TAX REFORM: A JOINT REPORT BY THE WHITE HOUSE AND THE DEPARTMENT OF THE TREASURY 1 (2012).

corporations to remain in the United States, such as "a new minimum tax on foreign earnings," which would reinforce the international tax system; (4) make tax filing easier so that businesses can focus on growth rather than corporate taxes; and (5) rebuild fiscal responsibility by fully paying for the temporary tax provisions.[74]

The Treasury believes that the U.S. corporate tax structure contains "greater tax expenditures and loopholes in exchange for a higher statutory tax rate" in comparison to other countries.[75] To achieve the president's goals, the Treasury Department believes that there should be a reduction in the corporate statutory rate from thirty-five percent to twenty-eight percent.[76] The belief is that a broader taxing base and a lower rate will encourage investment in the United States and will reduce the incentive for companies to move their operations to other countries.[77] The Treasury argues this change will place the United States in line with other countries to help encourage investment in the United States.[78] In addition, the Treasury wants to reduce the number of loopholes in the tax structure so that a lower tax rate can be sustained.[79]

These new regulations would make it more difficult for former U.S. companies to reincorporate, because the new test for determining "whether the former owners of the U.S. company own less than eighty percent" will: (1) not allow companies to consider passive assets when computing and evading the eighty percent rule;[80] and (2) not consider any extraordinary dividends paid by the U.S. company in order to reduce its size before the reincorporation and prevent the use of "spinversions" to evade anti-inversion regulations.[81]

A corporate tax rate of twenty-eight percent is further reduced by deducting manufacturing costs.[82] And, a tax credit would be easier to compute—a rate of seventeen percent—and it would be more attractive for businesses.[83] Furthermore, the new regulatory scheme would also create tax incentives for clear and renewable energy.[84] To encourage domestic investment, President

74. *Id.*

75. *Id.* at 3–4.

76. *Id.* at 9.

77. *Id.*

78. *Id.*

79. *Id.* at 9–10.

80. *IRS Issues New Anti-inversion Rules*, PRACTICAL LAW CO. (Sept. 23, 2014), http://us.practicallaw.com/2-582-2266?q=&qp=&qo=&qe= (on file with *The University of the Pacific Law Review*). A passive asset is an "asset other than an asset used in carrying on a trade or business." I.R.C. § 6166(9)(B).

81. *IRS Issues New Anti-inversion Rules*, *supra* note 80, at 1. A spinversion allows a larger company to create one line of business to its shareholders using a separate entity that, by itself, would move offshore through a merger with a non-U.S. partner. It is called a spinversion because it only involves part of a business rather than the whole company. Bernie Pistillo et al., *The Inversion Craze: Will Today's Routine Tax Planning Be Retroactively Outlawed?*, MORRISON FOERSTER ATTORNEY ADVERTISING, July 21, 2014, at 1.

82. WHITE HOUSE & DEP'T OF THE TREASURY, *supra* note 73, at 12.

83. *Id.*

84. *Id.*

Obama proposed a new minimum tax on foreign earnings and reduced tax deductions for sending jobs overseas.[85] These policy changes could deter companies from leaving the United States.[86]

Through this reform, President Obama would like to lower taxes for small businesses and, therefore, promote small business incorporation in the United States.[87] This plan would include double deductions for start-up costs and allow for more business expense write-offs in the amount of qualified expense investments.[88]

Finally, President Obama cautions that this tax reform must restore fiscal responsibility.[89] He asserts that the current state of the federal budget is "unsustainable."[90] The program must sustain itself and not add to the federal deficit.[91]

E. Another Proposed Presidential Solution

In February 2015, President Obama announced that he wanted U.S. companies to pay taxes on overseas earnings that remain overseas.[92] Companies pay taxes on income when the income is brought into the United States.[93] U.S. corporations that keep their profits overseas do not pay taxes on those profits.[94] However, they may not bring those funds into the United States and reinvest them.[95] The president's proposal would tax those foreign-kept profits at fourteen percent, but the companies could reinvest the funds inside the United States without paying more taxes.[96]

While keeping funds outside of the United States is not an inversion, the president's proposal could affect corporate inversions.[97] Corporations might find

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85. *Id.* at 14.
86. *Id.*
87. *Id.* at 16.
88. *Id.* at 17.
89. *Id.* at 18.
90. *Id.*
91. *Id.*
92. Nick Timiraos & John D. McKinnon, *Obama Proposes One–Time 14% Tax on Overseas Earnings*, WALL ST. J. (Feb. 2, 2015), http://www.wsj.com/articles/obama-proposes-one-time-14-tax-on-overseas-earnings-1422802103?tesla=y&mod=WSJ_hp_LEFTTopStories&utm_source=Sailthru&utm_medium=email&utm_term=*Situation%20Report&utm_campaign=Sit%20Rep%20February%202%202015 (on file with *The University of the Pacific Law Review*). The president wants U.S. companies to pay fourteen percent on the approximately two trillion dollars of overseas funds that companies keep offshores. This would raise money to boost infrastructure spending. *Id.*
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.*
97. Alanna Petroff, *Offshore Corporate Cash Piles at Risk from Obama Tax Plan*, CNN MONEY (Feb. 2, 2015), http://money.cnn.com/2015/02/02/news/companies/obama-tax-offshore-profits-apple/ (on file with *The University of the Pacific Law Review*).

themselves paying lower taxes because they can bring foreign profits back to the United States and not have to pay the thirty-five percent corporate tax rate.[98] However, it may still be more advantageous to incorporate offshore where most overseas profits will not be taxed.[99] Furthermore, large corporations may still choose not to bring offshore profits back to the United States, which would make the president's taxing proposal unsuccessful.[100]

III. THE SIMPLE SOLUTION TO THE GROWING PROBLEM

Eliminating the corporate tax, changing the "substantial part" safe harbor limits, or altering worldwide tax in other forms may prove arduous in its implementation.[101] Countries such as the Cayman Islands, Bermuda, and the Bahamas have no corporate tax.[102] Furthermore, Republicans and Democrats in Congress would not agree on a drastic corporate tax change.[103] The method to fix tax inversions must not be a revision or a complete change in tax rates.[104] While corporations and individuals are taxed at different rates and forms, a solution to tax inversions is to emulate the Expatriate Act tax and apply it to corporations.[105] This would overcome the concern that a new tax reform would increase the federal deficit, among other problems.[106] Since the Expatriate Act taxing scheme was implemented in 1966, it would not be a radical change.[107] While this ongoing problem necessitates an immediate response, any regulation or reform must not drastically change the way corporations are taxed.[108] The Expatriate Act, a preexisting and tested taxation scheme, should be implemented to prevent tax inversions.[109]

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98. *See id.* (suggesting the benefits in brining foreign earnings back to the United States).

99. Frank Clement, *Obama's Plan to Address Corporate Tax Offshore Profits Is 'Not Nearly Enough*,' HUFF POST POLITICS (Feb. 2, 2015), http://www.huffingtonpost.com/frank-clemente/obamas-plan-to-address-co_ b_6600566.html (on file with *The University of the Pacific Law Review*).

100. *Id.*

101. Mider, *supra* note 4.

102. *See supra* note 33.

103. Mider, *supra* note 4.

104. *Id.*

105. *See* William L. Dentino & Christine Manolakas, *The Exit Tax: A Move in the Right Direction*, 3 WM. & MARY BUS. L. REV. 341, 347 (2012) (describing the taxing regime on individuals as a move in the right direction to incentivize individuals to stay in the United States).

106. WHITE HOUSE & DEP'T OF THE TREASURY, *supra* note 73, at 18.

107. *Id.*

108. Ingold et al., *supra* note 2.

109. *See* Dentino & Manolakas, *supra* note 105, at 347 (demonstrating the amended Expatriate Act has been successful in deterring individuals from expatriating).

A. The Expatriate Act of 1966

The United States first taxed nonresident U.S. citizens in order to fund the American Civil War.[110] While this tax regime expired in 1872, it was reintroduced in the Income Tax Act of 1894.[111] The rationale was that wealthy, nonresident U.S. citizens should not escape the U.S. income tax.[112] Unfortunately, this nonresident taxing scheme encouraged individuals to renounce their citizenship.[113] In 1966, Congress enacted Internal Revenue Code Section 877 to safeguard against expatriation.[114] As a result, people who decided to renounce their citizenship were taxed on U.S.-sourced income for a ten-year period after their expatriation.[115] Congress determined that a ten-year period was a "sufficient remuneration for the benefits conferred on the expatriate" while the individual was in the United States.[116] The U.S. tax-incentivized expatriates were considered "Benedict Arnolds."[117] In 1966, the nation faced the same dilemma as it did in 1894.[118] It was more beneficial, from a tax standpoint, to renounce one's citizenship in order to receive better tax rates.[119] Just as the Treasury solved the problem of individuals expatriating for tax advantages, one solution for corporate "Benedict Arnolds" is to tax the foreign corporation's income for a ten-year period after the company restructures itself offshore.[120]

B. The Expatriate Act When Applied to Corporations

The criticism of Section 877 would not similarly resonate if it were applied to corporations.[121] One critique was the large burden Section 877 placed upon the state to show that the purpose of an individual's expatriation was for a tax benefit.[122] Showing the subjective intent of the taxpayer proved time-consuming and costly.[123] After Congress enacted Section 877, proving intent was difficult for the courts because all of the evidence and facts revealing the expatriate's

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110. *Id* at 348.

111. *Id.*

112. Reuven S. Avi-Yonah, *The Case Against Taxing Citizens*, 58 TAX NOTES INT'L 389, 390 (2010).

113. Dentino & Manolakas, *supra* note 105, at 341.

114. I.R.C. § 877 (2008); Dentino & Manolakas, *supra* note 105, at 347.

115. Dentino & Manolakas, *supra* note 105, at 341.

116. *Id.* at 379.

117. A "Benedict Arnold" is synonymous with a traitor. *Benedict Arnold Definition*, DICTIONARY.COM, http://dictionary.reference.com/browse/benedict%20arnold?s=t (last visited Nov. 4, 2015) (on file with *The University of the Pacific Law Review)*; Dentino & Manolakas, *supra* note 105, at 341.

118. Dentino & Manolakas, *supra* note 105, at 341.

119. *Id.* at 352.

120. I.R.C. § 877 (2006); Dentino & Manolakas, *supra* note 105, at 350–55.

121. *See* Dentino & Manolakas, *supra* note 105, at 355 (demonstrating that the criticisms of Section 877 are unique to individuals).

122. *Id.* at 355–56.

123. *Id.*

motivation was in the hands of the expatriate himself.[124] This will not apply to corporations to the same extent as it did to individuals.[125] The subjective intent of a corporation is easier to show since the predominant and primary purpose of an inversion is tax avoidance.[126] A large corporation's business decisions are advertised, especially with respect to public companies.[127] Because most corporations are publicly traded companies, their basic business decisions would be apparent in the news or in their shareholders reports.[128]

Prominent investor Warren Buffett immediately contacted U.S. Senator Orrin Hatch, a Republican on the Tax-Writing Finance Committee, demonstrating his concerns about changes in the corporate tax structure.[129] Buffett was expected to provide about twenty-five percent of the financing for the Burger King and Tim Horton merger—one of the most notorious examples of a corporate merger as a tax inversion.[130] A change in the corporate tax—specifically with regards to tax inversions could affect his investment in Burger King.[131] Buffett's concern demonstrates the intent behind tax inversions: reducing corporate tax.[132]

There will also be no issue enforcing the ten-year tax because the corporation will continue to do business within the United States.[133] While the corporation will not be headquartered in the United States, the amount of business it does will give the United States the ability to tax the corporation for a ten-year period.[134] Scholars probably have not applied Section 877 to corporations because it was

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124. *Id.* at 356.

125. *See* MARPLES & GRAVELLE, *supra* note 3 (suggesting corporations intend to reincorporate in order to reduce taxes).

126. *See id.* (illustrating that corporations intend to reduce their taxes by inverting).

127. Company filings are accessible to any person. Publicly traded companies are subject to regulation and the U.S. Securities and Exchange Commission keeps records of these companies' financial statements. Unlike private citizens, for companies, not very much remains concealed from the public. *See generally* U.S. SECURITIES & EXCHANGE COMM'N, *EDGAR: Company Filings*, https://www.sec.gov/edgar/searchedgar/companysearch.html (last visited Mar. 4, 2016) (on file with *The University of the Pacific Law Review*) (demonstrating that a public stock trading corporation's affairs are visible to the public).

128. *See id.* (demonstrating that a public stock trading corporation's affairs are visible to the public).

129. Emily Stephenson et al., *U.S. Senator Says Warren Buffett Called Him about Tax Inversions*, REUTERS (Sept. 11, 2014), http://www.reuters.com/article/2014/09/11/us-usa-congress-buffett-idUSKBN0H62H420140911 (on file with *The University of the Pacific Law Review*).

130. *Burger King's Tax Inversion and Canada's Favorable Corporate Tax Rates*, FORBES (Aug. 25, 2014), http://www.forbes.com/sites/jonhartley/2014/08/25/burger-kings-tax-inversion-and-canadas-favorable-corporate-tax-rates/2/ (on file with *The University of the Pacific Law Review*).

131. *See* Stephenson, *supra* note 129 (demonstrating Buffett's concern regarding the Burger King and Tim Hortons merger).

132. *Id.*

133. Dentino & Manolakas, *supra* note 105, at 379–80.

134. Di Portanova v. United States, 690 F.2d 169, 177 (Ct. Cl. 1982); *see What's a Source–based Taxations System?*, BUS. DAILY (Nov. 10, 2010), http://www.businessdailyafrica.com/Opinion-and-Analysis/What-is-a-source-based-taxation-system/-/539548/1050816/-/a85gm2/-/index.html (on file with *The University of the Pacific Law Review*) (defining how a source-based system works).

difficult to enforce against individuals.[135] However, because proving a corporation's intent will be easier, Section 877's largest drawback will not apply, and it is, therefore, a practical solution.[136]

Creating an expatriate tax to exist for a period of ten years on U.S.-derived income will discourage companies from leaving the United States.[137] In 2004, companies shifted approximately fifty billion dollars from the United States to countries with lower tax rates.[138] Therefore, if the consequences of moving a U.S. company to a foreign country resulted in the continuance of U.S. taxes for a period of ten years, it seems possible that companies may try to evade this form of tax by not initially incorporating in the United States.[139] However, this form of an expatriate tax will not deter corporations from incorporating in the United States because the number of benefits and resources available in the United States will continue to be advantageous to new businesses.[140]

The United States is a melting pot of business ideas.[141] It is easier for corporations to start in the United States because of pure convenience and practicality.[142] The United States' natural resources and growing market make it an ideal place for businesses to begin.[143] Consequently, corporate taxes, alone, will not deter businesses formation within the United States.[144] In addition, the United States, unlike many other countries, allows for the incorporation of a company in a location different than its headquarters.[145]

The United States allows corporations to headquarter in any state they may think is ideal for their business.[146] For example, a location near water allows for easy shipping, so headquarters in California allow a company to be in close

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135. Dentino & Manolakas, *supra* note 105, at 372; Elise Tang, *Solving Taxpatriation: "Realizing" It Takes More Than Amending the Alternative Tax*, 31 BROOK. J. INT'L L. 615, 629 (2006).

136. MARPLES & GRAVELLE, *supra* note 3, at 1.

137. ROBIN LANDAUER, MERCATUS RESEARCH, *FUNDAMENTAL TAX REFORM: FIXING THE CORPORATE TAX CODE*, *available at* http://mercatus.org/publication/fixing-corporate-income-tax (last visited Mar. 4, 2016) (on file with *The University of the Pacific Law Review*).

138. *Id.*

139. *Id.*

140. *Why Start a Business in the United States of America*, START UP OVERSEAS, http://www.startup overseas.co.uk/starting-a-business-in-usa (last visited Dec. 16, 2014) (on file with *The University of the Pacific Law Review*).

141. *Id.*

142. *North America: Resources*, NAT'L GEOGRAPHIC, http://education.nationalgeographic.com/education/encyclopedia/north-america-resources/?ar_a=1 (last visited Dec. 16, 2014) (on file with *The University of the Pacific Law Review)*; START UP OVERSEAS, *supra* note 140.

143. *See* NAT'L GEOGRAPHIC, *supra* note 142 (describing the different regions and the resources they have to offer); START UP OVERSEAS, *supra* note 140.

144. NAT'L GEOGRAPHIC, note 142 (suggesting there are other benefits to staying in a particular area); START UP OVERSEAS, *supra* note 140.

145. FRANKLIN GEVURTZ, GLOBAL ISSUES IN CORPORATE LAW 17–18 (2006); *see also* START UP OVERSEAS, *supra* note 140 (describing that one of the benefits of starting a business in the United States includes incorporating in a different location than operations).

146. GEVURTZ, *supra* note 145, at 6–10; START UP OVERSEAS, *supra* note 140.

vicinity to natural resources.[147] Because the state of incorporation's law governs the corporation's internal affairs regardless of where the corporation's headquarters are, many businesses incorporate in Delaware, where the corporate laws are most favorable, while headquartering elsewhere in the country.[148] Not all corporate laws allow such freedom of choice of headquarters.[149]

C. Slight Change to the Expatriate Act

Due to the difficulty in enforcing Internal Revenue Code Section 877, Congress reformed the Expatriate Act in 1996.[150] In the amended version, Congress made it difficult for individuals who expatriated to receive a U.S. visa.[151] Expatriates had the burden of showing that their expatriation was not motivated by tax reasons.[152] In addition, the statutory reform created a presumption of expatriation for tax purposes based upon net worth.[153] Despite the amendments, enforcement still required the government to prove subjective intent in cases.[154]

Due to the difficulty of amending the statute, Congress enacted the American Jobs Creation Act of 2004.[155] It applied to individuals who expatriated before June 17, 2008.[156] With respect to individuals, it introduced three significant changes.[157] First, it instituted an objective standard to determine whether expatriation was motivated by tax gains.[158] Second, it provided a tax-based, rather than immigration-based, set of rules to determine whether an individual was still a U.S. citizen for tax purposes.[159] Third, it presumed the individual expatriated for tax purposes if they returned to the United States for a long period of time.[160]

147. START UP OVERSEAS, *supra* note 140.

148. Jens C. Dammann, *Freedom of Choice in European Corporate Law*, 29 YALE J. INT'L L. 477, 477, 478 (2004).

149. *Id.* at 479–80.

150. Jerry R. Dagrella, Comment, *Wealthy Americans Planning to Renounce Their Citizenship to Save on Taxes Have a New Problem to Consider: This Time Congress Means Business*, 13 TRANSNAT'L LAW 363, 381 (2000).

151. *Id.* at 382; Dentino & Manolakas, *supra* note 105, at 359.

152. Dagrella, *supra* note 150, at 381; Dentino & Manolakas, *supra* note 105, at 359.

153. Tax-motivated expatriation is presumed if: (1) the average annual income was more than $100,000 for a five-year period before the expatriation; or (2) the individual had a net worth of greater than $500,000. I.R.C. § 877(a)(2) (2006); Dagrella, *supra* note 150, at 381 (2000); Dentino & Manolakas, *supra* note 105, at 359–60.

154. Dagrella, *supra* note 150, at 384–85; Dentino & Manolakas, *supra* note 105, at 372.

155. Dagrella, *supra* note 150, at 384–85; Dentino & Manolakas, *supra* note 105, at 372; Tang, *supra* note 135, at 629.

156. Dentino & Manolakas, *supra* note 105, at 372.

157. *Id.*; Tang, *supra* note 135, at 629.

158. Dentino & Manolakas, *supra* note 105, at 372; Tang, *supra* note 135, at 629–30.

159. Dentino & Manolakas, *supra* note 105, at 372; Tang, *supra* note 135, at 629.

160. Dentino & Manolakas, *supra* note 105, at 372; Tang, *supra* note 135, at 630.

Finally, it required the individual to file an informational return each year for a ten-year period after expatriating.[161]

However, as with Internal Revenue Code Section 877, enforcement remained difficult.[162] If individuals move outside of the United States and stop paying their taxes, it is impossible for the Internal Revenue Service to reach those individuals or their assets.[163] Another issue involved individuals who delayed receiving income abroad for the ten-year period to avoid paying any U.S. taxes under the AJCA taxation scheme.[164] Over time, the Act has created tax inequity.[165] Wealthy expatriates had the luxury of postponing income for the ten-year period, while other less wealthy expatriates earned income at the start of the ten-year period.[166] The former group was able to bypass the Expatriate Act.[167]

This issue will not arise in the application of the Expatriate Act to corporations, because corporations cannot postpone earning income in the same way an individual might.[168] A corporation will have expatriated to avoid U.S. taxes in order to increase its profits and, therefore, would not have the luxury of waiting until the Expatriate Act's ten-year period lapsed.[169] In order to please its shareholders, the corporation would have to continue recognizing profits and paying the expatriate tax.[170] Absent the luxury of postponing income, tax inequity amongst corporations would be irrelevant.[171] Additionally, businesses face different risks than individuals when relocating.[172] When inverting, corporations must acclimate to many changes, including different customs rates, labor laws, and foreign laws.[173]

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161. Dentino & Manolakas, *supra* note 105, at 372; Tang, *supra* note 135, at 629.

162. Dentino & Manolakas, *supra* note 105, at 378.

163. *Id.* at 379.

164. *Id.*

165. *Id.* at 380.

166. *Id.*

167. *Id.* at 379.

168. *See* JAMES FREELAND ET AL., FUNDAMENTALS OF FEDERAL INCOME TAXATION 574–80 (17th ed. 2013) (demonstrating how individuals tried to postpone income as a means of evading their taxes, which would be more difficult for a corporation as it would adversely impact their financial prospects).

169. *Id.*; *Corporate Inversion*, INVESTOPEDIA, http://www.investopedia.com/terms/c/corporateinversion.asp (last visited Dec. 16, 2014) (on file with *The University of the Pacific Law Review*).

170. Jia Lynn Yang, *Maximizing Shareholder Value: The Goal that Changed Corporate America*, WASH. POST (Aug. 26, 2013), http://www.washingtonpost.com/business/economy/maximizing-shareholder-value-the-goal-that-changed-corporate-america/2013/08/26/26e9ca8e-ed74-11e2-9008-61e94a7ea20d_story.html (on file with *The University of the Pacific Law Review*).

171. *See id.* (suggesting that because the company's primary purpose is to maximize shareholder value, postponing income may not be practical).

172. Joe Cahill, *Think Companies Can Flee the U.S. Risk-free? Think Again*, CRAIN'S CHICAGO BUS. (July 30, 2014), http://www.chicagobusiness.com/article/20140730/BLOGS10/140729768/think-companies-can-flee-the-u-s-risk-free-think-again (on file with *The University of the Pacific Law Review*).

173. *Id.*

A corporation must weigh the costs and benefits of relocation to ensure that it will thrive in its new location.[174] Aside from the expatriation tax, a corporation must find that the reincorporation will result in increased profits and will allow for future growth of the company.[175] If there is any uncertainty, the corporation might not find incorporating in another country advantageous.[176] Therefore, a ten-year taxing scheme might outweigh any benefit of reincorporating outside of the United States.[177]

Applying the Expatriate Act to corporations can serve as a deterrent from tax inversions.[178] To be successful, the expatriate tax rate must be a burden that poses enough of a risk to outweigh the tax benefits the other country may have.[179]

In the case of Fruit of the Loom, reincorporation in the Cayman Islands proved to have large costs for the company.[180] Even in the absence of any corporate tax, simply changing the location of their financial base was difficult.[181] An expatriate tax could deter a company in Fruit of the Loom's position from expatriating.[182] Even if a company was not in as bad of a financial situation as Fruit of the Loom, reincorporation carries enough risks of its own.[183] Adding an expatriate tax that spans over a ten-year period would create an additional risk that would keep companies in the United States, and, therefore, prevent expatriation in the volume that it is occurring today.[184]

More importantly, adopting a past taxing regime would reduce any possible resistance.[185] The Internal Revenue Service would understand how to incorporate and administer the new code section because of its previous experience doing so.[186] Because individuals and corporations are different, the problems that Section 877 created for individuals would not exist for corporations.[187] There may still be a chance that new problems will arise; however, there should be

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174. *Id.*; Yang, *supra* note 170.

175. Yang, *supra* note 170.

176. *Id.*

177. *See* Cahill, *supra* note 172 (illustrating customs within the industry that make foreign incorporation less favorable); Yang, *supra* note 170.

178. *See* Cahill, *supra* note 172 (demonstrating there are many deterrents that already exist).

179. *Id.*

180. Vincent, *supra* note 5, *Fruit of the Loom to Lay Off 5,100 Workers at 7 Plants*, *supra* note 5.

181. Cahill, *supra* note 172.

182. *See id.*; Vincent, *supra* note 5 (showing that even after Fruit of the Loom reincorporated they eventually had to file Chapter 11 bankruptcy); *Fruit of the Loom to Lay Off 5,100 Workers at 7 Plants*, *supra* note 5.

183. Cahill, *supra* note 172.

184. Dentino & Manolakas, *supra* note 105, at 379; Cahill, *supra* note 172.

185. Mider, *supra* note 4.

186. *See id.* (demonstrating that this code section has been enacted before).

187. *See* Dentino & Manolakas, *supra* note 105, at 355 (analyzing the criticisms of the code section as specific to individuals).

significantly fewer problems due to the previous use and testing of Section 877.[188] Intending to implement an efficient and easy solution, Section 877—a higher expatriate tax on profits lasting for a ten-year period—would be the most efficient and simple solution to implement, instead of a drastic tax reform.[189]

IV. THE AMENDED EXPATRIATE ACT

After facing issues with implementing Internal Revenue Code Section 877, Congress implemented a new code section that changed the expatriate taxing method.[190] Part A describes the new taxing regime and Part B describes the effects it will have when applied in the corporate context.[191]

A. *The Alternative Taxing Regime of 2008–Market-to-Market*

The Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART) made Internal Revenue Code Section 877 only apply to individuals who renounced their citizenship or residency before June 17, 2008.[192] Anyone who renounced their citizenship or residency after that date would not be subject to Section 877.[193] Previously there was debate over the methods of taxing individuals who expatriated.[194] The Clinton administration proposed an exit tax that would apply on the day immediately preceding the individual's loss of citizenship or long-term residency.[195] The Clinton administration began the market-to-market approach of taxing expatriates.[196] The Senate largely adopted the proposed legislation.[197] The debate amongst the House, Senate, and president became Internal Revenue Code Section 877A.[198]

Section 877A applies to individuals who relinquish their citizenship on or after June 17, 2008.[199] Instead of imposing a ten-year taxing regime, Section 877A imposes a one-time tax upon the net, unrealized gain on property as if it

188. *See* Mider, *supra* note 4 (recognizing that the criticisms of the code section were directed at individuals).

189. *See id.*; Dentino & Manolakas, *supra* note 105, at 351 (demonstrating that the Expatriate Act, even for individuals, was a positive move by Congress); WHITE HOUSE & DEP'T OF THE TREASURY, *supra* note 73, at 18.

190. *See* I.R.C. § 877A (suggesting that it came only after Section 877, and was a separate code section).

191. *See infra* Part IV.A–B.

192. Dentino & Manolakas, *supra* note 105, at 380.

193. *Id.*

194. *Id.*

195. *Id.*

196. The market-to-market approach taxes assets at the moment a company leaves one country's market and enters another country's market. *Id.* at 380–82; I.R.C. § 877A (2006).

197. Dentino & Manolakas, *supra* note 105, at 381; I.R.C. § 877A

198. I.R.C. § 877A; Dentino & Manolakas, *supra* note 105, at 382.

199. I.R.C. § 877A; Dentino & Manolakas, *supra* note 105, at 382.

had been sold at fair market value.[200] Normally, net gain is taxed when realized in the form of a sale or exchange.[201] However, the market-to-market taxing scheme allows the government to collect taxes on property that might have been moved outside of its reach due to the expatriation.[202]

One criticism of the market-to-market regime is that it is an "arbitrary infringement" on the right of individuals to expatriate.[203] Typically, when income is realized, taxes are imposed, but Section 877A imposes taxes in the absence of realized income.[204] Opponents to this form of taxation claim that it violates the individual's right to due process.[205] However, the due process violation is inapplicable because of the wide discretion Congress has in levying taxes.[206] The greater criticism is that the government does not have the power to tax individuals who are no longer within its jurisdiction and, therefore, the Fifth Amendment Due Process Clause would apply to this arbitrary taxing regime.[207] However, the U.S. Court of Claims dispensed with this issue when it held that alternative tax regimes were not jurisdiction-based tax regimes, but rather source-based tax regimes.[208]

B. *The Market-to-Market Regime Applied to Corporations*

Internal Revenue Code Section 877A, as applied to corporations, may deter inversions.[209] Applying Section 877A and taxing the unrealized gain of a corporation as soon as it crosses the U.S. border may solve the inversion problem.[210] It may also add another risk: taxing corporations on their assets or stocks would increase the initial cost of reincorporation.[211] However, this one-time cost, market-to-market, might not have as much of a deterrent effect as a

200. I.R.C. § 877A; Dentino & Manolakas, *supra* note 105, at 382.

201. I.R.C. §1001(b) (2014).

202. Dentino & Manolakas, *supra* note 105, at 382.

203. *Id.* at 401.

204. FREELAND, *supra* note 168 at 118–128.

205. Dentino & Manolakas, *supra* note 105, at 400.

206. *Di Portanova*, 690 F.2d at 180.

207. Dentino & Manolakas, *supra* note 105, at 400.

208. A source-based taxing structure is one that levies taxes on income accrued in a country regardless of the income earner's residence. This is different from the income-based tax system that taxes the income of residents without regard to where the income is derived. *What's a Source–based Taxations System?, supra* note 134; *Di Portanova*, 690 F.2d at 177.

209. *See* Cahill, *supra* note 172 (suggesting certain customs of the industry affects a company's decision on reincorporating); Peter Schroeder, *S&P: Inversions Carry Credit Rating Risks*, HILL (Sept. 10, 2014), http://thehill.com/policy/finance/217149-sp-inversions-carry-credit-rating-risks (on file with *The University of the Pacific Law Review*); Larry A. Cerutti & Jason Lee, *Corporate Inversions: Considerations Other Than Tax Benefits*, BLOOMBERG BNA (Oct. 2, 2014), http://www.bna.com/corporate-inversions-considerations-n17179895637/ (on file with *The University of the Pacific Law Review*).

210. Cahill, *supra* note 172; Schroeder, *supra* note 209; Cerutti & Lee, *supra* note 209.

211. Cahill, *supra* note 172.

taxing regime that taxes over a ten-year period.[212] Corporations are looking more long-term at their future growth and profit-making abilities.[213] Shareholders' asset sales and the corporation's extra savings can quickly offset a one-time cost.[214] Another issue that the application of Section 877A raises is how to determine a corporation's asset value.[215] While there may be difficulty in computing and defining unrealized gain in property, the larger problem is stopping corporations from concealing or liquidating certain assets before they incorporate offshore.[216] Corporations could also shift these assets onto their subsidiaries so that the Internal Revenue Service will not recognize them as unrealized gain in property, and, therefore, the corporation can offset the amount of tax they would have to pay.[217] A longer term and larger sum of tax will deter more corporations from evading their taxes by leaving the United States.[218]

V. RECOMMENDATION

While there are numerous ways to battle corporate inversions, the most advantageous option is one that is easily implemented and enforced.[219] With Congress' polarized tax views, a middle ground—implementing a previously used taxing regime—will gain both Republicans' and Democrats' acceptance.[220] Section 877 does exactly that; it is a previously tested taxing regime, and the criticism it received would not inhibit its implementation upon corporations.[221]

President Obama's solution may sound appealing at first; however, there is one inherent flaw within it: lowering corporate tax by seven percent does not make the United States' corporate tax rate enticing enough for U.S. corporations

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212. *See id.* (suggesting that industry customs deter corporations from using inversions).

213. *Id.*

214. *Paid-Up Capital*, INVESTOPEDIA, http://www.investopedia.com/terms/p/paidupcapital.asp (last visited Dec. 18, 2014) (on file with *The University of the Pacific Law Review*).

215. "The greatest difficulty in determining market value lies in estimating the value of illiquid assets like real estate and businesses, which may necessitate the use of real estate appraisers and business valuation experts respectively." *Market Value*, INVESTOPEDIA, http://www.investopedia.com/terms/m/marketvalue.asp (last visited Jan. 19, 2015) (on file with *The University of the Pacific Law Review*).

216. *See* Albert B. Ellentuck, *Determining Tax Consequences of Corporate Liquidation to the Shareholders*, TAX ADVISOR (Sept. 1, 2012), http://www.aicpa.org/publications/taxadviser/2012/september/pages/casestudy_sep2012.aspx (on file with *The University of the Pacific Law Review*) (suggesting that corporations can make a liquidating distribution under Section 331, thereby reducing the corporation's assets).

217. *See id.* (demonstrating that corporations can distribute a shareholder's interest and offset the gain with the corporation's incurred losses).

218. *See* Sam Ashe-Edmunds, *How Can the Cost of Capital Affect Long-Term Financing Decisions?*, CHRON. SMALL BUS., http://smallbusiness.chron.com/can-cost-capital-affect-longterm-financing-decisions-81689.html (last visited Dec. 18, 2014) (on file with *The University of the Pacific Law Review*) (alluding that there is already a great amount of costs associated with corporations).

219. MARPLES & GRAVELLE, *supra* note 3.

220. Mider, *supra* note 4.

221. *See supra* Part III.B (describing the effects of the taxing scheme when applied to corporations).

to remain incorporated in the United States.[222] Since the United States has a worldwide tax system, it is different from most other countries in that it taxes income generated within the United States and outside of the United States.[223] Countries that tax at higher rates are typically territorial-taxing countries—they only tax income generated within their borders.[224] However, the United States' proposed twenty-eight percent corporate tax rate combines a high tax rate with the worldwide taxing structure, thereby providing no benefit to corporations.[225]

Another possible solution involves applying both Internal Revenue Code Sections 877 and 877A to expatriated corporations.[226] By implementing Section 877A, there can be a small corporation exemption for the market-to-market part of the expatriate tax.[227] As seen in other Internal Revenue Code sections, a corporation with aggregate gross assets worth less than five million dollars will be exempt from the market-to-market tax regime.[228] This would further President Obama's goal of promoting small business growth.[229] While taxing corporations under both Sections 877 and 877A would be a strong deterrent against inverting, the costs of administering and implementing this dual taxing model might be counterproductive, and might even increase the federal deficit—something the president explicitly did not want.[230] Also, while the small corporation exemption would create equity amongst large and small corporations—an aspect in which Section 877 lacked—determining the value of the unrealized gain in property would overcomplicate the new corporate expatriate tax.[231]

Changing the corporate tax to a territorial taxing system would put the United States in a more competitive position.[232] It would incentivize corporations to incorporate in the United States.[233] Several countries, including the United

222. Scott A. Hodge, *Ten Reasons the U.S. Should Move to a Territorial System of Taxing Foreign Earnings*, TAX FOUND. (May 11, 2011), http://taxfoundation.org/article/ten-reasons-us-should-move-territorial-system-taxing-foreign-earnings (on file with *The University of the Pacific Law Review*).

223. *Id.*; Matthew Glans, *Research & Commentary: Worldwide vs. Territorial Taxation*, HEARTLAND INST. (Oct. 30, 2012), http://heartland.org/policy-documents/research-commentary-worldwide-vs-territorial-taxation (on file with *The University of the Pacific Law Review*).

224. Philip Dittmer, *A Global Perspective on Territorial Taxation*, TAX FOUND. (Aug. 10, 2012), http://taxfoundation.org/article/global-perspective-territorial-taxation (on file with *The University of the Pacific Law Review*).

225. *Id.*; Glans, *supra* note 223.

226. *See supra* Part III.B (describing the affects of the taxing scheme when applied to corporations); *supra* Part IV.B (describing the newer taxing scheme when applied to corporations).

227. *See* Dentino & Manolakas, *supra* note 105, at 380 (drawing a distinction between wealthier expatriates and average earning expatriates).

228. 26 U.S.C. §§ 448(c), 1202(c) (2014).

229. WHITE HOUSE & DEP'T OF THE TREASURY, *supra* note 73, at 16.

230. *Id.* at 18.

231. *See* Ellentuck, *supra* note 216 (demonstrating the already existing complexities in calculating a corporation's assets).

232. Hodge, *supra* note 222.

233. *Id.*; ERIC DRABKIN ET AL., IMPLICATIONS OF A SWITCH TO A TERRITORIAL TAX SYSTEM IN THE UNITED STATES: A CRITICAL COMPARISON TO THE CURRENT SYSTEM (2013), *available at* http://www.lift

Kingdom, Canada, and Australia, have territorial tax systems.[234] The tax rates might be higher than other countries, but the territorial tax system, itself, is an incentive for corporations.[235] However, shifting to a territorial taxing structure would be a highly drastic change, requiring years of implementation and a great deal of money.[236] And, while many argue that the United States needs tax reform, the tax inversion issue must be solved quickly and efficiently.[237] The Patent Cliff Era is making tax inversions more attractive to large pharmaceutical companies.[238] Disagreement among political parties will substantially delay tax reform and cause the government to lose its opportunity to remedy corporate inversions.[239]

The only quick and simple solution to deter tax inversions is to tax the corporation after it leaves the United States for a set period of time.[240] Ten years is enough time to have a financial impact upon the corporation.[241] In addition to relocation risks, a corporation would have to continue paying income taxes for up to ten years.[242] This would tip the risk-benefit analysis in favor of staying in the United States.[243]

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americacoalition.org/wp-content/uploads/2013/11/BRG_Implications-of-Territorial-Tax_Nov2013.pdf (on file with *The University of the Pacific Law Review*).

234. Dittmer, *supra* note 224.

235. Hodge, *supra* note 222.

236. Naomi Jagoda, *Congress May Work on Corporate Tax Reform in 2015*, BOND BUYER (Dec. 29, 2014), http://www.bondbuyer.com/news/washington-taxation/congress-may-work-on-corporate-tax-reform-in-2015-1069109-1.html (on file with *The University of the Pacific Law Review*).

237. MARPLES & GRAVELLE, *supra* note 3; WHITE HOUSE & DEP'T OF THE TREASURY, *supra* note 73, at 18.

238. Thomas, *supra* note 11.

239. Mider, *supra* note 4; WHITE HOUSE & DEP'T OF THE TREASURY, *supra* note 73, at 1.

240. *See* Cahill, *supra* note 172 (suggesting that there are many tax customs that apply to corporations both abroad and in the United States); Yang, *supra* note 170.

241. Christine L. Agnew, Comment, *Expatriation, Double Taxation, and Treaty Override: Who Is Eating Crow Now?,* 28 U. MIAMI INTER-AM. L. REV. 69, 80 (1996); Dentino & Manolakas, *supra* note 105, at 379.

242. Economic growth can happen in two ways: first, by using more of the economy's full potential and, in turn, generating more profits, and second, by expanding its potential, also known as aggregate supply. Aggregate supply arises from a combination of better workers, improved allocations of capital and labor, technological advances, and more investment. While tax might affect one aspect of economic growth, it alone does not have that potential. Jason Furman, *Business Tax Reform and Economic Growth* (Sept. 22, 2014), http://www.whitehouse.gov/sites/default/files/docs/business_tax_reform_and_economic_growth_jf. pdf (on file with *The University of the Pacific Law Review*).

243. *See* Tim Mitchell, *Five Ways to Manage Overseas Business Risks*, BLOOMBERG BUSINESSWEEK MGMT. (Sept. 1, 2011), http://www.businessweek.com/management/five-ways-to-manage-overseas-business-risks-09012011.html (on file with *The University of the Pacific Law Review)*; Fruit of the Loom & Corporate Taxes, *supra* note 8 (describing the risks and considerations that must be taken into account when owning an oversees business).

VI. CONCLUSION

In 1966, the United States faced the same problem with individuals that it faces today with corporations: "Benedict Arnolds."[244] Just as individuals tried to renounce their citizenship for tax advantages, corporations are using tax inversions for the same purpose.[245] Therefore, just as Congress enacted the Expatriate Act to curtail individuals from giving up their citizenship, Congress should similarly create an Expatriate Act applicable to corporations.[246] As in the past, corporations will find new loopholes to avoid taxes.[247] A taxing scheme that mandates taxes for a set period of time at a constant rate reduces those possible loopholes.[248] Section 877 is advantageous over other solutions simply because it has been tested before.[249] Unlike other options, a solution that Congress has implemented in the past will allow the United States to prevent similar problems and forecast the taxing regime's success.[250] Incorporating in the United States has many advantages for corporations, and the United States gains many advantages from having corporations within its borders.[251] Therefore, it is important that the United States create a simple and quick solution to prevent corporate inversions in order to keep U.S. companies at home.[252]

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244. *See supra* note 117 and accompanying text; Dentino & Manolakas, *supra* note 105, at 341.

245. Dentino & Manolakas, *supra* note 105, at 350–55.

246. I.R.C. § 877A; Dentino & Manolakas, *supra* note 105, at 350–55.

247. *See supra* Part II.C (illustrating loopholes corporations employed and the congressional response required).

248. *See supra* Part.III (suggesting a solution to the problem of inversions).

249. *See supra* Part III.B (demonstrating why the original taxing scheme will be successful when applied to corporations).

250. *See supra* Part III.B (describing that the previously used code section will be easier to implement than a new taxing scheme).

251. START UP OVERSEAS, *supra* note 140.

252. MARPLES & GRAVELLE, *supra* note 3.