Hastings Law Journal

Volume 69 | Issue 1 Article 8

12-2017

The Devil in the Details: How the Complexity, Costs, and Uncertainty of Treasury Regulations Encourage Corporate Inversion

Jessica Wilson

The Devil in the Details: How the Complexity, Costs, and Uncertainty of Treasury Regulations Encourage Corporate Inversion

JESSICA WILSON*

Politicians and scholars have discussed reforming the corporate tax system for many years, especially with the emergence of certain tax avoidance practices like inversion and earnings stripping. While debate in this area has focused primarily on making changes to the high corporate tax rate and the taxation of worldwide income in the United States as ways to reverse the inversion problem, less discussion has focused on how the Treasury's punitive approach via tax regulations can have the effect of encouraging, rather than discouraging, firms to relocate and shift profits overseas. Even considering the recent developments in international tax law under the Organisation for Economic Co-operation ("OECD") Base Erosion and Profit Shifting ("BEPS") *project and recent rulings by the European Commission, which focus on corporate tax avoidance, a corporation can greatly reduce its tax and compliance burden by relocating to a foreign jurisdiction.*

This Note examines the added burden of the U.S. Treasury's approach to dealing with corporate inversion, with a detailed discussion of the Treasury's 2016 anti-inversion regulations. Furthermore, this Note examines the costs and burdens associated with remaining a U.S. company for tax purposes, as compared to some of the costs and benefits associated with inversion. It argues that for many companies, the complexity and costs under corporate tax regulations in the U.S. provide an incentive for inversion separate from that of the high corporate tax rate and taxation of worldwide income.

* J.D. Candidate 2018, University of California, Hastings College of the Law. Many thanks to Professor Manoj Viswanathan for his guidance and encouragement in writing this Note, and to the editors of the *Hastings Law Journal* for their dedication and support.

TABLE OF CONTENTS

> "The goal of tax policy is to design a tax system that produces the desired amount of revenue and balances the minimization of these costs with other objectives, such as equity, transparency, and administrability."[1]

INTRODUCTION

In recent years, much public attention has been given to the laws governing the taxation of multinational corporations ("MNCs"). Led by the Organisation for Economic Co-operation and Development ("OECD"), tax authorities have discussed the inconsistencies of tax rules where a corporate entity spans multiple jurisdictions.[2] For the United States in particular, the varied tax treatment of MNCs in other jurisdictions, paired with the United States' relatively burdensome corporate tax laws, has resulted in corporations shifting their headquarters and profits overseas.[3] The benefits of escaping from—and the burdens of remaining under—the U.S. tax system have resulted in more than 50 large U.S. MNCs relocating to other jurisdictions over the past three decades;[4] over $2 trillion of accumulated corporate profits stashed overseas;[5] and an estimated $111 billion loss in tax revenue.[6] Rather than addressing the core problems of the tax system that motivate this movement of income and headquarters overseas, the Treasury has responded to each series of transactions with regulations that have dramatically complicated corporate tax laws and added to the heavy compliance burden for U.S. businesses.[7] Notably, the U.S. Department of Treasury's ("Treasury") recent anti-inversion action has increased these burdens by issuing rules restricting certain routine practices for businesses, significantly raising the standards and costs of compliance and disallowing important tax attributes for certain transactions. While the majority of debate in this area maintains that inversion stems from

1. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-878, TAX POLICY: SUMMARY OF ESTIMATES OF THE COSTS OF THE FEDERAL TAX SYSTEM (2005).

2. *See, e.g.*, ORG. FOR ECON. CO-OPERATION & DEV., ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING (2013).

3. Zachary Mider, *Tax Inversion*, BLOOMBERG QUICK TAKE (Mar. 2, 2017, 9:35 PM), https://www.bloomberg.com/quicktake/tax-inversion.

4. *Id.*

5. *See* Robert W. Wood, *Despite FATCA, U.S. Companies Stash $2.1 Trillion Abroad—Untaxed*, FORBES (Mar. 5, 2015, 8:24 AM), http://www.forbes.com/sites/robertwood/2015/03/05/despite-fatca-u-s-companies-stash-2-1-trillion-abroad-untaxed/#44d4192c100f.

6. Howard Gleckman, *How Much Revenue the U.S. Is Losing Through Tax Inversions, and How Much Worse It May Get*, FORBES (Jan. 26, 2016, 12:57 PM), http://www.forbes.com/sites/beltway/2016/01/26/tyco-tax-inversions-income-shifting-and-lost-revenue/#fc6ba624867a.

7. *See, e.g.*, text accompanying *infra* notes 107-125.

the high corporate tax rate and taxation on worldwide profits, the regulations governing corporate tax in the United States have become such an obstacle to corporate goals that the regulatory scheme provides a strong incentive for inversion all on its own.

With high stakes for both companies and governments, many have contributed to debate in these areas, with detailed plans and predictions for what the state of business and international tax will—or should—look like in the upcoming years. However, in November 2016, the United States saw the election of Donald Trump—a former reality television star who has never previously held elected office—to the Office of the President. President Trump's tax plan proposes some drastic alterations to tax law that may result in significant changes to the trends and practices of both businesses and governments.

A fundamental obstacle to tax reform, however, is that where a benefit is given in one area, it must be offset by some other area. This reality has led to months of debate and multiple amendments to any draft tax reform in 2017.[8] By mid-November 2017, the Republican tax plan remains uncertain, as there has been a constant tug-of-war between the proposed tax cuts and the limit on increases to the federal deficit.[9] While changes will very likely come in 2018 and the following years, there are currently mixed signals as to what the corporate tax arena will look like under the Trump administration.[10] Because any changes resulting from Trump's presidency are speculative at the time of writing this Note, this writing focuses on the state of the U.S. corporate tax system prior to any changes taking place in 2018.

This Note proceeds in three parts. Part I discusses the issue of corporate inversion, outlining some of the incentives for corporations to relocate, the scale of the problem in the United States, and the relevant

---

8. Jacob Pramuk, *House GOP Moving Full Speed to Get Tax Reform Done by Year-End*, CNBC (Nov. 14, 2017, 12:25 PM), https://www.cnbc.com/2017/11/14/house-will-vote-on-tax-reform-bill-on-thursday.html.

9. *See* JIM NUNNS, ET AL., AN ANALYSIS OF DONALD TRUMP'S TAX PLAN, TAX POL'Y CTR. 2, 5, 11, 21, 23–24 (2015). Estimates of the cost to lowering the corporate tax rate have predicted that the federal revenue would suffer by $9.5 trillion in the first ten years. *Id.* at 1, 6. Other estimates have predicted between $4.4 trillion and $5.9 trillion in just one year. *See* ALAN COLE, DETAILS AND ANALYSIS OF THE DONALD TRUMP TAX REFORM PLAN SEPTEMBER 2016, TAX FOUND. 1 (2016). Tax reform was a hot topic throughout the 2016 U.S. presidential election, and, following the results, House Republicans have said that they plan to move forward with a tax overhaul, and that they will "be ready to move this early in 2017." Ways and Means Committee Chairman Kevin Brady at the *Wall Street Journal* CEO Council in Washington, quoted in Naomi Jagoda, *House Panel Readying Tax Bill for Early Next Year*, THE HILL (Nov. 15, 2016, 1:40 PM), http://thehill.com/policy/finance/306124-house-panel-readying-tax-bill-for-early-next-year.

10. *See* Bob Bryan, *Senate Republicans Release Major Changes to Their Tax Plan That Would Make Your Tax Cut Temporary*, BUSINESS INSIDER (Nov. 15, 2017, 8:55 AM), http://www.businessinsider.com/trump-gop-tax-plan-senate-bill-individual-rate-cut-2017-11.

developments in international tax law bearing the potential to influence inversion. Part II examines the approach of the Treasury in addressing the issue of corporate inversion, highlighting specifically the added costs associated with anti-inversion regulations issued in 2016. Part III seeks to illustrate how the Treasury's approach can have the effect of encouraging inversion for companies with certain characteristics, and how this approach is contrary to the Treasury's goal of keeping corporations in the United States and collecting revenue.

I. Corporate Inversion

Debate on business tax reform has focused on two fundamental aspects of corporate and international tax law. First, tax burdens imposed by an MNC's home country affect the MNC's decision of where to place its headquarters.[11] High tax rates and the imposition of taxation on foreign profits in a company's home country can result in the company seeking to relocate.[12] Second, having and keeping an MNC within a jurisdiction brings benefits to that jurisdiction.[13]

A corporate "inversion," or "expatriation," is a transaction in which a U.S. based MNC restructures so that the U.S. parent is relocated in a foreign jurisdiction.[14] In the past two decades, the share of worldwide income from U.S. based MNCs that is declared abroad has dramatically increased.[15] This trend of moving corporate funds overseas is known as "income shifting."[16] One way a company accomplishes this is through inversion transactions, in which the corporation relocates so that it can shift its income to a jurisdiction with a lower tax burden.[17] These corporate inversions, which occur through the company's transfer of stock or assets to a foreign corporation, have been a popular method of shifting income and reducing tax liability.[18] While corporations all over the world have used this tactic for many years, there is evidence of

11. Omri Marian, *Home-Country Effects of Corporate Inversions*, 90 Wash. L. Rev. 1, 14 (2015).

12. Johannes Voget, *Relocation of Headquarters and International Taxation*, 95 J. Pub. Econ. 1067, 1079 (2010).

13. Kimberly A. Clausing, *Should Tax Policy Target Multinational Firm Headquarters?*, 63 Nat'l Tax J. 741, 744–45 (2010).

14. Press Release, U.S. Dep't. of the Treasury, Fact Sheet: Additional Treasury Actions to Rein in Corporate Tax Inversions (Nov. 19, 2015), https://www.treasury.gov/press-center/press-releases/Pages/jl0281.aspx.

15. *See* Wood, *supra* note 5.

16. Charles W. Christian & Thomas D. Shultz, *ROA-Based Estimates of Income Shifting by U.S. Multinational Corporations*, *in* Recent Research on Tax Administration and Compliance: Proceedings of the 2005 IRS Research Conference, Statistics Income Division, IRS 57 (2005).

17. *See* Donald J. Marples & Jane G. Gravelle, Cong. Research Serv., R43568, Corporate Expatriation, Inversions, and Mergers: Tax Issues (2014).

18. Office of Tax Pol'y U.S. Dept. of the Treas., Corporate Inversion Transactions: Tax Policy Implications 2 (2002).

income shifting specifically from the United States.[19] The increase in corporations relocating from the United States is partially the result of other countries adopting less strict corporate tax rules, lowering their corporate income tax, and operating under a territorial system through which a corporation's foreign profits are not subject to tax within the jurisdiction.[20] The United States, on the other hand, has not only held on to its undesirable tax features, but has continued to add to them. Apart from the United States having the highest corporate tax rate of all member countries of the OECD and subjecting U.S. corporations to tax on worldwide profits, the U.S. Treasury often complicates the tax rules and adds costs through the promulgation of regulations.[21]

A. THE SCALE OF THE PROBLEM IN THE UNITED STATES

Over the past thirty years, the U.S. has seen many of its corporations relocate to foreign jurisdictions. In 2000, the United States hosted 179 of the Fortune Global 500 companies.[22] In 2013, that number was reduced to 132.[23] In 2014, that number decreased to 128, with a total loss of 51 companies over 14 years.[24] These corporations did not disappear from the United States by going out of business or merging with each other. Rather, they engaged in inversion transactions, which allowed them not to be treated as U.S. corporations for tax purposes. While a primary objective of inversion is to reduce the tax liability of the corporation, inversion can also reduce its overall tax burden—that is, the company can pay less in tax liability *and* reduce the costs of compliance and planning.[25] This relocation—at least on paper—to a low-tax jurisdiction allows the inverted corporation to avoid being subject to the burdensome and complicated corporate tax system in the United States.

B. THE ALLURE OF INVERSION FOR U.S. MULTINATIONAL COMPANIES

Two major features of the U.S. tax system contributing to the appeal of inversion are its high corporate tax rate and the "worldwide" corporate

19. Harry Grubert, *Foreign Taxes and the Growing Share of Multinational Company Income Abroad: Profits, Not Sales, Are Being Globalized*, 65 NAT'L TAX J. 247, 247 (2012).

20. *See* MARPLES & GRAVELLE, *supra* note 17.

21. "Statutory Corporate Income Tax Rate," Table II.1, *Tax Database*, Country Representatives on the OECD Working Party 2: Tax Policy and Tax Statistics of the Comm. on Fiscal Affairs, http://stats.oecd.org//Index.aspx?DataSEtCode=TABLE_II1 (on file with Author).

22. Bob Carroll et al., *The Changing Headquarters Landscape for Fortune Global 500 Companies*, 240 DAILY TAX REP. J-1, 1 (Dec. 15, 2014).

23. *Id.*

24. *Id.*

25. *See* Nile Nwogu & Barry Plunkett, *Corporate Inversions: A Policy Primer*, PENN WHARTON SCH. BUS. PUB. POL'Y INITIATIVE (Oct. 24, 2016), https://publicpolicy.wharton.upenn.edu/live/news/1492-corporate-inversions-a-policy-primer.

tax system. Under a worldwide tax system, a domestic corporation is taxed on profits from all income, whether that income is derived in the United States or abroad.[26] Most other countries operate under a "territorial" system, taxing only income from within the country.[27] In addition to employing a worldwide system, the United States has a top corporate income tax rate of thirty-five percent, which is a clear motivation for inversion when compared to the United Kingdom at twenty percent, Luxembourg at nineteen percent[28], Ireland at 12.5 percent, Canada at fifteen percent[29], and the Cayman Islands at zero percent.[30]

These unattractive features of the U.S. corporate tax system are seemingly an easy fix. The United States could, like most other countries, lower its corporate tax rate and adopt territorial taxation. A possible reason for the lack of change is the notion that lowering the corporate tax rate and shifting to a territorial system would be giving in to the needs of wealthy corporations. Thus, although this solution has been widely discussed, it has generally been disregarded for political reasons.[31]

A third feature of the U.S. corporate tax system, which contributes to the greatest amount of change in the law from year to year, is the Treasury's authority to interpret the Internal Revenue Code ("Code") and issue regulations thereunder.[32] The Treasury's approach after each wave of inversions has been to issue regulations addressing the specific features of the transaction.[33] These regulations typically examine what methods were used in the most recent inversions and then create a new

26. *See* Thorton Matheson et al., *Territorial vs. Worldwide Corporate Taxation: Implications for Developing Countries* 3–4 (Int'l Monetary Fund Working Paper, Paper No. WP/13/205, 2013) https://www.imf.org/external/pubs/ft/wp/2013/wp13205.pdf.

27. *Id.*

28. *2017 Luxembourg Tax Reform Voted by the Luxembourg Parliament*, BAKER MCKENZIE (Dec. 16, 2016), http://www.bakermckenzie.com/en/insight/publications/2016/12/2017-luxembourg-tax-reform-voted/.

29. Canada provides a basic rate of tax at thirty-eight percent of taxable income, which is then reduced to twenty-eight percent after federal tax abatement. Corporation Tax Rates, Government of Candada, https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/corporations/corporation-tax-rates.html (last visited Nov. 21, 2017). After a general tax reduction, the federal corporate tax rate is fifteen percent, not including the varying provincial or territorial rates. *Id.*

30. KPMG, *Corporate Tax Rates Table*, KPMG INT'L COOPERATIVE, https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html (last visited Nov. 21, 2017).

31. *See* DELOITTE, THE POLITICS OF TAX REFORM IN THE 114TH CONGRESS 3–9 (Apr. 15, 2015), https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-the-politics-of-tax-reform-in-the-114th-congress-041415.pdf; *see also* John W. Diamond et al., *The Dynamic Economic Effects of a U.S. Corporate Income Tax Rate Reduction* (Oxford U. Ctr. for Bus. Taxation, Working Paper No. 14/05, 2014).

32. *See* I.R.C. § 7805(a) (2016).

33. *See* MARPLES & GRAVELLE, *supra* note 17, at 9.

rule with higher standards and higher costs for being treated as a non-U.S. corporation. As a result, any corporation undertaking the same type of transaction will be treated as a U.S. corporation for tax purposes and still be subject to U.S. tax; thus limiting or eliminating the benefits of these transactions.[34]

1. Factors Impacting Location Decisions for Multinational Entities

Deeply rooted in the U.S. legal system is the notion that corporations are "organized and carried on primarily for the profit of the stockholders."[35] Thus, when a corporation is placed under certain pressures that inhibit the ability of the firm to maximize shareholder value, it has a duty to examine the obstacles faced and pursue strategies that better accommodate reaching this goal. For example, in 2013, a global survey that interviewed a sample of the world's largest multinational research and development investors found that three factors primarily affect a firm's decision on where to invest, two of which were tax "planning certainty and simplicity" in the tax law.[36] In 2016, a survey examining the concerns of corporate officers found that over-regulation continued to be a primary interest.[37] Nearly half of the executives surveyed cited compliance with unclear regulations as adding to the cost of doing business, which is then often passed on to consumers through price increases.[38] When conducting business under unclear and inconsistent standards, companies face the issue of trying to balance shareholder expectations of growth and profitability with staying outside the reach of the often harsh consequences of the tax rules.[39]

When excessive time and money are required for compliance with the tax code and regulations thereunder, businesses consume resources that could otherwise be used for investment purposes and business operations, which contribute to the growth and value of the firm. Because the management of an MNC seeks to structure investment and financing

---

34. *See, e.g.*, Press Release, U.S. Dep't. of the Treasury, Treasury's Final Earnings Stripping Regulations to Narrowly Target Corporate Transactions That Erode U.S. Tax Base (Oct. 13, 2016), https://www.treasury.gov/press-center/press-releases/Pages/jl0580.aspx.

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

36. JOST H. HECKEMEYER ET AL., A SURVEY OF TAXATION & CORPORATE INNOVATION, PRICEWATERHOUSECOOPERS 13 (Aug. 2015), https://www.pwc.de/de/steuerberatung/assets/pwc-a-survey-of-taxation-and-corporate-innovation-2015.pdf. The third factor identified as affecting location decisions for investment in this survey is the "immediate impact on liquidity." *Id.*

37. PRICEWATERHOUSECOOPERS, 19TH ANNUAL GLOBAL CEO SURVEY: REDEFINING BUSINESS SUCCESS IN A CHANGING WORLD 2 (2016), https://www.pwc.com/gx/en/ceo-survey/2016/landing-page/pwc-19th-annual-global-ceo-survey.pdf.

38. *Id.* at 18.

39. *Id.* at 19.

decisions that maximize the firm's value, it is essential that management prioritize the most efficient use of the company's capital.[40] While there are certainly other factors to be weighed, the way MNCs are taxed "importantly affects their investment decisions, their location decisions, and how they finance themselves."[41]

a. Stability in Legal Regime

Theory on MNCs suggests that the choices it makes regarding location are a function of the need to reach corporate goals and create advantages for the firm.[42] Furthermore, investors and shareholders typically have a strong understanding of the relationship between companies and the regulatory systems in which they operate.[43] By relocating headquarters overseas, the MNC commits to laws and regulations of the new host country and potentially benefits from host country's improved legal and regulatory regime, thereby sending signals to investors that it is operating under certain standards of governance.[44] The signal sent to investors when a firm establishes headquarters or remains established in the United States is that the firm is operating under increasingly heavy regulatory burdens and costs that restrict flexibility, consume valuable time and resources, and reduce potential return.

b. Simplicity and Certainty in the Tax Law

Where a tax system lacks simplicity, is ambiguous, or is inconsistent, neither the government nor its taxpayers can effectively plan and budget in accordance with their goals. Certainty in the law, or lack thereof, can significantly affect a taxpayer's decision-making in several ways.[45] The ability to predict, or at least roughly estimate, tax liability can contribute to more rational choices in transactions, whereas uncertainty can

---

40. A.M. Goyal, *Impact of Capital Structure on Performance of Listed Public Sector Banks in India*, 2 INT'L J. BUS. & MGMT. INVENTION 35, 35 (2013).

41. *The Impact of International Tax Reform on U.S. Competitiveness: Hearing on H.R. 25, S, 1050, and H.R. 2060 Before the Subcomm. on Select Revenue Measures of the H. Comm. On Ways and Means*, 109th Cong. 6 (2006) (statement of Glenn Hubbard, Dean of Columbia Bus. Sch. and former Chair of the President's Council of Econ. Advisers).

42. *See* Julian Birkinshaw et al., *Why Do Some Multinational Corporations Relocate Their Headquarters Overseas?*, 27 STRATEGIC MGMT. J. 681, 684 (2006) (discussing MNC locational choices as a function of "firm-specific advantages" and "country-specific advantages").

43. Gregory Day, *Irrational Investors and the Corporate Inversion Puzzle*, 69 SMU L. REV. 453, 487 (2016).

44. MIKE W. PENG, GLOBAL STRATEGY 315 (2d ed. 2009).

45. JASON PIPER, ASS'N CHARTERED CERTIFIED ACCOUNTANTS, CERTAINTY IN TAX 3 (2014), http://www.accaglobal.com/content/dam/acca/global/PDF-technical/tax-publications/tech-tp-cit.pdf.

influence decisions on whether to pursue or continue a business or activity, based solely on the fear of harsh tax consequences.[46]

A firm's decision of whether and where to invest is complex, and will vary based on the specific goals and needs of the firm. The tax cost of being a U.S. company is undoubtedly high, but it is not the only factor taken into consideration when determining corporate location. While tax incentives influence decisions on corporate location, "[t]ransparency, simplicity, stability and certainty in the application of the tax law and [in] tax administration" generally bear greater weight than tax incentives.[47] Surveys examining firm decision making with respect to tax jurisdiction have found that tax incentives can actually be a *discouraging* feature of a jurisdiction where the rules are difficult to track, understand or comply with, because such complexity tends to increase costs to firm activity and limit growth.[48] Because instability and unpredictability in a tax system add risk and create excessive burden that consumes firm resources, these factors are considered key in a firm's decision on where to locate its headquarters and invest.[49] Thus, while the higher total tax liability a company faces under the U.S. tax system certainly factors into the decision to relocate, the unpredictability and complexity of the tax administration in the United States has an important influence on a firm's decision to relocate as well.

2. *The Volume and Complexity of the U.S. Tax Code and Regulations*

Most people get the short version of U.S. corporate tax law: a thirty -five percent corporate tax on worldwide profits. But the law that gives us that information is notorious for its length and complexity. By the end of 2015, the U.S. Tax Code contained just under 2.5 million words, while federal tax regulations contained over 7.6 million words.[50] This figure excludes the large body of case law to which taxpayers must also comply.[51] The October 2016 preamble and regulations to Section 385 of

46. *Id.*

47. ORG. FOR ECON. CO-OPERATION & DEV., *Tax Incentives for Investment: A Global Perspective Experiences in MENA and Non-MENA Countries*, *in* MAKING REFORMS SUCCEED: MOVING FORWARD WITH THE MENA INVESTMENT POLICY AGENDA 225, 229 (2008).

48. *Id.* at 228–29.

49. *See, e.g.*, ORG. FOR ECON. CO-OPERATION & DEV. ET AL., SOUTH EAST EUROPE REGION: ENTERPRISE POLICY PERFORMANCE A REGIONAL ASSESSMENT, OECD AND EUR. BANK FOR RECONSTRUCTION AND DEV. 34–35 (2003) (analyzing key factors prompting firms' location decisions in the context of South East Europe).

50. Scott Greenberg, *Federal Tax Laws and Regulations Are Now Over 10 Million Words Long*, TAX FOUND. (Oct. 8, 2015), http://taxfoundation.org/blog/federal-tax-laws-and-regulations-are-now-over-10-million-words-long.

51. *Id.*

the Code span over 500 pages long.[52] For large MNCs, the complexity of the U.S. tax rules requires a great amount of resources just for compliance. For example, Mobil Corporation once brought its federal tax documents to a congressional hearing to demonstrate the extent of its compliance burden.[53] The documents totaled 6300 pages and weighed seventy-six pounds.[54] And, in multiple years, Citigroup's tax returns have exceeded 30,000 pages.[55]

To complicate things further, each year there are changes or additions, requiring corporate taxpayers to track the changes and adapt with each new layer of rules. The rules become increasingly complex for firms with operations in more than one jurisdiction.

Businesses hire accountants, lawyers and tax professionals to help them navigate the Code and to prepare, file, and pay their taxes. When it comes to MNCs, more advanced legal and accounting services are typically required, including tax legal counsel; tax accounting counsel; transfer pricing consulting; certain technology systems to maintain a broader range of detailed records; corporate planning, financial planning and forecasting professionals; and other miscellaneous costs.[56]

3. The Burdens Associated With Doing Business Under U.S. Tax Law

The cost of compliance usually refers to all tax-related costs other than the actual taxes paid.[57] The core legal costs include time costs, such as the time spent maintaining books and receipts; cash outlays related to tax obligations; purchases of tax-related software or publications; and payments to others, such as tax lawyers and accountants.[58] The major activities involved in tax compliance can include maintaining accounting data; filing returns; planning and strategy to reduce liability; audits, appeals and dispute proceedings; and, possibly, tax penalties and prosecution proceedings, to name a few.[59] Aside from these direct costs, businesses may incur indirect costs, such as delayed tax refunds that

---

52. *See* Treas. Reg. § 1.385 (2016).

53. Chris Edwards, *Simplifying Federal Taxes: The Advantages of Consumption-Based Taxation*, 416 POL'Y ANALYSIS 1, 5 (2001).

54. *Id.*

55. *Id.*

56. PRICEWATERHOUSECOOPERS, HOW THE PROPOSED SECTION 385 REGULATIONS COULD IMPACT CORPORATE TREASURY 17 (2016), https://www.pwc.com/us/en/risk-management/assets/how-the-proposed-section-385-regulations-could-impact-corporate-treasury.pdf.

57. INV. CLIMATE ADVISORY SERVS. OF THE WORLD BANK GRP., A HANDBOOK FOR TAX SIMPLIFICATION 34 (2009).

58. *Id.*

59. *Id.* at 36.

reduce the present value of the net cash flow of the business.[60] Certain indirect costs are less quantifiable, such as the costs of ambiguous guidelines or rates, which change firm behavior.[61]

From a leadership perspective, inversion can be attractive as a way to limit these costs by reducing the corporate management's duty to comply with difficult regulations.[62] While the corporate tax rate imposes high cost burdens, the corporate tax regulations in the United States impose not just financial burdens, but also consume a significant amount of time and effort. As the complexities within the tax regulations continue to multiply, the costs of doing business increase as well. The ongoing compliance requirements and uncertainties arising from the changing regulatory scheme result in the need to keep a number of highly qualified tax professionals employed so that a firm can adapt to unexpected changes. For example, Citigroup, a Delaware corporation, employed approximately 30,000 regulatory and tax compliance staff in 2015, as compared to approximately 14,000 in 2008, with compliance costs as high as $4.4 billion in a given year.[63]

In a 2013 case study using data compiled by the World Bank, analysts considered 166 different economies using three indicators to measure a tax system's administrative burden on businesses.[64] In 2013, the United States averaged approximately 175 hours to comply with federal taxes per entity.[65] Compare this figure to the averages of 59 hours in Luxembourg, 63 hours in Switzerland, and 80 hours in Ireland for the same year.[66] Most countries saw a decline in the number of hours needed to comply in the years following 2013.[67] However, the U.S. remained at 175 hours through 2015, which is only slightly lower than the 187-hour average in the four years prior to 2013.[68]

It also costs American companies significantly more to compute their U.S. tax on foreign income than to compute their U.S. tax on domestic income.[69] For U.S. MNCs, foreign activities have accounted for

60. *Id.*

61. *Id.*

62. Day, *supra* note 43, at 457.

63. U.S. SEC. & EXCH. COMM'N, FORM 10-K CITIGROUP INC. ANNUAL REPORT 62 (Jan. 15, 2016).

64. Andrew Sentance, *An Economic Analysis: Taxation, Economic Growth and Investment*, *in* PAYING TAXES 2013: THE GLOBAL PICTURE 23, 25 (2013), https://www.pwc.com/gx/en/paying-taxes/assets/pwc-paying-taxes-2013-full-report.pdf (comparing the total tax rate as a percentage of profits; the number of different payments which businesses are required to deal with; and the time spent by businesses in complying with the tax laws).

65. *Id.* at 118 Fig.2.48.

66. *Id.* at 16 Fig. 1.3, 98 Fig. 2.38.

67. PRICEWATERHOUSECOOPERS & WORLD BANK GRP., PAYING TAXES 2015: THE GLOBAL PICTURE 116 (2015), https://www.pwc.com/gx/en/paying-taxes/pdf/pwc-paying-taxes-2015-high-resolution.pdf.

68. *Id.*

69. BUS. ROUNDTABLE, TAXATION OF AMERICAN COMPANIES IN THE GLOBAL MARKETPLACE: A PRIMER

39 percent of costs incurred to comply with U.S. tax rules, even though the percentage of assets and employment located abroad was less than half of that.[70] While some industries encounter greater compliance costs than others, the general finding in this area has been that part of a U.S. company's disadvantaged status compared to foreign competitors is the costs of complying with the U.S. tax rules.[71]

As the Treasury continues to impose even more costs to an even broader range of businesses in the U.S., relocating headquarters may begin to seem like the only way to remain profitable for firms with certain features. Having a multinational group owned beneath a U.S. corporation has become not only unappealing, but practically bad business if the goal of the corporation is to maximize value and operate in the best interests of its shareholders.

4. Post-Inversion Advantages to a Corporation

The following examples illustrate how inversion can allow a company to substantially reduce its effective tax rate, increase its attractiveness for investment, and operate with the flexibility to improve and expand the business.

a. Lower Effective Tax Rate

As a very basic example of the potential for tax savings through inversion, imagine that U.S. Corporation, taxed at a thirty-five percent rate, has $90,000 income generated in the United States and $10,000 from the Irish territory. Similarly, Irish Corporation, taxed at 12.5 percent in Ireland, has $10,000 income from the U.S. and $90,000 from Ireland.[72]

If there is no inversion, U.S. Corporation is taxed at thirty-five percent on both United States and Irish-source income. U.S. Corporation will have a tax liability of $35,000—thirty-five percent multiplied by its income from both territories. Irish Corporation, however, will have a tax liability of $14,750—thirty-five percent multiplied by the U.S. income of

---

24 (2011).

70. *Id.*

71. Joel Slemrod, The (Compliance) Cost of Taxing Business 7–10 (Apr. 25, 2006) (unpublished research paper) (on file with Mimeo Uni. of Mich.), http://webuser.bus.umich.edu/jslemrod/pdf/cost_of_taxing_business.pdf; *see also* Martha Blumenthal & Joel B. Slemrod, *The Compliance Cost of Taxing Foreign-Source Income: Its Magnitude, Determinants, and Policy Implications*, 2 INT'L TAX PUB. FIN. 37 (1995) (finding that the compliance cost of taxing foreign-source income is about forty percent of total tax compliance costs to large U.S. corporations).

72. The structure of this example was adapted from James G. S. Yang, *Corporate Inversions: Rules and Strategies*, 43 J. CORP. TAX'N 3, 8 (May/June 2016).

$10,000, plus 12.5 percent multiplied by the Irish-source income of $90,000. The combined tax liability for the two corporations is $49,750.

Alternatively, if inversion occurs and U.S. Corporation merges with Irish Corporation, then the total U.S. income of $100,000 ($90,000 plus $10,000) is always taxed at thirty-five percent, leaving a tax liability of $35,000. On the other hand, the total income from the Irish territory of $100,000 is always taxed at 12.5 percent, resulting in a tax liability of $12,500. Thus, the total tax liability on income from both territories after the inversion is $47,500.

Because the foreign territory income is not subject to the higher U.S. tax rate, as the example illustrates, part of the tax savings from inversion comes from the lower tax rate on income from the foreign territory. Lowering the firm's tax liability, however, is just one of the ways a firm can benefit from leaving the United States. Other factors encouraging the decision include the opportunity for earnings stripping; modest transactional costs, especially as compared to the costs of remaining in the United States; continued access to capital markets; market acceptance and eligibility for government contracts following the inversion; and the ability to avoid the deficiencies in the U.S. tax laws governing multinationals.[73]

b. Examples of Post-Inversion Tax Savings

A study released in late 2016 examining inverted companies from 1983 to 2014 found that, in the aggregate, firms reduced their corporate tax liabilities between $16.9 billion and $25.3 billion through inversion.[74] This research further found that many shareholders experience a positive net benefit from inversion.[75]

For example, Transocean, an oil drilling company, inverted to Switzerland in 1999 and reduced its tax rate by approximately 50 percent, saving more than $2 billion in taxes over a ten-year period.[76] Similarly, Caterpillar, Inc., a Delaware construction equipment manufacturer, also relocated to Switzerland in 1999, saving approximately $2.4 billion in tax in the twelve years following its inversion.[77] Many other inverted

73. John C. Hamlett, *The Declining Allure of Being "American" and the Proliferation of Corporate Tax Inversions: A Critical Analysis of Regulatory Efforts to Curtail the Inversion Trend*, 93 WASH. U. L. REV. 767, 775 n.77 (2016).

74. Anton Babkin et al., *Are Corporate Inversions Good for Shareholders?*, J. FIN. ECON. 26 (2016).

75. *Id.* at 23.

76. Mitchell Franklin et al., *To Invert or Remain a U.S. Multinational: The Consequences Are the Question*, 43 J. CORP. TAXATION 17, 19 (Nov./Dec., 2016).

77. *Caterpillar's Offshore Tax: Strategy: Hearing Before the Permanent Subcomm. On Investigations Comm. on Homeland Security & Gov't Affairs*, 113th Cong. (Apr. 1, 2014) (statement of Sen. Levin, Chairman, S. Comm. on Investigations).

companies have experienced similar tax savings, including Burger King in 2014, with an estimated tax savings of $275 million in the three years following its inversion; and Medtronic, in the largest inversion deal so far, with expected savings large enough that its executives agreed to trigger the roughly $63 million in capital gains taxes as part of the transaction.[78]

C. Corporate Inversion and Changes in International Tax Law

Recent changes in international tax law are worth noting, as they affect a firm's decision on whether or not to relocate.[79] With the OECD's 2013 report on Base Erosion and Profit Shifting ("BEPS"), a global action plan was initiated to address the perceived flaws in international tax law that have allowed MNCs to shift profits and avoid taxation.[80] However, even taking into consideration the potential for upcoming changes to foreign countries' domestic tax laws, which might decrease the appeal of relocating to a particular jurisdiction, the costs associated with remaining in the United States continue to outweigh those of relocating.

1. Inversion in the United Kingdom

The previous tax system in the United Kingdom tells a familiar story. Prior to 2009, the U.K.—like the U.S. now—operated under a worldwide system and had a high corporate tax rate. In the early 1990s, the U.K. had a corporate tax rate of 33 percent and charged tax on global profits of U.K.-resident companies.[81] In 2006, a decision issued by the European Court of Justice ("ECJ") sparked a wave of corporate inversions out of the U.K.[82] The ruling established that the U.K. could not impose its corporate tax on foreign subsidiaries of U.K. MNCs.[83] Following this ruling, U.K. corporations began moving quickly to Ireland.

After the U.K. saw many of its large corporations fleeing to Ireland, it reformed its corporate tax system in an attempt to stop the problem of inversion and become a more attractive jurisdiction for corporations. The

78. Franklin et al., *supra* note 76, at 20.

79. *See supra* notes 36-45.

80. *See generally About the Inclusive Framework on BEPS*, OECD, http://www.oecd.org/tax/beps/beps-about.htm (last visited Nov. 21, 2017).

81. Org. for Econ. Co-operation & Dev., OECD Economic Surveys: United Kingdom 2007 141 (2007).

82. Marples & Gravelle, *supra* note 17, at 7.

83. *See* Case C-196/04, Cadbury Schweppes Overseas Ltd., et al., v. Commissioners of Inland Revenue, 2006 E.C.R. I-07995. In *Cadbury Schweppes*, a corporate group, Cadbury Schweppes Overseas, had established two subsidiaries in Ireland so that profits related to the internal financing activities of the Cadbury Schweppes group would benefit from Ireland's more favorable tax regime. The case called into question the Freedom of Establishment Clause, which the Court ultimately held could not be invoked in another European Union member state purely for tax purposes. *See id.*

U.K. (1) shifted from taxing worldwide profits to a territorial system, under which it applied the corporate income tax only to income earned within its borders; (2) lowered its corporate tax rate to 28 percent in 2010, and then again to 21 percent in 2014; and (3) reformed its rules for controlled foreign corporations ("CFCs") to tax overseas profits only where there was artificial reduction of U.K. tax, rather than taxing all profits of the CFC.[84] Following the changes to the corporate tax system in the U.K. in 2009, many previously inverted companies returned to the U.K., and many previously U.S. headquartered companies followed.[85]

The U.K.'s corporate inversion problem and subsequent tax reform is often used as a possible example for the United States to follow in dealing with its own inversion problem. Beyond the example of the U.K., the argument has been made multiple times for the United States to lower its corporate tax rate and switch to a territorial system. However, the United States has firmly resisted change in these areas, and continues to address its inversion problem primarily through the regulatory system.

2. *The OECD, BEPS, and the European Commission*

One concern surrounding the U.S. corporate tax system and the inability to reverse the inversion trend is the level of competitiveness the United States offers its MNCs. Because most other countries offer considerably lower corporate tax rates, tax only income earned within a jurisdiction, and provide much simpler rules for businesses to navigate, there are obvious incentives for a corporation to relocate. But recent changes in international tax were initiated with the goal of limiting certain tax-avoidance practices like, for example, corporate inversion.

Since the release of the OECD's report and BEPS Action Plan, many of the OECD member countries have taken steps to enact changes to local tax laws, including new rules regarding CFCs, permanent establishment status, and transparency—all which aim to support the OECD's guidelines for creating a more clear and functional international tax landscape.[86] These adjustments to the local tax laws of OECD countries have the potential to make it difficult for corporations to invert and shift profits overseas. In addition, the European Commission's ("Commission") recent decisions regarding its Member States' provision

84. William McBride, *Tax Reform in the UK Reversed the Tide of Corporate Tax Inversions*, TAX FOUND. 4 (Oct. 2014).

85. *See, e.g.*, Tom Bergin, *Britain Becomes Haven for U.S. Companies Keen to Cut Tax Bills*, REUTERS (June 8, 2014, 11:10 PM), http://www.reuters.com/article/us-britain-usa-tax-insight-idUSKBN0EK0BF20140609.

86. *See* BNA, *BEPS Tracker*, BLOOMBERG (Oct. 11, 2016), http://0-taxandaccounting.bna.com.hopac.uchastings.edu/btac/T17302/beps_aqb.adp.

of tax benefits to corporations offers another potential hurdle for companies seeking to invert and receive the same tax "deals" that have previously been available to other inverted corporations.[87]

However, these changes are not enough to outweigh the burdens associated with incorporating or remaining incorporated in the United States. OECD members have been quick to participate in discussion, but slow to act. And the United States, on the other hand, is quick to issue punitive domestic measures that require businesses to change practices and adapt, without taking the time to reach the root of the inversion problem. Thus, even with the progress taken toward changing international tax laws, U.S. corporations continue to have a strong incentive to invert.

a. OECD Members and Implementation of BEPS' Actions

A goal of the OECD in issuing the BEPS Action Plan is to coordinate domestic tax rules across borders so that international tax standards may keep pace with the changing global business environment.[88] Akin to the U.S. regulations regarding related-party debt between multinational groups and location of headquarters is BEPS Action 4. Action 4 seeks to limit base erosion via interest deductions and other financial payments by focusing on third party, related party, and intragroup debt.[89]

Tax rules in a jurisdiction can greatly influence debt transactions within multinational groups, as groups often use intragroup financing as a way to claim interest deductions and defer income.[90] Additionally, the definition of a permanent establishment is important in determining whether a non-resident entity must pay income tax in another country.[91] While Actions 4 and 7, as well as other BEPS Actions, seek to address problems that have the potential to reduce inversion issues for the United States, the fact that the OECD is a global consortium with no implementation authority makes the guidelines set forth just that —guidelines.[92] Passage and enforcement of the Actions proposed by the

---

87. *See* Press Release, European Comm'n, State Aid: Ireland Gave Illegal Tax Benefits to Apple Worth Up to €13 Billion (Aug. 30, 2016), http://europa.eu/rapid/press-release_IP-16-2923_en.html.

88. ORG. FOR ECON. CO-OPERATION & DEV., EXPLANATORY STATEMENT: OECD/G20 BASE EROSION PROFIT SHIFTING PROJECT 5 (2015), www.oecd.org/tax/beps-explanatory-statement-2015.pdf.

89. ORG. FOR ECON. CO-OPERATION & DEV., LIMIT BASE EROSION VIA INTEREST DEDUCTIONS AND OTHER FINANCIAL PAYMENTS, ACTION 4—2015 FINAL REPORT 11 (2015), http://dx.doi.org/10.1787/9789262411176-en.

90. *See* ORG. FOR ECON. CO-OPERATION & DEV., OECD/G20 BASE EROSION AND PROFIT SHIFTING PROJECT—2015 FINAL REPORTS, FREQUENTLY ASKED QUESTIONS 10, 13–14 (2015), http://www.oecd.org/ctp/beps-frequently-asked-questions.pdf.

91. *Id.*

92. Hamish Boland-Rudder, *OECD's Tax Crackdown Calls for Global Profit Reporting*, INT'L CONSORTIUM OF INVESTIGATIVE JOURNALISTS (Sept. 18, 2014), https://www.icij.org/blog/2014/09/oecds-tax-crackdown-calls-global-profit-reporting/.

OECD are left to individual countries to implement domestically if, and as they choose.

The primary countries to which U.S. corporations have typically relocated—the Netherlands, Luxembourg, Ireland, and the U.K.—have discussed making changes to their domestic laws regarding Actions 4 and 7.[93] As members of the OECD, this discussion is natural. But these jurisdictions still have a need and desire to attract investment. Because the BEPS Actions—described as "best practice" or "common approach" —are not minimum standards, it is not likely that there will be change in many areas, at least in the short term.[94] The Irish government, for example, has expressed that it is completely committed to keeping its corporate tax rate of 12.5 percent and, while it is open to "playing fair[,]" it is also "playing to win."[95] The Dutch government has also recognized the need to remain attractive to MNCs, stating that its broad participation exemption, lack of withholding tax on royalties and interest payments, and other advantages will remain unchanged.[96]

The OECD, through the BEPS initiative, has provided some useful guidance and tools for tax authorities to use in addressing base erosion and profit shifting. But even if countries adopt the guidelines with full force—which is highly unlikely and would require the rewriting of thousands of tax laws—the U.S. problem of inversion does not pend solely on whether *other* countries become less desirable than they are currently, but rather on whether the United States becomes less costly and less burdensome to its corporate taxpayers.

b. The European Commission and State-Aid Rulings

The OECD is not the only force with the potential to spark change in international corporate tax practices. The Commission recently released rulings and initiated investigations on EU member states providing selective state aid to certain companies.[97] For example, in July 2016, the

93. *See generally* DELOITTE, BEPS ACTIONS IMPLEMENTATION BY COUNTRY: LUXEMBOURG (Mar. 2017), https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-beps-actions-implementation-luxembourg.pdf; DELOITTE, BEPS ACTIONS IMPLEMENTATION BY COUNTRY: IRELAND (March 2017), https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-beps-actions-implementation-ireland.pdf; DELOITTE, BEPS ACTIONS IMPLEMENTATION BY COUNTRY: LUXEMBOURG (March 2017), https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-beps-actions-implementation-netherlands.pdf.

94. Louise Kelly, *Ireland: An Attractive Location in a Post-BEPS World*, 27 INT'L TAX REV. 60 (2016).

95. *Ireland Tax Alert: BEPS Consultation Process Launched*, DELOITTE (May 27, 2014), https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-ireland-270514.pdf.

96. *Tax Insights: Dutch Government Responds to Final BEPS Reports*, PRICEWATERHOUSE COOPERS (Oct. 15, 2015), https://www.pwc.com/us/en/tax-services/publications/insights/assets/pwc-dutch-government-responds-to-final-beps-reports.pdf.

97. *See* ROBERT B. STACK, U.S. DEP'T OF THE TREASURY, TREASURY RELEASES WHITE PAPER ON

Commission issued a decision holding that Spain's tax treatment of certain football clubs—applying a special corporate tax rate—constituted unlawful state aid.[98] Again, in August 2016, the Commission ruled that Ireland gave illegal "tax benefits to Apple worth up to €13 billion" (or $14.5 billion).[99] Over the past few years, the Commission has also initiated investigations into similar generous tax deals offered to MNCs. Note that deals between Luxembourg and Fiat, and between the Netherlands and Starbucks, have already been found unlawful.[100]

However, the winners and losers of the Commission's rulings are not exactly clear. While the countries to which the Commission has ordered companies to pay back taxes will benefit from the income, these governments want companies like Apple, Fiat, and Starbucks investing in their jurisdiction and there is concern that too much change will deter investment.[101] As such, the Irish government has announced that it will seek to appeal the Commission's Apple ruling, claiming that Ireland needs to "maintain the jobs [they] have and develop jobs for the future."[102]

The attitude of the Irish government is a perfect indicator that the domestic tax laws of other countries will not change to the extent needed to stop corporations from leaving the United States. While part of the appeal of inversion may be the tax opportunities in other jurisdictions, the crux of the problem is the inability for U.S. companies to manage the convoluted U.S. tax system and remain competitive. For instance, Irish Finance Minister Michael Noonan recently commented that Ireland has not sought out U.S. businesses, and that the U.S. needs to look to its own tax system, stating "[w]e don't invite U.S. companies to come to Ireland on the basis of inversion and we don't welcome them when they do, but under international law we cannot stop them . . . it is a matter for U.S. authorities to change the law[.]"[103]

EUROPEAN COMMISSION'S RECENT STATE AID INVESTIGATIONS INTO TRANSFER PRICING RULINGS 4–5 (Aug. 24, 2016).

98. Press Release, European Comm'n, State Aid: Commission Decides Spanish Professional Football Clubs Have to Pay Back Incompatible Aid, (July 4, 2016), http://europa.eu/rapid/press-release_IP-16-2401_en.

99. Press Release, *supra* note 87.

100. Press Release, European Comm'n, Commission Decides Selective Tax Advantages for Fiat in Luxembourg and Starbucks in the Netherlands Are Illegal Under EU State Aid Rules (Oct. 21, 2015), http://europa.eu/rapid/press-release_IP-15-5880_en.htm.

101. *Id.*

102. Paul Hannon, *Ireland to Appeal EU's Apple Tax Ruling*, WALL ST. J., (Sept. 2, 2016, 1:58 PM) http://www.wsj.com/articles/ireland-appeals-eus-apple-tax-ruling-1472820356 (quoting Paschal Donohoe, Ireland's Minister for Public Expenditure and Reform).

103. Holly Ellyatt, *Here Are the Likely Winners and Losers from the Apple Tax Ruling*, CNBC EUROPE NEWS (Aug. 31, 2016, 7:58 AM), http://www.cnbc.com/2016/08/31/heres-the-likely-winners-and-losers-from-the-apple-tax-ruling.html.

Foreign governments have benefited greatly from the U.S. tax system driving corporations out, as these firms bring with them jobs and innovation to their new corporate homes. Even given the potential of the BEPS Actions and the rulings by the Commission, governments will not be inclined to make their tax systems as undesirable as the U.S. system, and the United States would be mistaken to bet the solution to its inversion problem on the current posture of international tax laws.

II. THE UNITED STATES' APPROACH: PUNITIVE ANTI-INVERSION REGULATIONS

The historical approach of the United States in addressing inversion has resisted making changes to the corporate tax rate or the taxation of worldwide profits of U.S. MNCs. Rather, the Treasury has adopted a primarily punitive approach to addressing inversion by adding to the existing layers of regulations, complicating the day-to-day operations of businesses, and increasing the costs of remaining in the United States. This approach, as will later be examined in more detail, is contrary to the overall goal of the United States in keeping businesses within the jurisdiction for tax purposes. A potential consequence of the increasing costs of doing business in the United States is that corporations, which perhaps have never planned on engaging in inversion, may now consider doing so as the best option of remaining, or becoming, competitive.

A. THE REGULATORY SYSTEM AND THE TREASURY'S PREVIOUS EFFORTS TO CURB INVERSION

Inversion is nothing new, and the United States has struggled to find a balance between keeping and attracting corporations to the United States, and ensuring that corporations contribute a fair amount to the U.S. tax base. Previous attempts to stop corporate inversion allowed two main avenues to remain. First, the American Jobs Creation Act of 2004 ("Jobs Act")—which added Section 7874 to the Code and sought to stop inversions by denying certain tax benefits—still allowed for a corporation to invert if it had substantial business operations in the country where the firm sought to relocate.[104] Second, corporations could invert through merging with a foreign corporation if the percentage of ownership by the original U.S. stockholders was less than a certain amount after the transaction.[105] Corporations continued to engage in inversions following the Jobs Act, and the Treasury responded by issuing multiple rounds of regulations that altered the ownership threshold, limited the benefits of

104. Jefferson P. VanderWolk, *Inversions Under Section 7874 of the Internal Revenue Code: Flawed Legislation, Flawed Guidance*, 30 NW. J. INT'L L. BUS. 699, 699 (2010).
105. MARPLES & GRAVELLE, *supra* note 17, at 1, 5.

inverting, and created harsher penalties for corporations engaging in these transactions.[106]

1. *A History of Retaliatory Anti-Inversion Regulations*

a. *1980s and 1990s*

The international relocation of McDermott to Panama in 1983 began a three-decade long story of U.S. corporate inversions.[107] The following decade saw the highly publicized inversion of Helen of Troy, a cosmetics company, which relocated to Bermuda in 1993.[108] In response to the Helen of Troy inversion, in 1994 Treasury issued a set of regulations in which the U.S. target companies' shareholders would be generally taxed (despite nonrecognition provisions) if (1) any more than fifty percent of the new parent company's stock was received by the U.S. transferors in the transaction; (2) the foreign acquirer was not engaged in active foreign business for the prior three years; or if (3) the foreign acquirer was not worth at least as much as the U.S. target company.[109] Following the regulations, Tyco International inverted in 1997 with a new corporate home in Bermuda, followed by Transocean inverting in 1999 with a new home in the Cayman Islands.[110]

b. *Early 2000s and Beyond*

In 2001 and 2002, Cooper Industries, Ingersoll Rand, and Nabor Industries all left their U.S. home to enjoy a zero percent corporate tax rate in Bermuda, followed by Noble Drilling in 2002 to the Cayman Islands.[111] To address this growing trend in corporate relocation, Congress passed the Jobs Act, adding Section 7874 to the Code.[112]

Although the goal of Section 7874 was to curb inversions, the trend continued throughout the following decade. From 2005 to 2015, the following companies engaged in inversions and reincorporation to low- or no-tax jurisdictions:[113]

---

106. *See* I.R.S. Notice 2014-52, 2014-8, I.R.B 2014-42; I.R.S. Notice 2015-79, 2014-9, I.R.B. 2015-49; *see also* Press Release, *supra* note 34.

107. *See* Orsolya Kun, *Corporate Inversions: The Interplay of Tax, Corporate, and Economic Implications*, 29 DEL. J. CORP. L. 313, 315–16 (2004) (attributing McDermott's relocation as "the first major restricting to attract significant attention from the IRS.").

108. Radha Mohan, *The Erosion of the States' Tax Base—A Whopper of a Problem? An Examination of Possible Solutions to Corporate Inversions*, 41 TAX MGMT. WKLY ST. TAX REP. (2014).

109. *See* Treas. Reg. § 1.367(a)–3(c) (1995).

110. *See* Stuart Webber, *Escaping the U.S. Tax System: From Corporate Inversions to Re-Domiciling*, 63 TAX NOTES INT'L 273, 276 (2011).

111. *Id.*

112. VanderWolk, *supra* note 104 at 699.

113. The table data was compiled from the following source: Mider, *supra* note 4; EY, WORLDWIDE CORPORATE TAX GUIDE (2016).

Year	U.S. Corporation	New Country of Incorporation	New Corporate Tax Rate
2005	Lazard	Bermuda	0%
2007	Argonaut Group	Bermuda	0%
2007	Western Goldfields	Canada	15%
2009	Tim Hortons	Canada	15%
2009	Ensco	United Kingdom	20%
2009	Hungarian Telephone	Denmark	22%
2009	Altisource Portfolio Solutions	Luxembourg	21%
2010	Valeant	Canada	15%
2011	Alkermes	Ireland	12.5%
2012	Jazz Pharmaceuticals	Ireland	12.5%
2012	Aeon	United Kingdom	20%
2012	Rowan	United Kingdom	20%
2012	Tronox	Australia	30%
2012	DE Master Blenders 1753	Netherlands	25%
2012	Eaton	Ireland	12.5%
2012	Stratasys	Israel	25%
2013	Tower Group	Bermuda	0%
2013	Liberty Global	United Kingdom	20%
2013	Actavis	Ireland	12.5%
2013	Perrigo	Ireland	12.5%
2014	Endo International	Ireland	12.5%
2014	Theravance Biopharma	Cayman Islands	0%
2014	Horizon Pharma	Ireland	12.5%
2014	Burger King	Canada	15%
2015	Medtronic	Ireland	12.5%
2015	Mylan	Netherlands	25%
2015	Civeo	Canada	15%
2015	Wright Medical	Netherlands	25%
2015	LivaNova	United Kingdom	20%
2015	Steris	United Kingdom	20%

In response to this rush of inversions, the Treasury released Notice 2014-52 ("Notice").[114] This Notice addresses certain cross-border transactions that the IRS identified as facilitating inversions and

114. *See* Press Release, U.S. Dep't of the Treasury, Treasury Announces First Steps to Reduce Benefits of Corporate Inversions: Unfair Practice Erodes the U.S. Tax Base (Sept. 22, 2014), https://www.treasury.gov/press-center/press-releases/Pages/jl2647.aspx.

avoiding the application of Section 7874.[115] The guidance within Notice 2014-52 (1) disregarded certain stock of a foreign acquiring corporation holding a significant amount of passive assets; (2) disregarded certain non-ordinary course distributions by the U.S. company; (3) changed the treatment of certain transfers of stock of the foreign acquiring corporation; and (4) addressed post-transaction steps that the taxpayer may take with respect to U.S.-owned foreign subsidiaries.[116]

Again, in November of 2015, the Treasury announced guidance that made it more difficult to engage in inversion and reduced the benefits of doing so. Notice 2015–79 expanded on the guidance from Notice 2014-52 by (1) providing a "substantial business activities" test that must be satisfied if the foreign acquiring corporation is a tax resident in the foreign jurisdiction; (2) limiting the scope of where the new foreign parent company may be organized; and (3) clarifying previous regulations dealing with active business assets involved in the transfer.[117] Further, the 2015 Notice announced rules to decrease the tax benefits of inversion by expanding the scope of inversion gain to include certain income that cannot be offset by losses, and required that all unrealized built-in gain in CFC stock be recognized if the transaction terminates the status of the foreign subsidiary as a CFC.[118]

c. *2016 Anti-Inversion Regulations*

On April 4, 2016, the Treasury issued temporary regulations further addressing inversion and earnings stripping.[119] The April 2016 proposed regulations not only supported the guidance in the previous two notices regarding Section 7874 of the Code, but also targeted transactions that increase related-party debt that does not finance new investment in the U.S., relating to Code Section 385.[120]

Immediately following the announcement and release of the proposed regulations in April 2016, U.S. businesses expressed concerns about the excessiveness of the proposed regulations in both their reach

---

115. *See* Internal Revenue Bulletin: Notice 2014-52, INTERNAL REVENUE SERV. (Oct. 14, 2014).

116. *Id.* For purposes of Notice 2014-52, non-ordinary course distributions mean "the excess of all distributions made during a taxable year by the domestic entity with respect to its stock or partnership interests, as applicable, over 110 percent of the average of such distributions during the thirty-six month period immediately preceding such taxable year." *Id.*

117. *See* I.R.S. Notice 2015-79 (discussing additional rules regarding inversions and related transactions).

118. *Id.*

119. U.S. Dep't of the Treasury, *Fact Sheet: Treasury Issues Inversion Regulations and Proposed Earnings Stripping Regulations* (Apr. 4, 2016), https://www.treasury.gov/press-center/press-releases/Pages/jl0404.aspx.

120. *Id.*

and cost.[121] In the six months following the release of the new rules, there were multiple estimates on how the proposed rules would impact the day-to-day operations of U.S. businesses, and much of the discussion stressed the impracticability of complying with the Treasury's rules.[122] As a result of much public comment on the proposed regulations under Section 385, the Treasury announced the final and temporary versions of the regulations in October 2016, which included certain exemptions from the earlier version of the rules.[123] While the final version of the regulations exempts certain types of corporations that were included in the proposed rules, debt issued by these corporations will still have to meet the criteria set forth in the regulations, which required the same standards of compliance as noted under the proposed rules.[124] Moreover, for the corporations to which the rules do apply, the final rules preserve the heavy compliance burden and the harsh consequences of re-characterization.[125] Even with the exceptions provided by the final regulations, these rules still make it more expensive for companies to remain in the United States, thereby increasing the incentive to invert.

B. THE SCOPE OF THE 2016 ANTI-INVERSION REGULATIONS

As mentioned above, the proposed and final regulations announced in 2016 expand and provide guidance primarily on two sections of the Code: Section 7874 and Section 385. Section 7874 addresses the structure of transactions commonly used for inversion, and Section 385 addresses whether the character of an interest in a corporation is treated

mechanics of the regulations.

1. *Certain Acquisition Transactions Under Regulations to Code Section 7874*

Section 7874 is the primary section governing inversion under the Code. Section 7874 generally applies to inversion transactions only if (1) the transaction includes an acquisition of a U.S. entity by a foreign

121. *See* Letter from Advanced Med. Tech. Ass'n Am. Chemistry Council et al., to Jacob Lew, U.S. Treas. Sec. (May 12, 2016) (on file with BusinessRoundtable.org).

122. *See generally* PRICEWATERHOUSECOOPERS, *supra* note 56 (analyzing the impacts of proposed Section 385 regulations on corporate taxation).

123. Press Release, *supra* note 34.

124. Peter L. Faber, *SALT Implications of Final Section 385 Debt-Equity Regulations*, MCDERMOTT, WILL & EMERY (Oct. 26, 2016), https://www.mwe.com/en/thought-leadership/publications/2016/10/salt-implications-debt-equity-regulations.

125. *See* Treas. Reg. § 1.385 (2016).

126. *See* I.R.C. § 7874 (2005); I.R.C. § 385 (2016).

acquiring entity; (2) the former shareholders of the acquired U.S. entity own at least sixty percent of the stock of the combined foreign acquiring entity following the acquisition; and (3) the foreign acquiring corporation does not have substantial business activities in its country of incorporation.[127] More simply stated, whether or not Section 7874 applies to the transaction rests primarily on the percentage of ownership of the foreign entity that is held by the U.S. entity shareholders and the substantiality of the business activities in the foreign country in which the entity is created.[128]

One available alternative for companies to avoid the applicability of Section 7874 is to engage in a multiple-step acquisition, in which they cascade the increases in the value of the foreign acquiring corporation after each acquisition of a U.S. corporation, which allows for acquisitions of larger U.S. corporations without falling within the scope of the Section 7874 rules.[129] This strategy was the motivation for issuing the April 2016 temporary regulations under Section 7874.[130] In the "multiple-step acquisition," or "serial inverter" rule, the Treasury targeted U.S. companies that acquire a foreign company that has a history of inversion itself.[131] The rule applies to prior transactions that occur within a three-year period, ending on the signing date of the relevant transaction.[132] When the multiple-step acquisition rule applies, the ownership ratios are adjusted so that the consequences of Section 7874 likely still apply.[133]

---

127. SIDLEY, NEW INVERSION REGULATIONS IMPLEMENT AND EXPAND THE SCOPE OF THE ANTI-INVERSION TAX RULES 1 (Apr. 7, 2016), http://www.sidley.com/~/media/update-pdfs/2016/04/20160407-tax-update.pdf. If the level of ownership after the transaction continues at somewhere between sixty percent and eighty percent of what the ownership was of the acquired U.S. entity, then Section 7874 imposes special gain recognition on the U.S. entity *and* any entities which are part of the "expanded affiliate group" ("EAG") of the U.S. entity. *See* VanderWolk, *supra* 112, at 700 (analyzing the application of I.R.C. § 7874 (2005)). The term "expanded affiliate group" pertains to one or more chains of includible corporations connected through stock ownership with a common parent. I.R.C. § 1504(a) (2014). The special gain ("inversion gain") recognition on the U.S. entity and members of the EAG applies for ten years from the last date on which properties are acquired as part of the transaction. *See* I.R.C. § 7874(d)(1)(A) (2005). If the former shareholders of the acquired U.S. entity own at least eighty percent of the stock of the combined foreign acquiring entity following the acquisition, then the foreign corporation will be treated as a domestic corporation for tax purposes, thus denying the tax benefits of the transaction. I.R.C. § 7874(b) (2005).

128. *See* I.R.C. 7874.

129. SIDLEY, *supra* note 127.

130. *See* U.S. Dep't of the Treasury, *supra* note 119.

131. Jeffrey Zients & Seth Hanlon, *The Corporate Inversions Tax Loophole: What You Need to Know*, WHITE HOUSE BLOG (Apr. 8, 2016, 6:39 PM), https://www.whitehouse.gov/blog/2016/04/08/corporate-inversions-tax-loophole-what-you-need-know.

132. *Id.*

133. *Id.*

2. *Rules Regarding the Treatment of Debt Under Code Section 385*

Under section 385 of the Code the Secretary has the authority to prescribe regulations "as may be necessary or appropriate to determine whether an interest in a corporation is treated as debt or equity for tax purposes."[134] The section provides factors, developed through case law, to be taken into account in determining "whether a debtor-creditor relationship exists or a corporation-shareholder relationship exists.[135]

a. *The Existing Rules and the Importance of the Debt/Equity Distinction*

Corporations typically prefer debt, rather than equity, because of the way U.S. tax law—as well as other jurisdictions—has traditionally treated debt for tax purposes.[136] The different tax treatment of debt and equity is most important to an issuing corporation with regard to the deductibility of current payments (either interest or distributions) made on debt or equity.[137] Because the Code provides this divergent treatment of debt and equity, corporate taxpayers often structure transactions in a way that treats an instrument as debt if there is no pressing non-tax reason for classifying the instrument as equity.[138]

In addition to the preference for debt financing under most tax regimes, the use of internal debt within a multinational group leads to important cost savings and increased flexibility.[139] For U.S. multinational groups in particular, internal market activity reflects firm reaction to expensive and uncontrollable features of the external market.[140] Due to

---

134. I.R.C. § 385(a) (2016).

135. *Id.* at (b). These factors include whether there is a written agreement for repayment accompanied by interest; whether there is subordination to or preference over any other debt of the corporation; the ratio of debt to equity of the corporation; and the option of convertibility of the debt into equity. *Id.* at (b)(1)–(5).

136. *See* I.R.C. § 163(a) (2015). First, the Code allows businesses a deduction for interest paid on a debt, which can be taken against both ordinary and capital gain income to the business. Equity, however, is treated much differently under the Code. Section 163(a) allows a deduction for "all interest paid or accrued within the taxable year on indebtedness," but no such deduction is allowed for distributions to the corporation's shareholders. *Id.* A corporation may not recognize any loss or deduction on the distribution of dividends or on the repurchase of stock. *See* I.R.C. § 311. Dividends, therefore, are paid out of after-tax income and are typically subject to multiple levels of tax. Harry Huizinga, Luc Laeven & Gaëtan Nicodème, *Capital Structure and International Debt Shifting* (Eur. Comm'n. Working Paper No. 263, 1, 2 2006).

137. William M. Gentry & R. Glenn Hubbard, *Fundamental Tax Reform and Corporate Financial Policy*, 12 TAX POL'Y & ECON. 191, 196–97 (1998).

138. *See, e.g.*, United States v. Title Guarantee & Trust Co., 133 F.2d 990, 993 (6th Cir. 1943).

139. Nico Dewaelheyns & Cynthia Van Hulle, *Internal Capital Markets and Capital Structure: Bank Versus Internal Debt*, 16 EUR. FIN. MGMT. 345, 351 (2010).

140. Mihir A. Desai, C. Fritz Foley, & James R. Hines Jr., *The Internal Markets of Multinational Firms*, 87 SURV. CURRENT BUS. 42, 42 (2007).

the tax treatment, as well as the non-tax benefits of this type of financing, internal debt has become a key feature of multinational corporations.[141]

b. Proposed, Temporary, and Final Changes Under the 2016 Section 385 Regulations

When the Treasury issued the April 2016 proposed regulations under Section 385, it added rules regarding the criteria for treating an interest as debt or equity for tax purposes.[142] Prior to the proposed and final regulations, a U.S. subsidiary could issue debt to its foreign parent as a dividend distribution following an inversion, and the foreign parent could then transfer that debt to a related foreign entity in a low-tax jurisdiction.[143] In turn, the U.S. subsidiary was able to deduct the subsequent interest paid to the related foreign affiliate.[144] Because this type of transaction is one of the benefits to a firm after inversion, the Treasury's goal in issuing the proposed regulations under Section 385 was to reduce the post-inversion benefits available to the entire group.[145]

In the six months between the announcement of the April 2016 proposed regulations and the release of the October 2016 final regulations, the Treasury made a number of changes to the scope and application of the rules regarding the treatment of debt.[146] Due to the excessive burdens estimated under the proposed regulations and the criticism received by the Treasury thereafter, the final regulations were created with a number of revisions to the April 2016 proposed rules.[147] Most notably, the final regulations relaxed the timing and scope of the documentation requirements; reserved application to debt instruments issued by a foreign corporation to a foreign corporation in a group; provided guidance on satisfying the documentation requirements with regards to cash pooling and other internal financing arrangements; removed the proposed bifurcation rule, under which the Treasury could treat an instrument as part-debt and part-equity; and created exclusions for S corporations and other certain tax-exempt entities.[148]

141. Thiess Buettner, Michael Overesch, & Georg Wamser, *Restricted Interest Deductibility and Multinationals' Use of Internal Debt Finance*, 23 INT'L TAX PUB. FIN. 785, 787 (2016).

142. *See* U.S. Dep't of the Treasury, *supra* note 119.

143. *Id.*

144. *Id.*

145. *Id.*

146. *See* Press Release, *supra* note 34 (discussing "regulations to address earnings stripping.").

147. *Id.*

148. *See* Treas. Reg. § 1.385 (2016). Under the April 2016 proposed regulations, the Treasury required debt instruments to be substantiated within 30 days of issuance; applied to all members of an EAG, including foreign corporations with no U.S. tax relevancy; applied generally to all related party debt, including cash pooling; and applied to S corporations and certain tax-exempt entities. Prop. Treas. Reg. § 1.385-2(b)(3), 81 Fed. Reg. 20912, 20919–21 (Apr. 8, 2016).

First, under the proposed regulations, if debt was issued by a foreign parent company to a U.S. subsidiary, then the rules treated the instrument as equity, thereby denying any deduction to the U.S. subsidiary on interest payments to the foreign parent.[149] If the debt is treated as equity for U.S. tax purposes, then the interest payments on the debt would be treated as dividends subject to outbound withholding tax at whatever rate is provided by the applicable income tax treaty with the foreign parent's jurisdiction.[150] In the final version of the section 385 regulations, however, the Treasury withdrew its application of this treatment to foreign issuers.[151] Thus, the final rules extend to debt instruments issued by members of a group that are domestic corporations.[152]

Second, the documentation corporate taxpayers must prepare and maintain to substantiate an interest as debt, rather than equity, generally applies to an "expanded affiliate group" ("EAG").[153] The proposed and final regulations broadened the definition of EAG to include foreign and tax-exempt corporations, as well as certain corporations held indirectly.[154] Further, if the section 385 regulations apply to an entity based on these criteria, then the entity will be required to comply with documentation and reporting requirements for any debt instruments issued by a member of an EAG to another member of the EAG.[155] If the

149. Treas. Reg. § 1.385-2(b)(3), 81 Fed. Reg. 20912, 20919–21.

150. David P. Hariton, *U.S. Taxation of Related Party Debt: New Proposed Regulations*, HARV. L. SCH. F. ON CORP. GOVERNANCE FIN. REG. (Apr. 20, 2016), https://corpgov.law.harvard.edu/2016/04/20/u-s-taxation-of-related-party-debt-new-proposed-regulations.

151. Treas. Reg. § 1.385-1.

152. *Id.*

153. Prop. Treas. Reg. § 1.385-1, 81 Fed. Reg. 20912, 20919 (Apr. 8, 2016). This section uses the definition of "affiliate group" from Code section 1504. An "affiliate group" under section 1504(a) is one or more chains of includible corporations connected through stock ownership with a common parent corporation. *See* I.R.C. § 1504(a) (2014). The stock ownership test under this section requires that the common parent owns directly at least fifty percent stock of at least one of the other includible corporations, and that stock meeting the fifty percent requirement is owned directly by one or more of the includible corporations. *Id.* For example, if FC, a foreign corporation, owns more than fifty percent of the stock of DC, a domestic corporation that owns more than fifty percent of the stock of DS, another domestic corporation, then FC, DC, and DS make up an EAG. Under the definition in section 1504, however, foreign corporations and tax-exempt corporations are excluded from the term "includible corporation." *Id.* § 1504(b).

154. Prop. Treas. Reg. § 1.385-1, 81 Fed. Reg. 20912, 20919 (Apr., 8, 2016). In the April 2016 proposed regulations, the term "expanded affiliate group" applied also to S corporations, regulated investment companies and real estate investment trusts, and partnerships; Treas. Reg. § 1.385-B(2)(b). In final version of the regulations released in October 2016, the Treasury modified the expanded definition of an EAG to exclude S corporations, regulated investment companies, and real estate investment trusts, and provided a partial exemption for certain partnerships.

155. Prop. Treas. Reg. § 1.385-2, 81 Fed. Reg. 20912, 20929 (Apr. 8, 2016); Treas. Reg. § 1.385-2 (2017) (Under the April proposed regulations, these requirements must have been satisfied within thirty days of the issuance of the instrument between the group, or result in being automatically

documentation requirements are not met or fail to establish the characteristics of debt, the instrument risks reclassification as equity, therefore losing any deduction.[156] However, even if the documentation requirements are satisfied, the instrument is not certain to remain characterized as debt, and is subject to re-characterization if the Treasury later determines so.[157]

Another widely contested rule in the proposed regulations was the "Funding Rule," which generally provided that debt issued in connection with certain stock transactions would be treated as equity if it was issued within three years before, or three years after, the transaction.[158] This application to transactions within a six-year range received much public comment under the proposed regulations.[159] A major concern under the Funding Rule was the cascading effect of the recharacterization of debt, whereby the recharacterization of one transaction as equity would trigger the recharacterization of another within the six-year period, and so on. The final rules, in response to comments received, offered limited relief from the duplicating effect of the proposed rules by providing that once a covered instrument is recharacterized under the Funding Rule, the transaction that caused said recharacterization cannot cause the recharacterization of another debt instrument after the first instrument is repaid.[160] This limitation still allows for a cascading effect, however, it limits the potentially vast number of chains of reclassification that can be initiated by a single transaction.

While the rules in the final regulations offer relief from some of the excessive burdens of the proposed rules for certain companies, they preserve the harsh consequences for the companies to which they still apply. These regulations add punitive consequences to ordinary transactions, increase the cost of compliance, decrease the flexibility of corporate financing activities, and provide uncertainty to companies operating under them.

---

treated as equity. However, the October 2016 final regulations modified this rule, giving the taxpayer until the time of filing to complete the documentation).

156. Treasury Reg. § 1.385-2.

157. *Id.*

158. *See* Prop. Treas. Reg. § 1.385-3, 81 Fed. Reg. 20912, 20922. Specifically, the transactions that trigger recharacterization include any distribution on stock, in exchange for stock of any member of the EAG, or as "boot" in an internal asset reorganization. *Id.* "Boot" refers to certain "nonqualified preferred stock" under Code Section 351(g)(2), which is certain preferred stock with debt-like characteristics. STEPHEN SHWARZ & DANIEL J. LATHROPE, FUNDAMENTALS OF BUSINESS ENTERPRISE TAXATION 457 (Found. Press 5th ed. 2012).

159. *See, e.g.*, Letter from Advanced Med. Tech. Ass'n Am. Chemistry Council et al., *supra* note 121 (This letter, on behalf of twenty-three U.S. corporations to Treasury Secretary Jacob Lew, expressed the burdens and costs the new rules would place on continuing to do business in the U.S.).

160. *See* Treas. Reg. § 1.385-3(b)(6) (2017).

C. THE ADDED COSTS AND BURDENS UNDER THE 2016 ANTI-INVERSION RULES

The new rules set forth in the 2016 anti-inversion regulations will further increase the costs of doing business in the U.S. and further disadvantage U.S. businesses as compared to their foreign competitors, thereby increasing the incentive for inversion. Because the re-characterization rules and documentation requirements increase the cost of daily operations and planning, in addition to lost deductions, the costs associated with compliance may outweigh those of inversion for certain companies. Further, the drastic changes to such a critical aspect of corporate finance within such a short timeframe have created concern and confusion as to what the appropriate standards are, how they can be met, and what other essential business practices are at risk of experiencing the same changes in treatment.[161]

While the revisions under the final Section 385 regulations are an improvement over the April 2016 proposed rules, the issue of reclassifying a debt instrument as equity is still a major concern for the firms to which the final regulations do apply. Moreover, the compliance burden extends to even those entities that are exempted from the re-characterization rules. The final regulations preserve the significant consequences for noncompliance and impact a large number of internal financing, reorganization, and ordinary course transactions.[162]

1. The Risk of Re-characterization and Lost Deductions

The re-characterization rule in the final regulations will recast debt as equity if a member of an EAG issues the instrument in a "tainted" transaction to another member of the EAG, and if the instrument is deemed to have funded the transaction.[163] For example, consider a foreign parent that has a U.S. subsidiary seeking to expand in the United States with a loan financed by the parent company. The parent company finances the expansion, loaning $200 million to its subsidiary, which was borrowed from a foreign bank in the country where the parent company

161. *See* Philip R. Hirschfeld & Stanley C. Ruchelman, *Uproar over Proposed § 385 Regulations: Will Treasury Delay Adoption?*, 3 RUCHELMAN INSIGHTS 40 (2016), http://publications.ruchelaw.com/news/2016-09/Code-385-pushback.pdf.

162. Grant Thornton, *Treasury Finalizes and Significantly Modifies the Debt-Equity Regulations Under Section 385* (Oct. 14, 2016), https://www.grantthornton.com/issues/library/alerts/tax/2016/Flash/treasury-modifies-debt-equity-regulations.aspx.

163. Treas. Reg. § 1.385-3 (2017). (A "tainted" transaction within the meaning of the 385 regulations includes, generally, "a distribution to shareholders; acquisition of an EAG member in an asset reorganization with boot; and acquiring stock of another EAG member in exchange for property"); KPMG, *Section 385 Final Regulations: Initial Reactions* (Oct. 14, 2016), https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2016/10/16460v5.pdf.

is located. The parent is able to use its worldwide assets as collateral, while the U.S. subsidiary is only able to use its own assets. Therefore, the parent company has the ability to borrow on better terms.[164] Assume the parent company borrowed the $200 million from a bank for 20 years at a three percent interest rate and that the U.S. subsidiary took the loan from the parent with a twenty-year term and a four percent interest rate. Prior to the regulations, the U.S. subsidiary would have been able to deduct $8 million per year for interest paid on its debt to the parent.[165] Assuming the affiliate group meets the criteria for application of the regulations, and that the earnings and profits of the entities are such that the section 385 regulations are triggered by this transaction, the $8 million of annual interest payments on the loan would be recharacterized as dividends to the parent, and is therefore not deductible.[166]

2. *The Increased Costs of External Borrowing*

If the companies in the above example want to avoid this risk of recharacterization, then the U.S. subsidiary can borrow directly from a bank, likely with less desirable loan terms. In addition, the parent company would lose $2 million in net income from the difference between the lower interest it paid on the loan to the bank ($6 million) and the higher interest payments received by the U.S. subsidiary ($8 million). Further, the subsidiary borrower would make interest payments charged at a higher rate, and thus the cost of borrowing would increase to above $8 million, depending on the rate offered by the third party lender.

Subsidiaries of MNCs rely heavily on these types of loans from parent corporations or related parties to finance a broad range of business activities.[167] Because of the limitations placed on the use of cash between related entities under the section 385 regulations, companies to which the regulations apply may need to increase the use of third party financing to fund business activities traditionally funded through internal financing. This limited ability to use internal cash to fund business activities, as the above example illustrates, will potentially

164. *See* Senay Agca et al., *Financial Reforms, Financial Openness, and Corporate Borrowing: International Evidence* 12 (IMF Working Paper, 2007), https://ssrn.com/abstract=1007935 (explaining that larger firms with more assets are able to borrow at more favorable terms because they are able to offer the lender more verifiable collateral).

165. *See* I.R.C. § 163(a) (2015).

166. *See* Treas. Reg. § 1.385-3.

167. Bhagwan Chowdhry & Vikram Nanda, *Financing of Multinational Subsidiaries: Parent Debt vs. External Debt*, 4 J. OF CORP. FIN. 87, 88 (1998).

increase the cost of capital, thereby reducing the appeal of business investments.[168]

3. The Increased Compliance Burden

In addition to increasing the cost of capital, the documentation requirements under the proposed Section 385 regulations were the primary concerns raised in the nearly 200 comment letters received by the Treasury and IRS between April and October 2016.[169] While the October 2016 final regulations reduced the transactions and entities to which the rules apply, companies still need to implement and maintain systems of documentation that can support the character of transactions and meet the requirements under the regulations if they wish to keep an instrument classified as debt.

a. Compliance Complications for Certain Ordinary Course Transactions

One area where the proposed regulations would have been particularly burdensome was the application of the rules to common forms of intercompany financing, specifically a practice known as "cash pooling." Cash pooling involves multiple affiliates that "pool" excess funds together and make those funds available to affiliates that need it.[170] The excess funds that are pooled together from the affiliates are usually transferred from each affiliate's account and deposited into one "pool" account, which is typically recorded as a loan to the cash pooling account.[171]

The proposed rules under section 385 were not particularly clear on how the documentation rules applied to arrangements like cash pooling or revolving credit arrangements, which are not generally documented by any separate legal agreement.[172] The final regulations make clear that

---

168. PRICEWATERHOUSECOOPERS, *supra* note 56.

169. PRICEWATERHOUSECOOPERS, STATE TAX IMPLICATIONS OF NEWLY RELEASED IRC SECTION 385 REGULATIONS, TAX INSIGHTS 1 (2016), http://www.pwc.com/us/en/state-local-tax/newsletters/salt-insights/assets/pwc-state-tax-uncertainty-continues-under-new-section-385-regulations.pdf.

170. PRICEWATERHOUSECOOPERS, POTENTIAL IMPACTS OF PROPOSED SECTION 385 REGULATIONS: INBOUND AND OUTBOUND EXAMPLES, 4, 8 (2016).

171. *See id.* at 4. For example, suppose you have Parent Corp., a U.S. parent of a multinational group owning all stock of four foreign subsidiaries: 1, 2, 3, and Pool Corp. (together, with Parent Corp., "U.S. Group"). Foreign subsidiaries 1, 2, and 3 are all operating corporations and Pool Corp. is the group's cash pool leader. When subsidiaries 1, 2, and 3 have excess funds, they deposit those funds to Pool Corp. into the cash pool. If foreign subsidiaries 1, 2, or 3 need extra funds, then the corporation will borrow those funds from Pool Corp. rather than obtaining external financing from a bank or other third party. *Id.* at 9.

172. SKADDEN TAX GRP., IRS AND TREASURY ISSUE FINAL DEBT/EQUITY REGULATIONS (2016), https://www.skadden.com/sites/default/files/publications/IRS_and_Treasury_Issue_Final_Debt_Equity_Regulations.pdf.

the documentation rules apply not only to instruments issued in the legal form of debt, but also to various similar transactions that are not typically supported by a separate agreement, including revolving credit agreements and cash pooling arrangements.[173]

The final Section 385 regulations provide an exception from the recharacterization rule, however, for certain short-term debt and cash pooling arrangements, given that the instrument satisfies one of two tests.[174] So while certain arrangements will not be subject to recharacterization, they will still need to comply with the documentation requirements. While these exceptions were issued with the intent of relieving businesses of some of the burdensome consequences to ordinary course transactions, the rules remain complex and potentially difficult to administer.[175]

b. *Estimated Costs of Compliance Under the Section 385 Regulations*

Accompanying the announcement of the proposed regulations in April 2016, the Treasury provided a Regulatory Impact Analysis including estimated costs of documentation and compliance under the proposed regulations.[176] The Treasury's estimate for the annual "paperwork burden associated with the proposed regulations" for substantiation of related party debt was approximately $13 million for all companies annually.[177] The government estimated that the total number of entities to which the proposed regulations would apply was 21,000; estimated that annual reporting burden per entity would have been 35 hours; and estimated that the total reporting burden to all entities complying with the proposed regulations would have been 735,000

173. *See* Treas. Reg. § 1.385-2(3)(i)(A) (2017).

174. *See* Temp. Treas. Reg. § 1.385-3(c)(i) (2017). Under the "current assets test," (1) the interest rate must be no greater than an arm's length rate, and (2) immediately after the issuance, the issuer's balance of expanded group debt, which meets one of four criteria, cannot exceed the issuer's "short-term financing needs" during the course of the normal operating cycle. *Id.* The second test is the "270-day test," which is generally met if the debt instrument has a term of 270 days or less; bears an arm's length interest rate; and where the issuer is not a net borrower for more than 270 days during the taxable year or 270 consecutive days across taxable years; or where the issuer is a not a net borrower from any other member of the group for 270 days of the year. *Id.*

175. *See* PRICEWATERHOUSECOOPERS, *supra* note 170, at 8. If these transactions are completed at the end of each day, or even each week, with multiple members within a cash pool, then meeting the documentation requirements under the section 385 regulations could potentially require the formal documentation of hundreds of transactions each day, which is currently not the common practice with these types of arrangements. *Id.*

176. INTERNAL REVENUE SERV., REGULATORY IMPACT ANALYSIS (2016), https://www.regulations.gov/document?D=IRS-2016-0014-0001.

177. *Id.*

hours.[178] Taking the government's estimate with a total annual cost of $13 million and dividing it by the estimated 735,000 hours, the estimate implies an average cost of labor at $18 per hour. The government's estimate—when taking into consideration the current standards of compliance and the need to implement new compliance systems; the hourly costs of legal, tax, and other professionals needed to advise on and structure a system; the number of companies to which the regulations apply; and the amount of related party debt within those companies—seems optimistically and unrealistically low.[179]

Other estimates predicted that the costs associated with complying with the proposed regulations would be much higher. In July 2016, PwC released a report analyzing the proposed regulations and the potential costs of compliance for Fortune 100 companies.[180] The analysis took into consideration both the initial startup costs of implementing the new compliance systems and the ongoing operational costs thereafter.[181] In start-up costs, the report includes fees relating to legal, accounting, financial planning and forecasting, tax, and even human resources.[182] In total, the report estimated that the number of hours needed to design such a compliance system would require approximately 21,600 hours between the cost items listed.[183] The report pulled statistics from the Department of Labor for wages associated with each of the cost items, multiplying the associated wages by the estimated hours needed for each item.[184] In the year of implementation alone, for just the Fortune 100 companies, the total estimated startup and operating costs for each company totaled $3.994 million.[185] For each year thereafter, the report estimated that the annual maintenance and operations of the new compliance system would require 9,660 hours per entity, estimating costs of $1.245 million per entity, per year.[186]

Note that these figures are attributable to the costs of compliance *only* with the new rules in the section 385 regulations, and not inclusive of a corporation's total tax compliance costs. Considering that these estimates were based on a sample using characteristics from only Fortune 100 companies and that the final regulations were narrowed in

178. *See* I.R.S. Notice 2016-17, INTERNAL REVENUE SERV. 636, 637 (Apr. 25, 2016).

179. For example, the hourly rate for tax attorneys typically ranges anywhere from $200 to $1,000 per hour of work. *See How Much Does a Tax Attorney Cost?*, CROSS LAW (Jan. 16, 2017), http://www.crosslawgroup.com/blog/hiring-tax-attorney-worth-cost.

180. *See* PRICEWATERHOUSECOOPERS, *supra* note 170, at 1.

181. *Id.*

182. *Id.* at 16.

183. *Id.* at 17 Table V-1.

184. *Id.*

185. *Id.*

186. *Id.* at 18.

scope so that they would not affect a number of smaller entities, these figures are likely fair estimates, as they consider only the costs of implementation and maintenance of compliance systems for larger companies.

While the Treasury has decreased the number of transactions to which the documentation requirements apply, the compliance burdens of applicable transactions are the same. A group engaging in debt transactions will first need to (1) determine whether each type of transaction used falls within scope of the proposed and final regulations; (2) go through the list of new exceptions to the rules to determine the risk of recharacterization; and then (3) figure out how to organize a system that will support the transaction under the criteria outlined in the regulations. Because many related party debt transactions are documented by formal agreements, setting up this type of system could potentially require a significant amount of time and resources.

III. The Treasury's Punitive Approach Provides A Greater Incentive for Inversion

A. Discouraging U.S. Residence Through Competitive Disadvantage

The Treasury has established as one of its goals the promotion of "a level playing field for U.S. financial institutions internationally, and to enhance U.S. competitiveness."[187] This goal, however, is contrary to the approach taken in the recent anti-inversion regulations, and the punitive regulatory approach in general.

The foreign competition faced by U.S. corporations has grown as the globalization of business has accelerated. When globalization of business activities increased dramatically in the 1980s, competition for MNC investment grew as well.[188] This resulted in other countries lowering corporate tax rates, adopting less burdensome corporate tax rules, and simplifying tax laws for MNCs.[189]

The allure of inversion stems from the competitive disadvantages that flow from being taxed as a U.S. corporation.[190] U.S.-based companies are at a disadvantage when compared to their foreign competitors because they can either operate in a high-tax jurisdiction, paying tax at a higher rate than the U.S. rate; or, if they attempt to lower

187. U.S. DEP'T OF THE TREASURY, STRATEGIC PLAN FY 2012–2015 12 (2012).

188. David C. Elkins, *The Merits of Tax Competition in a Globalized Economy*, 91 IND. L.J. 905, 912 (2016).

189. *Id.*

190. James Mann, Note, *Corporate Inversions: A Symptom of a Larger Problem, The Corporate Income Tax*, 78 S. CAL. L. REV. 521, 522 (2005).

the tax they pay, fall under Subpart F of the Code, which triggers immediate taxation at the U.S. tax rate.[191] Thus, a U.S. company operating in a foreign jurisdiction will pay more in tax on every dollar than its competition within the same jurisdiction. All else equal, the lower amounts of after-tax income for the U.S. company create a disadvantage by reducing the company's ability to set competitive prices, engage in financing activities, and invest, thus offering a greater after-tax return on investment.[192]

The disadvantage of U.S. companies has steadily increased for a mix of reasons—the high tax rate, the taxation of foreign profits, and the Subpart F rules.[193] Constant changes and expansion of tax rules through regulations in the U.S. further accelerate the erosion of a U.S. company's competitive position.[194] The Treasury has persisted in its practice of responding to each transaction by adding to the complexity of the system, which has merely triggered new tax planning opportunities and increased the costs of doing business.[195] By increasing the costs of doing business, the regulations increase the need for a company to make up for these disadvantages in other ways, for example, through inversion and earnings stripping. The 2016 regulations increase the incentive to relocate, just as the U.S. saw many of its corporations do after each set of anti-inversion regulations in order to avoid the consequences of the new rules and escape any further regulations that would likely follow.[196]

While there certainly was a time when the strengths of the U.S. economy were enough to offset the disadvantages of its tax system, many other countries have grown to offer most of those same strengths, but with much less burden, and the U.S. has failed to adjust. By continuing this pattern of punitive regulation, the Treasury is attempting to repair the corporate inversion problem by the very approach that created it—an uncompetitive corporate tax system.

---

191. NAT'L FOREIGN TRADE COUNCIL, 2 INTERNATIONAL TAX POLICY FOR THE 21ST CENTURY 7 (2001), http://www.nftc.org/default/tax/fip/NFTC1a%20Volume2(1).pdf.

192. *Id.* at 12.

193. *Id.* at 13-14.

194. *Id.* at 14.

195. *See, e.g.*, *Tax Complexity, Compliance, and Administration: The Merits of Simplification in Tax Reform Hearing Before the Comm. On Fin. U.S. S.*, 114th Cong. 7 (2015) (statement of Mihir A. Desai, Ph.D., Mizuho Financial Group Professor of Finance & Professor of Law, Harvard University).

196. *See supra* Part II.A.1.

B. Creating Costs To U.S. Residence That Outweigh The Consequences of Inversion

Another important policy concern in international taxation, as in all areas of taxation, is neutrality—that tax laws be designed in a way that avoids affecting economic decision-making as much as possible.[197] In the United States, the high corporate tax rate and taxation of worldwide profits already play a large role in disrupting this goal, as is evidenced by the amount of time and resources U.S. companies devote to tax planning, strategy, and avoidance.[198] The added uncertainty and complexity brought by the regulations also adds pressure for a corporation to relocate to a less burdensome jurisdiction. Over time, these combined factors provide a significant incentive for inversion.

1. Remaining a U.S. Corporation versus Relocating to a Foreign Jurisdiction

To put this all into perspective, take the very simplified example of two multinational corporations—one domiciled in the U.S. and one in Luxembourg, each with one U.S. subsidiary and one foreign subsidiary, and each subsidiary produces $100 million in pre-tax earnings that it will distribute to the parent.

a. The U.S. Company Falls Behind: The Cost of the Corporate Tax Rate

Due to the different tax rate and treatment of foreign earnings, the U.S. Corporation will end up with $130 million of after-tax earnings, while the Luxembourg Corporation will end up with $145 million of after-tax earnings.[199] With the U.S. Corporation already trailing $15 million behind its foreign competition, consider now the time it takes each company just to file its tax returns.

197. *See, e.g.*, Mihir A. Desai & James R. Hines, *Evaluating International Tax Reform*, 56 NAT'L TAX J. 487 (2003), http://www.jstor.org/stable/41790118 (presenting concepts of neutrality applied to proposals for tax reform in the United States).

198. *See* PRICEWATERHOUSECOOPERS, *supra* note 170.

199. The tax on the earnings U.S. subsidiary of each corporation will be $35—thirty-five percent U.S. tax rate applied to the $100 of earnings—leaving $65 after-tax; while the tax on the foreign subsidiary will be $20—twenty percent Luxembourg corporate tax rate applied to $100 of earnings—leaving $80 after the foreign tax authorities have been paid, and leaving a total in after-tax earnings of $145. However, because the subsidiaries will distribute these earnings to the parent corporations, the dividend to the U.S. Corporation will be taxed at thirty-five percent as well; crediting the $20 already paid to the Luxembourg tax authorities on the amount, and leaving the U.S. Corporation with an additional $15 in taxes owed on the same amount. *See* I.R.C. § 901 (2010).

b. Falling Further Behind: The Cost of Compliance

For the U. . Corporation, the average time committed to filing is 175 hours, while the average time for the Luxembourg Corporation is 55 hours.[200] Based on Department of Labor data, the average hourly cost of tax and legal services is approximately $127 per hour, which puts U.S. Corporation further behind the Luxembourg company by slightly over $15,000 just for filing.[201]

In addition to the cost of filing, U.S. Corporation has a team of lawyers and accountants to help the company navigate the ambiguity and complexity of the tax rules for MNCs. If U.S. Company is on the larger side, the extra legal and tax fees can be estimated to cost around $7.5 million per year.[202] Increasing this burden, the 2016 regulations are expected to impose costs of approximately $4 million in the year of implementation, and approximately $1.25 million to comply each year thereafter.[203]

c. Loss of Ability to Compensate For Disadvantage

Assume (somewhat safely) that the U.S. Corporation wants to avoid the tax on its foreign income. To achieve this goal, the U.S. Corporation will likely deem the foreign income as "permanently reinvested earnings," and therefore not be taxed on the distribution.[204] This, however, comes at the cost of not being able to currently use those earnings that are permanently reinvested, and thus the U.S. Corporation will need to make up for the unavailability of this income in other ways, for example, through intercompany loans.[205]

---

200. PRICEWATERHOUSECOOPERS, PAYING TAXES 2016 123, 125 (10th ed. 2016), http://www.pwc.com/gx/en/paying-taxes-2016/paying-taxes-2016.pdf. The compliance calculation in this report includes only compulsory payments, and takes into consideration only three types of taxes—corporate income tax, sales tax, and labor taxes; and the preparation time includes the time to collect information necessary to compute tax liability, the time needed to actually file, and the time needed to make payments. *Id.* at 103. Thus, this report excludes any non-compulsory tax compliance hours, such as maintaining accounting data; planning and strategy to reduce liability, which includes the time spent interpreting regulations; audits, appeals, and dispute proceedings; and, possibly, tax penalties and prosecution proceedings.

201. PRICEWATERHOUSECOOPERS, *supra* note 170, at 17.

202. *See* JOEL SLEMROD & JON BAKIJA, TAXING OURSELVES: A CITIZEN'S GUIDE TO THE DEBATE OVER TEXAS 162 (4th ed. 2008) (finding that large companies in the U.S. pay about $5 million per year on tax matters, with many of the largest spending over $10 million).

203. *See* PRICEWATERHOUSECOOPERS, *supra* note 170 at 17.

204. CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, RECOGNITION OF INCOME TAXES TOPIC 740, § 30-25.

205. *See supra* Part II.C.1. For example, in 2010, HP used intercompany loans quite heavily, with two HP entities lending the parent about $6 billion in a single year. Kate Linebaugh, *How Firms Tap Overseas Cash: U.S. Companies Can Borrow Millions of 'Trapped' Funds from Foreign Units If They Follow the Rules*, WALL ST. J., Mar. 28, 2013, at B1.

Referring back to the earlier example of intercompany debt under the 2016 regulations, the U.S. Corporation is now faced with the risk of having certain affiliate debt recharacterized as equity.[206] To avoid this risk, the U.S. Corporation can seek more expensive external borrowing, which results in the loss of income to the group from the interest charged on the loan, the loss of deduction relating to the interest payments, and the likely higher cost of borrowing from a third party.[207]

d. *Inversion-Related Costs Can Be Less Than the Cost To Comply With the 2016 Regulations Alone*

The actual costs incurred in inversion are difficult to gauge, as they depend on specific characteristics of a company. However, for example, consider a company with similar characteristics to Altisource Portfolio Solutions, a formerly U.S. corporation, which inverted to Luxembourg in 2009.[208] Altisource incurred one-time inversion-related fees of $3.4 million.[209] If Altisource were subject to the 2016 anti-inversion regulations, the legal and accounting costs incurred for its inversion would be more than $2 million less than the cost of compliance with the regulations in the first two years.[210]

Altisource reduced its tax liability by nearly $12 million following its inversion, reducing its effective tax rate from thirty percent in 2009 as a U.S. corporation to ten percent in 2011 as a resident of Luxembourg.[211] In addition, the company recognized revenue of $423.7 million in 2011, as compared to $103 million in revenue in 2009, which grew to over $1 billion by 2016.[212]

While not every firm will have the same characteristics as the example of the Altisource inversion, the fact that a firm can pay less in one-time legal fees to completely relocate than it would to implement the requirements of a *single* set of regulations indicates that anti-inversion regulations, at least for certain companies, can have the effect of encouraging inversion. For companies in similar situations, not only could inversion increase the value to shareholders through the availability of resources otherwise allocated to U.S. tax and tax

206. *See supra* Part II.C.1.
207. *Id.*
208. U.S. SEC. & EXCH. COMM'N, FORM 10-K: ALTISOURCE PORTFOLIO SOLUTIONS, S.A. (Dec. 31, 2009).
209. *Id.* at 21.
210. This figure is the result of the approximately $4 million estimated in startup fees and $1.2 million in annual fees thereafter estimated under the 2016 Section 385 regulations, less the amount Altisource paid for professional services on the inversion. *See id.*; PRICEWATERHOUSECOOPERS, *supra* note 170.
211. *Id.* at 29.
212. *Id.* at 3; U.S. SEC. & EXCH. COMM'N, FORM 10-K: ALTISOURCE PORTFOLIO SOLUTIONS, S.A. (Dec. 31, 2015).

compliance, but it may be the only option of remaining competitive or sustaining the enterprise.

For a larger company, the added cost to comply with the documentation requirements under the regulations may not be as damaging as it is likely to be to a smaller company. However the loss of flexibility in internal financing will likely interrupt a significant amount of routine transactions and result in higher costs in outside borrowing. Because of the way debt has traditionally been treated under the Code, these companies have relied heavily on intercompany financing, with related party debt transactions totaling multiple billions in a single year.[213] Limiting the ability to continue these transactions disrupts a major feature of how these companies operate and removes one of the few ways in which a company can attempt to make up for the competitive disadvantages it faces by remaining in the U.S., thus increasing the incentive for inversion.

CONCLUSION

Through the seemingly endless regulations issued by the Treasury, the goal of the U.S. appears to be to reduce the tax benefits that a company can receive with a foreign legal address, thus reducing the incentive to invert. However, the Treasury should redirect its focus to the benefits the United States can receive from creating a more welcoming tax home for corporations. Of the three main factors driving corporations out of the U.S.—the corporate tax rate, a worldwide system, and increasingly burdensome and complex regulations—the Treasury's authority to issue rules under the Code consumes the most time, results in more confusion, and creates greater costs for corporations.

Taking into account the goals of a corporation and the factors impacting location decisions for multinational companies—the high corporate tax rate on a company's worldwide income in the United States; the existing costs of compliance for a U.S. company; the estimated costs of compliance under the 2016 regulations; and the diminished ability to compensate for these disadvantages through certain practices—when compared to the potential costs and benefits available through inversion, corporations have an incentive to invest slightly more initially to relocate, rather than undergo the added annual costs of compliance required by the rules and the potential costs of any new regulations the Treasury may issue.

Rather than trying to discourage tax avoidance by increasing tax liability—by making what was once tax-deductible interest into taxable dividends and by increasing the tax burden by adding costly and time-

213. *See* PRICEWATERHOUSECOOPERS, *supra* note 200.

consuming compliance requirements—the next administration should veer away from the punitive approach and simplify the tax system in a way that allows U.S. MNCs to compete with international competitors.

***