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A ROCKET WITH NO FUEL: HOW THE TAX CUTS AND JOBS ACT CREATES MORE LOOPHOLES FOR CORPORATIONS TO EXPLOIT THE U.S. ECONOMY

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A ROCKET WITH NO FUEL: HOW THE TAX CUTS AND JOBS ACT CREATES MORE LOOPHOLES FOR CORPORATIONS TO EXPLOIT THE U.S. ECONOMY

*Varun Kukreja**

The Tax Cuts and Jobs Act of 2017 ("TCJA" or "Act") brought sweeping changes to the Internal Revenue Code and the overall U.S. tax system. President Trump promised that the Act would be "rocket fuel for our economy." Trump anticipated that corporations would repatriate offshore profits and use those profits to hire more U.S. workers. However, since the Act went into force, economic growth has not increased because corporations have instead used their tax breaks under the Act primarily to boost their balance sheets and issue dividends to shareholders.

This Note addresses three key "loopholes" evident in the old U.S. tax laws and analyzes how these loopholes were addressed by the TCJA. Part II provides a historical understanding of the inverter loophole, the tax haven loophole, and the jobs loophole prior to the TCJA. Part III summarizes key changes implemented by the Act, particularly the domestic and international corporate tax provisions. Part IV analyzes how the Act attempted to address the loopholes under the old tax laws. Part V offers proposals to amend the Act to strengthen some of its provisions to help achieve the Act's objective to be a "rocket fuel" for the U.S. economy.

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I. INTRODUCTION

On December 22, 2017, President Donald Trump signed "[a]n Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," commonly referred to as

the "Tax Cuts and Jobs Act" ("TCJA" or "Act").[1] The TCJA brought about the most sweeping changes to the Internal Revenue Code since the Tax Reform Act of 1986.[2] Despite its significant impact, this legislation was drafted hurriedly and under a highly partisan process, denying lawmakers, tax professionals, and the public a reasonable opportunity to assess and comment on many of its complex tax provisions.[3] The TCJA primarily affects U.S. corporations and how they might achieve corporate tax efficiencies on their worldwide income.[4] The TCJA is estimated to increase the U.S. budget deficit by $1.5 trillion over a cumulative ten-year period.[5] President Trump promised that the TCJA would be "rocket fuel for [the U.S.] economy . . . [with the] biggest winners [being] everyday families . . . and [] companies, which will produce the jobs."[6] However, since the TCJA came into effect, economic growth remains substantially unchanged, and the Act, considered alone, has not really been responsible for "rocket fuel" powered job growth in the country.[7]

This Note addresses three apparent loopholes prevalent under the pre-TCJA tax laws and discusses the TCJA's efforts in addressing them. Part II provides a background on the relevant pre-TCJA provisions that gave rise to the inverter loophole, the tax haven loophole, and the jobs loophole. Part III gives a summary of the key provisions enacted under the TCJA. Part IV discusses the TCJA's attempts to address these loopholes. Part V presents proposals on how to strengthen the TCJA to potentially eliminate these loopholes and fulfill its objective as a "rocket fuel" for the U.S. economy.

II. BACKGROUND: PRE-TCJA TAX LOOPHOLES

This section discusses three loopholes that companies exploited under the old tax laws. First, the high U.S. domestic corporate tax rate and its "worldwide" tax regime gave rise to the inverter loophole.[8] Second,

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1. Samuel A. Donaldson, *Understanding the Tax Cuts and Jobs Act*, GA. ST. U. C. OF L. 1 (Legal Studies Research Paper No. 2018-07, Jan. 8, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3096078.

2. *Id.*

3. Kamin et al., *The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Tax Legislation*, 103 MINN. L. REV. 1439, 1441-42 (2019).

4. Jim Blasingame, *The Good, The Bad And the Ugly Of The Tax Cuts And Jobs Act*, FORBES (Dec. 29, 2017), https://www.forbes.com/sites/jimblasingame/2017/12/29/the-good-the-bad-and-the-ugly-of-the-tax-cuts-and-jobs-act/#6a8830746cf9.

5. *See* Donaldson, *supra* note 1, at 1.

6. Andrew Schwartz & Galen Hendricks, *One Year Later, the TCJA Fails to Live Up to Its Proponents' Promises*, CTR. FOR AM. PROGRESS (Dec. 20, 2018), https://www.americanprogress.org/issues/economy/reports/2018/12/20/464534/one-year-later-tcja-fails-live-proponents-promises/.

7. *See id.*

8. *See infra* Part II.A.

the exclusion of certain types of foreign income of a U.S. corporation from domestic taxation, coupled with lucrative tax regimes abroad led to the tax haven loophole.[9] Third, the ineffectiveness of the enforcement of tax holidays offered to companies to repatriate their foreign earnings created the jobs loophole.[10] Together, these loopholes have deemed the United States a far less competitive tax regime and have cost the country large sums of money in potential tax revenue to bolster the domestic economy.

A. The Inverter Loophole: Pre-TCJA Legislative Efforts

Prior to the TCJA, the United States had the highest domestic corporate tax rate among developed nations at 35%.[11] Additionally, the United States followed a "worldwide" tax system.[12] Under the "worldwide" system, the United States taxed U.S. corporations at the 35% domestic rate on their foreign income earned by its foreign branch.[13] If a U.S. corporation incurred taxes on its foreign income in a foreign jurisdiction, it could claim the foreign tax as a credit against its U.S. tax.[14]

Both the high domestic rate and the "worldwide" tax regime were seen as the main drivers behind U.S. multinational corporations engaging in corporate inversion.[15] In an inversion, a group of companies with a common U.S. parent reorganizes its corporate structure such that the parent is the company incorporated in a low-tax foreign jurisdiction.[16] The motives behind such inversions are largely tax-driven, as many of these companies do not see any managerial or operational benefits from moving abroad.[17]

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9. *See infra* Part II.B.

10. *See infra* Part II.C.

11. *See* MARK P. KEIGHTLEY & MOLLY F. SHERLOCK, THE CORPORATE INCOME TAX SYSTEM: OVERVIEW AND OPTIONS FOR REFORM, CONG. RES. SERV. NO. R42726, at Summary (Dec. 1, 2014).

12. *See* Stuart Webber, *Escaping the U.S. Tax System: From Corporate Inversions to Re-Domiciling*, 63 TAX NOTES INT'L 273, 277 (July 25, 2011).

13. *See* Melissa Redmiles & Jason Wenrich, *A History of Controlled Foreign Corporations and the Foreign Tax Credit*, INTERNAL REVENUE SERV. 129, 130, 132, https://www.irs.gov/pub/irs-soi/historycfcftc.pdf (last visited May 14, 2020).

14. Elizabeth Chorvat, *You Can't Take it With You: Behavioral Finance and Corporate Expatriations*, 37 U.C. DAVIS L. REV. 453, 459-60 (2003).

15. *See* Webber, *supra* note 12, at 276-79.

16. Cathy Hwang, *The New Corporate Migration: Tax Diversion through Inversion*, 80 BROOK. L. REV. 807, 808 (2015).

17. Webber, *supra* note 12, at 273.

One of the first well-known U.S. corporate inversions occurred in 1983.[18] Oil and gas company McDermott, Inc. inverted under its Panamanian subsidiary, McDermott International.[19] The inversion enabled the McDermott group of companies to "retain, re-invest and redeploy earnings from operations outside the United States without subjecting such earnings to [U.S.] income tax."[20] As a result of this inversion, McDermott, Inc. saved an estimated $200 million in taxes.[21]

Since then, Congress has implemented several additional anti-deferral rules to disincentivize corporate inversions.[22] The last significant addition before the TCJA was Section 7874 under the American Jobs Creation Act of 2004, which made it difficult for U.S. corporations to invert.[23] Section 7874 treats a foreign corporation as a domestic corporation if, after the inversion, between 60% to 80% of the foreign corporation's combined shareholders are the company's former U.S. shareholders.[24]

Although corporate inversions slowed down after the implementation of Section 7874, companies circumvented these rules by ensuring the ownership of their U.S. shareholders did not carry over to their foreign inversions beyond the 60% to 80% threshold.[25] U.S. inverters achieved this by combining with non-U.S. companies to create larger entities of which U.S. shareholders owned a smaller proportion.[26] Despite Congress' best efforts, more than fifty U.S. companies have reincorporated in low-tax foreign jurisdictions since 1982.[27]

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18. *See* Keith Hall, *An Analysis of Corporate Inversions*, CONG. BUDGET OFF. 1 (Sept. 2017), https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/53093-inversions.pdf.

19. Reuven S. Avi-Yonah, *For Haven's Sake: Reflection on Corporate Inversion Transactions*, 95 TAX NOTES 1793, 1793 (2002).

20. Steven M. Surdell, *Inversions 2014—Self Help International Tax Reform for U.S. Multinationals?*, 92 TAXES 63, 65 (Mar. 2014).

21. Inho Andrew Mun, *Reinterpreting Corporate Inversions: Non-Tax Competitions and Frictions*, 126 YALE L.J. 2152, 2162 (2017).

22. *See* Hwang, *supra* note 16, at 824-25, 829.

23. *See* Mun, *supra* note 21, at 2165.

24. Jefferson P. VanderWolk, *Inversions under 7874 of the Internal Revenue Code: Flawed Legislation, Flawed Guidance*, 30 NW. J. INT'L. L. & BUS. 699, 700, 704 (2010).

25. *See* ERIKA K. LUNDER, CORPORATE INVERSIONS: FREQUENTLY ASKED LEGAL QUESTIONS, CONG. RES. SERV. NO. R44617, at Summary (Sept. 17, 2016).

26. *See* Surdell, *supra* note 20, at 79.

27. Zachary Mider, *Tax Inversion*, BLOOMBERG, https://www.bloomberg.com/quicktake/tax-inversion (last updated Mar. 2, 2017). *See also Tracking Tax Runaways*, BLOOMBERG, https://www.bloomberg.com/graphics/tax-inversion-tracker/ (last updated Mar. 1, 2017) (identifying the most popular destinations for U.S. tax inversions).

B. The Tax Haven Loophole: "Double Irish with a Dutch Sandwich"

Perhaps the most significant addition to the U.S. anti-inversion regulations was the introduction of "Subpart F" rules to the Internal Revenue Code under the Revenue Act of 1962.[28] Unlike a U.S. corporation's foreign branch income, foreign income earned by a "controlled foreign corporation" ("CFC")[29] of a U.S. corporation was not taxable until the income was repatriated back to the country.[30] Under Subpart F rules, certain types of income, such as a corporation's "foreign personal holding company income" ("FPHCI"),[31] were required to be included in the corporation's U.S. taxable income "regardless of their repatriation to the United States."[32] FPHCI includes several types of passive income, such as royalties.[33] However, royalties received by a U.S. corporation's foreign subsidiary from a related CFC are excluded from FPHCI,[34] meaning that such royalties are not required to be included in the U.S. corporation's taxable income.

The exclusion of related CFC royalties from FPHCI under Subpart F rules gave rise to the tax haven loophole. Several tax reforms abroad, particularly in Europe, played a key role in driving U.S. corporate inversions.[35] For instance, between 1982 and 2017, Ireland was a preferred destination for a majority of U.S. inverters.[36] The Irish corporate tax rate is an attractive 12.5%,[37] less than half of the pre-TCJA 35% domestic rate.[38] As Jeffrey L. Rubinger delineates in his article, *Death of the 'Double Irish Dutch Sandwich'? Not So Fast*, companies such as Apple have resorted to creative tax practices such as the "Double Irish with a

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28. Redmiles & Wenrich, *supra* note 13, at 133.

29. *See* I.R.C. § 957(a) (West 2018) (defining a CFC as a foreign corporation if more than 50% of the corporation is owned by a "United States shareholder[.]" The TCJA defines a "United States shareholder" as a U.S. person "who owns . . . 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation, or 10 percent or more of the total value of shares of *all classes of stock* of such foreign corporation." I.R.C. § 951(b) (West 2017) (emphasis added)).

30. Redmiles & Wenrich, *supra* note 13, at 132.

31. Jeffrey L. Rubinger, *Death of the 'Double Irish Dutch Sandwich'? Not So Fast*, LAW360 (Oct. 27, 2014), https://www.law360.com/articles/590806?scroll=1&related=1.

32. Redmiles & Wenrich*, supra* note 13, at 133.

33. Rubinger, *supra* note 31.

34. *Id.*

35. *See, e.g.*, Hwang, *supra* note 16, at 833 (hypothesizing the ease of selling inversions to the public and shareholders in Europe may be a driving force behind recent inversions in the United States).

36. *Tracking Tax Runaways*, *supra* note 27.

37. Rubinger, *supra* note 31.

38. Redmiles & Wenrich*, supra* note 13, at 130.

Dutch Sandwich" to take advantage of the favorable tax laws in Ireland and the rest of Europe.[39]

1. The "Double Irish"

A typical "Double Irish" tax structure follows this scheme: First, a U.S. parent corporation forms two Irish subsidiaries, for example, IrelandCo1 and IrelandCo2.[40] Second, IrelandCo1 is incorporated in Ireland and domiciled in Bermuda, or any other low- or no-tax jurisdiction such as the British Virgin Islands or the Cayman Islands.[41] IrelandCo2 is incorporated and domiciled in Ireland as a subsidiary to IrelandCo1.[42] Third, IrelandCo1 holds the company's intellectual property ("IP") in Bermuda.[43] IrelandCo1 licenses its IP to IrelandCo2 and IrelandCo2 pays royalties in Ireland on its worldwide use of the IP.[44] IrelandCo2 deducts these royalty payments as an expense on its Irish tax return, thus reducing its overall Irish tax burden.[45] The remaining income of IrelandCo2 is taxed at the 12.5% Irish corporate tax rate.[46] Since there is no corporate tax in Bermuda, IrelandCo1 will not be taxed on the royalties received from IrelandCo2.[47] Finally, IrelandCo2 files a check-the-box election in the U.S. to be considered as a "disregarded entity."[48]

This maneuver effectively disregards the royalties paid by IrelandCo2 to IrelandCo1, as both subsidiaries are now treated as a single entity for U.S. tax purposes.[49] Royalties paid by IrelandCo2 to IrelandCo1 are excluded from FPHCI under Subpart F rules, as IrelandCo1 is subject to tax only on foreign-sourced income besides the IrelandCo2 royalties, and the deferred royalties are effectively taxed only if it is repatriated back to the U.S.[50]

39. Charles Duhigg & David Kocieniewski, *How Apple Sidesteps Billions in Taxes*, N.Y. TIMES (Apr. 28, 2012), https://www.nytimes.com/2012/04/29/business/apples-tax-strategy-aims-at-low-tax-states-and-nations.html.

40. Rubinger, *supra* note 31.

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

45. *Id.*

46. Rubinger, *supra* note 31.

47. *Id.*

48. *Id.*

49. *Id.*

50. *Id.*

2. The "Dutch Sandwich"

In some cases, the royalty payments between IrelandCo1 and IrelandCo2 may be subject to certain withholding taxes in Ireland.[51] However, in combination with the "Double Irish" structure, the "Dutch Sandwich" further helps U.S. corporations reduce their overall effective tax rate. As an example of this approach, consider the following:

a. A company (NetherlandsCo) incorporated and domiciled in the Netherlands (or any other European Union-member country) is added as a subsidiary of IrelandCo1. IrelandCo2 is incorporated as a subsidiary of NetherlandsCo instead of a subsidiary of IrelandCo1.[52]
b. IrelandCo1 licenses its IP to NetherlandsCo, which then licenses that IP to IrelandCo2.[53]
c. NetherlandsCo files a check-the-box election in the U.S. to be considered as a "disregarded entity."[54]

European Union rules mandate that tax authorities cannot impose withholding taxes on payments between EU-resident countries.[55] As a result, royalty payments between IrelandCo2 and NetherlandsCo are not subject to Irish withholding taxes under the "Dutch Sandwich" structure.[56] Further, royalty payments between NetherlandsCo and IrelandCo1 are also not subjected to withholding taxes pursuant to the Netherlands tax laws.[57]

3. Google: The "Double Irish with a Dutch Sandwich" in Practice

Google is an important example of a large tech behemoth executing the "Double Irish Dutch Sandwich" to perfection to reduce its overall tax bill. In 2017 alone, Google's tax structure was instrumental in avoiding imposition of U.S. corporate taxes and EU withholding taxes on over $22 billion in royalties received by the company's Bermuda-based subsidiary.[58] Google created Google Ireland Holdings as a Bermuda tax-resident that owns the company's search and advertising IP for the

51. *Id.*
52. Rubinger, *supra* note 31.
53. *Id.*
54. *Id.*
55. *Id.*
56. *Id.*
57. *Id.*
58. Joseph Boris, *Google Shifted $22.8B To Bermuda Via Shell Co., Filing Says*, LAW360 (Jan. 7, 2019), https://www.law360.com/tax/articles/1115168/google-shifted-22-8b-to-bermuda-via-shell-co-filing-says.

Europe, Middle East, and Africa ("EMEA") region.[59] Google Ireland Holdings is analogous to the aforementioned IrelandCo1, under which Irish subsidiary Google Ireland Ltd. sells advertising space to its customers.[60] Sandwiched in between is Google Netherlands BV, and a Dutch intermediary that licenses IP rights from the Bermuda-based Google Ireland Holdings before sublicensing it to Google Ireland Ltd.[61]

Google Ireland Ltd. pays royalties on customer sales to the company's Dutch subsidiary, which is not subject to withholding taxes pursuant to EU tax regulations.[62] Google Netherlands BV then pays royalties to the Bermuda-based Google Ireland Holdings, which is also not subject to withholding taxes pursuant to the Netherlands tax laws.[63] Further, since Google Ireland Holdings is a Bermuda tax-resident, it is not taxed on the royalty income in Ireland.[64] Therefore, the royalty income is effectively retained tax-free in Bermuda and will only be taxed in the U.S. upon repatriation.[65]

4. End of the "Double Irish"?

In response to the corporate tax avoidance strategies adopted via the "Double Irish" scheme, the Irish government passed legislation to prevent tech companies and other large multinationals from channeling their IP royalties tax-free through non-resident Irish subsidiaries.[66] The legislation phases out current non-resident Irish subsidiaries by the end of 2020.[67] Moving forward, the legislation requires companies registering in Ireland to claim tax residency in the country, thereby subjecting them to the Irish corporate tax rules.[68]

However, in addition to blocking the "Double Irish" loophole, the Irish government implemented another incentive to remain a competitive tax jurisdiction. The government established a "Knowledge Development Box," for which it would tax Ireland-based IP below the 12.5% corporate tax rate.[69] Despite the residency requirement for Irish subsidiaries, the "Knowledge Development Box" effectively mitigates the

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59. Rubinger, *supra* note 31.
60. *Id.*
61. *Id.*
62. *Id.*
63. *Id.*
64. *Id.*
65. Rubinger, *supra* note 31.
66. Ama Sarfo, *Ireland Will Quash Tech-Favored 'Double Irish' Tax Loophole*, LAW360 (Oct. 14, 2014), https://www.law360.com/articles/586794.
67. *Id.*
68. *Id.*
69. Ama Sarfo, *'Double Irish' Tax Quash Unlikely To Send Cos. Packing*, LAW360 (Oct. 16, 2014), https://www.law360.com/articles/587549?scroll=1&related=1.

effects of this requirement by incentivizing companies to shift their IP to Ireland and benefit from the lower tax treatment.[70]

5. Apple's Holy Grail: A Worldwide Non-Resident Corporation

Apple generates over 70% of its income abroad.[71] Apple was a pioneer in the "Double Irish" strategy, stockpiling over $100 billion among its Irish subsidiaries before the country proposed to block this loophole.[72] At that time, Apple's Irish subsidiaries had not declared tax residency in any country.[73] In Ireland, tax residency is determined based on where the corporation is "managed and controlled," unlike the United States, where tax residency is determined based on country of incorporation.[74] Accordingly, Apple managed to convince the authorities that its Irish subsidiaries are "managed and controlled" in the United States, and thus avoid Irish tax residency.[75] Further, since Apple's Irish subsidiaries were incorporated in Ireland, the company avoided U.S. tax residency as well.[76] As a result, as long as Apple's foreign earnings remained in Ireland, the company would not be subject to U.S. tax on these earnings unless it were repatriated back to the country.[77]

However, when the Irish government proposed to shut down the "Double Irish" loophole, the company began to rethink its tax structure.[78] This, coupled with a $14.5 billion European tax bill imposed on the company, forced Apple to declare a tax residency.[79] After a thorough investigation, Apple decided upon Jersey, a small island nation with strong ties to the British banking system.[80] Jersey is yet another popular tax haven that is not subject to EU legislation and does not tax corporate income.[81]

Accordingly, Apple moved two of its three Irish subsidiaries to Jersey before the 2020 phase out deadline for non-resident Irish subsidiaries to declare their Irish residency.[82] However, Apple's third Irish

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70. *See id.*
71. Jesse Drucker & Simon Bowers, *After a Tax Crackdown, Apple Found a New Shelter for Its Profits*, N.Y. TIMES (Nov. 6, 2017), https://www.nytimes.com/2017/11/06/world/apple-taxes-jersey.html?module=inline.
72. *Id.*
73. *Id.*
74. Rubinger, *supra* note 31.
75. Drucker & Bowers, *supra* note 71.
76. *See id.*
77. *See id.*
78. *See id.*
79. *Id.*
80. *Id.*
81. Drucker & Bowers, *supra* note 71.
82. *See id.*

subsidiary declared tax residency in Ireland.[83] While the company's motives are unclear, experts theorize that the third subsidiary is to be used to take advantage of Ireland's "Knowledge Development Box" legislation.[84] Apple will potentially benefit from over $13 billion in tax deductions through this generous IP incentive.[85]

Overall, U.S. corporations are considered the "global grandmasters" of tax avoidance strategies.[86] Companies such as Apple, Google, Amazon, and Starbucks have denied several countries approximately $240 billion annually in tax revenues.[87]

C. The Jobs Loophole: Ineffectiveness of Repatriation Tax Holidays

The creative inversion methods adopted by U.S. corporations, coupled with the ease of access to foreign tax havens, have led Congress to thoroughly deliberate the country's corporate tax system.[88] In 2004, when Congress enacted the American Jobs Creation Act, it created a temporary tax holiday for U.S. corporations to repatriate their foreign earnings at a reduced 5.25% effective tax rate.[89] The reduced rate was conditioned upon companies using their repatriated earnings for "domestic investment."[90]

The 5.25% tax holiday was strongly advocated by well-established U.S. corporations such as Cisco Systems and Oracle Corporation.[91] John Chambers, former Chairman and Chief Executive Officer of Cisco Systems, and Safra Catz, President of Oracle Corporation, argued that these repatriation rates were "prohibitive," particularly when compared to other countries such as Germany, Japan, and the United Kingdom, which taxed foreign earnings at a nominal 0%-2% rate.[92] The 2004 tax holiday was therefore perceived to be a useful tool in "creating jobs, investing in research, building plants, purchasing equipment, and other uses."[93]

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83. *Id.*
84. *See id.*; *see also* Sarfo, *supra* note 69.
85. Drucker & Bowers, *supra* note 71.
86. *Id.*
87. *Id.*
88. *See* DONALD J. MARPLES & JANE G. GRAVELLE, TAX CUTS ON REPATRIATION EARNINGS AS ECONOMIC STIMULUS: AN ECONOMIC ANALYSIS, CONG. RES. SERV. NO. R40178, at 1 (Dec. 20, 2011).
89. *Id.* at 2.
90. *Id.*
91. *See, e.g.*, John Chambers & Safra Catz, *The Overseas Profits Elephant in the Room*, WALL ST. J. (Oct. 20, 2010), https://www.wsj.com/articles/SB10001424052748704469004575533880328930598#articleTabs%3Darticle.
92. *Id.*
93. *Id.*

In terms of repatriated earnings alone, the tax holiday was successful. The pharmaceutical and technology industries accounted for approximately half of the repatriated income.[94] Overall, there was a "greater-than-eight-fold" increase in repatriations, where approximately $265 billion in foreign earnings were transferred from foreign subsidiaries to their respective U.S. parents.[95]

However, the tax holiday was sharply criticized because the "domestic investment" requirement was overbroad and not linked to specific economic uses such as creating jobs, investing in research, or other domestic benefits.[96] The "domestic investment" requirement allowed for several categories of reinvestment that companies could pursue, with the exception of executive compensation and stock repurchase programs.[97]

The tax holiday had an insignificant impact on increasing domestic economic activity and boosting job growth.[98] Ten of the top fifteen repatriating companies suffered job losses between 2004 and 2007.[99] Oracle, which experienced the largest employment gain among the repatriating companies, only did so by virtue of acquiring other companies.[100] Instead, a loophole in the executive compensation and stock repurchase exception to the "domestic investment" requirement allowed a sizeable chunk of the repatriated earnings to be spent on such programs.[101] Companies were able to take advantage of the stock repurchase exception so long as they used only part of their repatriation income to repurchase shares.[102] Subsequently, the tax holiday achieved an undesired result of boosting the corporations' cash flows without increasing investment in the economy.[103]

Since the 2004 tax holiday, Congress has considered similar incentives to stimulate the flow of foreign income into the country.[104] However, none of the repatriation proposals were adopted, primarily due to the ineffectiveness of foreign repatriation in stimulating U.S. investment.[105]

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94. MARPLES & GRAVELLE, *supra* note 88, at 4.
95. *Id.*
96. *See id.* at 1, 6.
97. *See id.*
98. *See id.* at 7-8.
99. *Id.* at 7.
100. MARPLES & GRAVELLE, *supra* note 88, at 7.
101. *See id.* at 1, 8.
102. *See id.* at 8.
103. *Id.* at 6.
104. *See id.* at 1.
105. *See id.*

III. TCJA: THE ANSWER TO ALL LOOPHOLES?

Congress enacted the TCJA in an attempt to address the loopholes discussed above and bolster the U.S. economy. This section briefly summarizes some of the changes made to both the domestic[106] and international[107] tax provisions under the TCJA.

A. Changes to Domestic Tax Provisions

The centerpiece of the TCJA was the reduction of the domestic corporate tax rate from a statutory maximum of 35% to a flat rate of 21%.[108] The prior four-tiered corporate tax system was replaced by a standard 21% tax on all C corporations.[109] Further, the 21% tax rate is a permanent change to the Internal Revenue Code, unlike some of the other individual and flow-through tax deductions that phase out over a number of years.[110]

The reduction in the U.S. corporate tax rate is intended to make the country more competitive against the various tax jurisdictions abroad.[111] This tax rate also applies for personal services corporations such as health, law, and accounting services that were previously subjected to the highest tax rates under the tiered system.[112] Further, the 21% corporate tax rate is significantly lower than the maximum individual income tax rate of 37%, thereby forcing individuals earning income via flow-through entities to rethink whether to incorporate as a C corporation.[113]

1. Repealing the Alternative Minimum Tax ("AMT")

Another important piece of legislation was repealing the AMT.[114] Under the old AMT rules, a corporation that would normally be taxed up to 35% would instead be taxed at 20%, provided they qualified for the lower rate.[115] However, AMT did not allow corporations to fully benefit from deductions for research and development expenses.[116]

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106. *See infra* Part III.A.
107. *See infra* Part III.B.
108. Kamin et al., *supra* note 3, at 1445.
109. *Corporate Tax Reform – Summary of New Laws Taking Effect*, BDO USA LLP 1 (Jan. 2018), https://www.bdo.com/insights/tax/federal-tax/corporate-tax-reform-summary-of-new-laws.
110. *Id.*
111. *Tax Reform – KPMG Report on New Tax Law*, KPMG 39 (Feb. 6, 2018), https://home.kpmg/content/dam/kpmg/us/pdf/2018/02/tnf-new-law-book-feb6-2018.pdf.
112. BDO USA LLP, *supra* note 109.
113. *See* KPMG, *supra* note 111, at 39.
114. Donaldson, *supra* note 1, at 42.
115. *Id.* at 41.
116. Yair Holtzman, Sharlene Sylvia & Michael Ganz, *INSIGHT: A Tactical Approach to R&D Tax Credits for Defense Contractors*, BLOOMBERG BNA (Nov. 9, 2018),

Repealing AMT helped mitigate some of the complexities apparent under the old U.S. tax laws.[117] It was therefore perceived to be a positive step in allowing companies to claim deductions against their research expenses, thereby fueling innovation in the economy.[118]

2. Qualified Business Income for Flow-Through Entities

The TCJA added Section 199A to the Internal Revenue Code.[119] Section 199A allows individual owners of flow-through entities—such as sole proprietorships, shareholders in a S corporation, or partnerships—to claim a temporary 20% deduction on their "qualified business income" ("QBI").[120] QBI includes any trade or business except a "specified service trade or business" ("SSTB") or the "trade or business of performing services as an employee."[121] On its face, the QBI deductions maintain the competitive tax treatment of flow-through entities, because QBI deductions guarantee an approximately 10% lower effective tax rate to flow-through entities when compared to C corporations.[122]

However, there are significant limitations on what actually qualifies as QBI.[123] For instance, several professional services entities, such as healthcare, law firms, and financial services do not qualify for the 20% deduction.[124] Further, foreign income of all flow-through entities does not qualify as QBI.[125] Overall, the largest beneficiaries of the QBI deduction are primarily businesses that hold more labor and tangible assets than intangible assets.[126]

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https://news.bloombergtax.com/daily-tax-report/insight-a-tactical-approach-to-r-d-tax-credits-for-defense-contractors.

117. KPMG, *supra* note 111, at 40.

118. BDO USA LLP, *supra* note 109, at 2 (AMT was repealed under the TCJA because "retaining the corporate AMT could reduce research and development incentives intended to improve competitiveness and innovation.").

119. Tony Nitti, *Tax Geek Tuesday: Making Sense Of The New '20% Qualified Business Income Deduction'*, FORBES (Dec. 26, 2017), https://www.forbes.com/sites/anthonynitti/2017/12/26/tax-geek-tuesday-making-sense-of-the-new-20-qualified-business-income-deduction/#23806b8244fd.

120. *Id.*

121. *KPMG Report: Analysis and observations of final section 199A regulations*, KPMG 2 (Jan. 24, 2019), https://assets.kpmg/content/dam/kpmg/us/pdf/2019/01/tnf-199a-kpmg-report-jan24-2019.pdf.

122. Nitti, *supra* note 119.

123. *See* Kamin et al., *supra* note 3, at 1460.

124. Gunnar Haugen, *New QBI Deduction Could Benefit Taxpayers Who Operate Businesses through Pass-Through Entities*, MOSS ADAMS (May 30, 2018), https://www.mossadams.com/articles/2018/may/qualified-business-income-deduction.

125. *Id.*

126. *See* Kamin et al., *supra* note 3, at 1460.

B. Changes to International Tax Provisions

The TCJA marked a seismic shift from the worldwide tax system with the adoption of the "territorial" system for taxing foreign income.[127] Under this system, a domestic company that holds more than 10% ownership in a foreign company is entitled to a 100% deduction on dividend income received from these foreign companies.[128] Unlike the worldwide system,[129] the territorial system prevents "double" taxation of a corporation's profits both in the U.S. and abroad.[130]

1. Repatriation Tax on Accumulated Foreign Income

Similar to the tax holiday provided in 2004, the TCJA introduced a one-time repatriation tax on a U.S. corporation's foreign earnings that had previously been saved abroad and are now repatriated.[131] This one-time repatriation tax applies to the last taxable year of a corporation's deferred foreign income before January 1, 2018, and it taxes the greater of the corporation's accumulated foreign earnings and profits either as of November 2, 2017, or December 31, 2017.[132] This provision taxes repatriated foreign earnings held in cash at a reduced rate of 15.5%, while other repatriated foreign earnings held in illiquid assets are taxed at 8%.[133] Further, the TCJA allows corporations to pay this repatriation

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127. *See generally* Eric Toder, *Territorial Taxation: Choosing Among Imperfect Options*, AEI ECON. PERSP. (Dec. 2017), https://www.aei.org/wp-content/uploads/2017/12/Territorial-Taxation.pdf.

128. IRS Newsroom, *Tax Cuts and Jobs Act: A Comparison for Large Businesses and International Taxpayers*, INTERNAL REVENUE SERV., https://www.irs.gov/newsroom/tax-cuts-and-jobs-act-a-comparison-for-large-businesses-and-international-taxpayers (last updated Sept. 11, 2019) (explaining that "[a] 100 percent deduction is allowed for the foreign-source portion of dividends received from specified 10-percent owned foreign corporations by domestic corporations that are U.S. shareholders §of [sic] those foreign corporations.").

129. *See* Chorvat, *supra* note 14, at 459-60 (discussing the "worldwide" tax system, where a U.S. corporation's foreign-sourced earnings are subject to taxes in their respective countries. The corporation subsequently receives a foreign tax credit to offset their foreign income taxes.).

130. Toder, *supra* note 127, at 2.

131. Chuck Marr & Chye-Ching Huang, *Repatriation Tax Holiday Would Lose And Is a Proven Policy Failure*, CTR. ON BUDGET AND POL'Y PRIORITIES 3 (June 19, 2014), https://www.cbpp.org/research/repatriation-tax-holiday-would-lose-revenue-and-is-a-proven-policy-failure (explaining that "the 2004 American Jobs Creation Act (AJCA) . . . enacted a one-time 'dividend repatriation tax holiday' that allowed firms to bring overseas profits back to the United States at a dramatically reduced tax rate during 2005 and 2006.").

132. I.R.S. Notice 2018-07, at 1-2 (Dec. 29, 2017), https://www.irs.gov/pub/irs-drop/n-18-07.pdf.

133. *How U.S. Tax Reform Affects International Tax Considerations (article)*, CBIZ (Jan. 3, 2018), https://www.cbiz.com/insights-resources/details/articleid/6168/how-u-s-tax-reform-affects-international-tax-considerations-article.

tax over an extended eight-year period.[134] Although this provision generally applies to C corporations, S corporations also benefit from the reduced repatriation tax rate and further benefit by being permitted to defer this tax on their foreign earnings until they "sell[] substantially all of [their] assets, cease[] to conduct business, change[] its tax status, or the electing shareholder transfers its stock."[135]

It was estimated that this one-time repatriation tax would help cause "all of [the foreign earnings] to come back into [the United States]."[136] Indeed, when President Trump signed the TCJA into law, it was estimated that U.S. corporations held $2.6 trillion in foreign earnings abroad.[137] Apple capitalized on this provision, promising to repatriate most of its $252 billion in foreign earnings, subsequently incurring a sizeable $38 billion tax on their repatriated income.[138] Other companies have also followed suit; and by the first half of 2018, U.S. corporations repatriated an estimated $218 billion in foreign earnings.[139] Since then, however, repatriation activity has slowed.[140] U.S. corporations booked an estimated $37 billion in repatriated foreign earnings during the third quarter of 2018.[141]

2. Global Intangible Low-Taxed Income

The TCJA introduces a tax on "global intangible low-taxed income" ("GILTI").[142] This provision attempts to prevent corporations from shifting profits outside the United States.[143] GILTI imposes a minimum 10.5% tax on certain types of income, namely "highly mobile

134. *Id.*
135. *Id.*
136. *See* Richard Phillips, *New Study Confirms Offshore Earnings are Flowing into Stock Buybacks, Not Jobs and Investments*, INST. ON TAX'N AND ECON. POL'Y (Sept. 7, 2018) (hereinafter "*Offshore Earnings Are Flowing into Stock Buybacks*"), https://itep.org/new-study-confirms-offshore-earnings-are-flowing-into-stock-buybacks-not-jobs-and-investments/.
137. *Id.*
138. Daisuke Wakabayashi & Brian X. Chen, *Apple, Capitalizing on New Tax Law, Plans to Bring Billions in Cash Back to U.S.*, N.Y. TIMES (Jan. 17, 2018), https://www.nytimes.com/2018/01/17/technology/apple-tax-bill-repatriate-cash.html.
139. *See* Safehaven, *U.S. Companies No Longer Repatriating Foreign Profits*, NASDAQ (Dec. 24, 2018), https://www.nasdaq.com/article/us-companies-no-longer-repatriating-foreign-profits-cm1073422.
140. *Id.*
141. *Id.*
142. Kamin et al., *supra* note 3, at 1490.
143. *Id.*

income" such as patent income.[144] The 10.5% tax is effective until 2025, after which the effective GILTI rate goes up to 13.125%.[145]

3. Foreign-derived Intangible Income

The "foreign-derived intangible income" ("FDII") provision taxes certain earnings at a reduced 13.125% effective rate.[146] FDII is income that is "derived from exporting U.S.-generated goods and services and attributable to intangible business assets."[147] FDII essentially works as an export subsidy with the goal to keep U.S.-developed IP within the country.[148]

4. Base Erosion and Anti-abuse Tax

The "base erosion and anti-abuse tax" ("BEAT") imposes an addition tax liability on certain U.S. corporations that significantly reduce their domestic tax liability by making payments to a foreign affiliate.[149] BEAT increases a corporation's overall tax base by excluding tax benefits they receive from "base erosion payments."[150] BEAT proposes to mitigate some of the corporate inversion issues apparent under the old tax laws,[151] as it applies broadly to both foreign subsidiaries and foreign parent corporations.[152]

IV. THE LEGAL PROBLEM

A. The Inverter Loophole: Skipping the BEAT

The inverter problem resulted from the high 35% statutory tax rate and U.S. tax law that permitted multinational corporations to avoid

144. Gordon Gray, *Global Intangible Low-Taxed Income Taxation – A Primer*, AM. ACTION F. (Sept. 13, 2018), https://www.americanactionforum.org/research/global-intangible-low-taxed-income-taxation-a-primer/.

145. Eric Toder, *Explaining the TCJA's International Reforms*, TAX POL'Y CTR. (Feb. 2, 2018), https://www.taxpolicycenter.org/taxvox/explaining-tcjas-international-reforms ("Between 2018 and 2025, companies can claim a 50 percent deduction for GILTI, creating a 10.5 percent effective rate . . . . After 2025, the GILTI deduction declines to 37.5%, the effective tax rate increases to 13.125%, and GILTI will apply in countries with corporate rates of less than 16.406%.").

146. Chris William Sanchirico, *The New U.S. Tax Preference for "Foreign-Derived Intangible Income"*, 71 TAX L. REV. 625, 630 (2018).

147. *Id.*

148. Kamin et al., *supra* note 3, at 1498-99.

149. *Id.* at 1507.

150. *See id.* (defining "base erosion payments" as "deductible amounts paid to the foreign affiliate, such as interest, amounts paid to the foreign affiliate in connection with depreciable or amortizable property, and certain reinsurance premiums").

151. *See id.* (discussing that under the old tax laws, interest payments made to foreign parent corporations were tax deductible).

152. *Id.*

paying tax on unrepatriated foreign earnings.[153] While the TCJA positively brought down the corporate tax rate to 21%, its shift from a worldwide to a territorial corporate tax system did little to nothing to solve the inverter problem.[154] Although statistical evidence of inversions since the passage of the TCJA is not yet available, two major loopholes exist that only serve to incentivize corporations to get more creative with inverting to their foreign affiliates: the tax haven loophole and the jobs loophole. These loopholes are discussed in more detail following this section.[155]

1. Problems with BEAT

BEAT significantly broadened the scope of the tax laws by imposing tax liability on payments made to both foreign subsidiaries and parent corporations.[156] In theory, this was a positive step towards mitigating corporate inversions since U.S. companies previously were permitted to deduct payments made to foreign parents from their overall tax base. However, the current BEAT legislation simply lacks the punch necessary to curb inverting corporations.

First, BEAT applies only to multinationals with average revenues above $500 million over a three-year period.[157] This automatically excludes several U.S. corporations that have previously inverted abroad.[158] Second, BEAT applies only when the corporation's tax benefits from the base erosion payments are more than 3% of their overall deductions.[159] Third, the base erosion payments do not include cost of goods sold.[160] This potentially allows companies to classify their foreign IP-related royalties as cost of goods sold and avoid incurring BEAT liability.[161] Finally, BEAT imposes a meagre 10% liability on the excess tax benefits received from the corporation's base erosion payments.[162] This is hardly a deterrent for corporate inversions when the tax rate for U.S. earnings is more than double this amount (i.e., 21%).[163]

153. *See supra* Part II.A.
154. *See supra* Part II.A.
155. *See infra* Part IV.B-C.
156. *Id.*
157. Kamin et al., *supra* note 3, at 1508.
158. *Id.*
159. Richard Phillips, *Understanding and Fixing the New International Corporate Tax System*, INST. ON TAX'N AND ECON. POL'Y, at 9 (July 17, 2018), https://itep.org/understanding-and-fixing-the-new-international-corporate-tax-system/ [hereinafter Phillips, *Understanding and Fixing the New International Corporate Tax System*].
160. *Id.*
161. *Id.*
162. Kamin et al., *supra* note 3, at 1508-09.
163. *Id.* at 1445.

2. Subpart F Issues

Under the old Subpart F rules, FPHCI included passive and mobile income such as interest, dividends, royalties, and rent payments that were taxed when earned, not repatriated.[164] The typical passive income targeted was IP-related and highly mobile, as evidenced by the plethora of U.S. corporations restructuring their IP abroad.[165] The purpose of Subpart F was to deter U.S. corporations from engaging in inversion activity by taxing their highly mobile income at the domestic rates immediately when they are earned.[166] However, corporations were still able to beneficially take advantage of inversions due to the check-the-box election rules, which allowed corporations to elect their foreign affiliate as a "disregarded entity" and effectively cause some of the highly mobile Subpart F income to be "disregarded" for U.S. tax purposes.[167]

The TCJA went a step further in compounding the corporate inversion issues associated with the Subpart F rules. The new Subpart F rules broaden the definition of a U.S. shareholder,[168] which effectively expands the definition of foreign "passive income" and thus excludes certain foreign earnings by individuals from U.S. taxation.[169] By filing a simple check-the-box election, the new Subpart F rules now allow both corporations and wealthy individuals to shelter their profits abroad, thereby undermining the anti-inversion objectives of the TCJA.[170]

B. The Tax Haven Loophole: Everyone Is GILTI

With BEAT, GILTI was another corporate tax provision that was problematic in the TCJA. Both these provisions were introduced with a goal to impose tax on earnings by U.S. corporations' foreign affiliates and investments.[171] Both GILTI and BEAT were meant to offset some of the costs associated with the switch to a territorial tax system. However, while BEAT gives companies an incentive to shift their intangible assets, GILTI incentivizes companies to move their tangible assets to low-tax jurisdictions, and potentially avoid incurring any GILTI liability

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164. *See* Limitation on Deduction for Dividends Received From Certain Foreign Corporations and Amounts Eligible for Section 954 Look-Through Exception, 84 Fed. Reg. 28398 (June 18, 2019). *See also* I.R.C. § 954(c) (West 2017).

165. Lawrence Lokken, *Whatever Happened to Subpart F? U.S. CFC Legislation after the Check-the-Box Regulations*, 7 FLA. TAX REV. 186, 201-02 (2005).

166. *See id.* at 188.

167. *Id.* at 195-96.

168. *See* Neha Rastogi et al., *Changes to C.F.C. Rules – More C.F.C.'s, More U.S. Shareholders, More Attribution, More Compliance*, 5 RUCHELMAN INSIGHTS 17, 18 (Apr. 1, 2018), http://publications.ruchelaw.com/news/2018-03/InsightsVol5No3.pdf.

169. 26 U.S.C. § 951(b) (West 2017).

170. Lokken, *supra* note 165, at 1888.

171. *See* Kamin et al., *supra* note 3, at 1490, 1507.

on their foreign income.[172] This creates significant economic issues that directly oppose the intended objectives of the TCJA.

1. Shifting Tangible Assets to Tax Havens

GILTI taxes a company's foreign income, but only if that income is more than 10% of the corporation's foreign tangible asset value.[173] The determination of GILTI based on a corporation's foreign tangible assets potentially creates three significant issues.

First, U.S. corporations that generate foreign income below GILTI's 10% tangible asset threshold may entirely avoid the tax.[174] Second, corporations now have an incentive to shift more of their tangible assets abroad to increase the offshore base that is not subject to taxation.[175] Third, the 10% threshold on tangible assets is significantly higher than the average return on these investments, which means that a corporation may rarely incur GILTI liability on their foreign assets.[176]

The rationale behind deciding upon the 10% foreign tangible asset threshold was that any foreign income in excess of that threshold must come from a corporation's foreign intangible assets.[177] The legislators assumed that tangible assets typically make a 10% return on their investment, which is rarely the case.[178] Although GILTI attempts to deter companies from moving their intangible assets abroad via limits on their foreign tangible assets, it only incentivizes companies to move even more of their tangible assets abroad to shield their offshore profits from any GILTI liability.[179]

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172. Although the GILTI moniker implies a corporation's intangible income, GILTI includes both tangible and intangible income, with certain exceptions that are over the provision's 10% tangible asset threshold. *See* Phillips, *Understanding and Fixing the New International Corporate Tax System*, *supra* note 159, at 5-7.

173. *Id.* at 5.

174. *Id.*

175. *Id.*; *see also* Phillips, *Understanding and Fixing the New International Corporate Tax System*, *supra* note 159.

176. Chuck Marr, Brendan Duke & Chye-Ching Huang, *New Tax Law Is Fundamentally Flawed and Will Require Basic Restructuring*, CTR. ON BUDGET AND POL'Y PRIORITIES 19 (last updated Aug. 14, 2018), https://www.cbpp.org/research/federal-tax/new-tax-law-is-fundamentally-flawed-and-will-require-basic-restructuring#_ftnref46.

177. *See id.* ("The idea is that a company's tangible assets should yield a 'routine' rate of return of 10 percent, so any income above that exemption amount must arise from intangible assets . . . .").

178. *See id.* (discussing that the 10 percent GILTI threshold is "well above a 'routine' rate of return for tangible assets").

179. *Id.*

2. GILTI Taxes Unintended Targets

The problem with GILTI's application is that the tax has inadvertently targeted companies that have little to no intangible assets abroad.[180] This speaks further to the TCJA's inadvertent result in being a detriment to labor-intensive industries at the expense of intangible-driven tech giants receiving the bulk of the TCJA's benefits.

Since the TCJA was signed, two major companies have unintentionally felt the adverse effects of the GILTI liability.[181] Kansas City Southern, a railroad company, was recently slapped with a $25 million GILTI liability, despite having no income attributable to any intangible assets held abroad.[182] Similarly, container giant Tupperware reported a roughly 12% increase in their effective tax rate since the TCJA was enacted, citing GILTI as a source for the bulk of its rate hike.[183]

The logic behind GILTI in taxing U.S. corporations with unusually high returns on their foreign investments is sound. However, determining GILTI based on a company's foreign tangible assets is flawed. For example, several labor-intensive companies with long-held tangible assets have already depreciated those assets and have no significant tax basis remaining to calculate GILTI.[184] On the other hand, service-oriented companies typically do not hold significant tangible assets.[185] Both these types of companies are slapped with GILTI as *all* their foreign income appears to generate a higher than 10% return on their negligible tangible assets held abroad.[186]

The result of this is that GILTI strays away from its intended purpose of targeting highly mobile intangible-related income resulting from trademarks and patents.[187] Further, without any mechanism to distinguish between tangible and intangible foreign income, GILTI will continue taxing unintended companies without intangible-related income, and detrimentally affect their ability to fuel the economy.[188]

180. *See* Douglas Holtz-Eakin & James Carter, *New 'GILTI' tax is killing private enterprise, and it must be fixed*, THE HILL (Sept. 17, 2018), https://thehill.com/opinion/finance/406968-new-gilti-tax-is-killing-private-enterprise-and-it-must-be-fixed.

181. *Id.*

182. *Id.*; *see also* Richard Rubin, *New Tax on Overseas Earnings Hits Unintended Targets*, WALL ST. J., (Mar. 26, 2018), https://www.wsj.com/articles/new-tax-on-overseas-earnings-hits-unintended-targets-1522056600.

183. Holtz-Eakin & Carter, *supra* note 180.

184. *See id.*

185. *Id.*

186. *Id.*

187. *See id.*

188. *See id.*

C. The Jobs Loophole: More Money for No Jobs

1. Repatriation Does Not Work

During the 2016 presidential elections, President Trump had proffered to "turn America into a magnet for new jobs" by promising to reform the country's tax code.[189] Subsequently, the TCJA was introduced with the goal of boosting innovation and employment in the country.[190] In order to boost jobs, the TCJA included several repatriation provisions that proponents hoped would encourage U.S. corporations to repatriate most of the estimated $2.6 trillion that they held offshore.[191]

The TCJA was estimated to increase the country's Gross Domestic Product by 1.7%, create 339,000 new jobs, and boost wages by 1.5%.[192] In the first quarter of 2018 alone, U.S. corporations brought back roughly $300 billion of their offshore earnings, compared to $312 billion repatriated during the entirety of the 2004 tax holiday.[193] Out of the $300 billion, publicly traded companies accounted for about $143 billion in foreign earnings.[194]

Out of the $143 billion repatriated by public companies, Cisco and drug manufacturer Gilead Sciences accounted for two-thirds of the repatriated income.[195] A majority of the foreign earnings repatriated through the one-time repatriation tax have been associated with a significant uptick in U.S. corporations engaging in stock buyback programs.[196] While the Trump administration argues that stock buyback programs allow shareholders to reinvest the extra cash they receive in the domestic economy, some argue that stock buybacks help the corporate investors

189. *See Offshore Earnings Are Flowing into Stock Buybacks*, *supra* note 136.

190. White House Infographic, *The Tax Cuts and Jobs Act*, THE WHITE HOUSE (Feb. 2018), https://www.whitehouse.gov/wp-content/uploads/2018/02/WH_CuttingTaxesForAmericanWorkers_Feb2018.pdf ("In December 2017, President Donald Trump signed the Tax Cuts and Jobs Act (TCJA), which had four goals: [t]ax relief for middle-income families[,] [s]implification for individuals[,] [e]conomic growth[,] [and] [r]epatriation of overseas income[.]").

191. *Id.*

192. *Preliminary Details and Analysis of the Tax Cuts and Jobs Act*, TAX FOUND. 5 (Dec. 18, 2017), https://files.taxfoundation.org/20171220113959/TaxFoundation-SR241-TCJA-3.pdf.

193. Michael Smolyansky, Gustavo Suarez & Alexandra Tabova, *U.S. Corporations' Repatriation of Offshore Profits*, BOARD OF GOVERNORS OF THE FED. RES. SYS. (Sept. 4, 2018), https://www.federalreserve.gov/econres/notes/feds-notes/us-corporations-repatriation-of-offshore-profits-20180904.htm.

194. *See* Richard Rubin & Theo Francis, *Trump Promised a Rush of Repatriated Cash, But Company Responses Are Modest*, WALL ST. J. (Sept. 16, 2018), https://www.wsj.com/articles/companies-arent-all-rushing-to-repatriate-cash-1537106555?mod=hp_lead_pos3.

195. *Id.*

196. *Id.*

over domestic workers.[197] Below is a list of investments made by major tech companies that have repatriated or promised to repatriate their foreign earnings after the TCJA:

a. Apple spent $22.8 billion in stock buyback programs during the first quarter of 2018.[198]
b. Cisco repatriated $67 billion and used the money to increase its dividends and buy back $31 billion of stock.[199]
c. AT&T announced a plan to spend $1 billion on employee bonuses to over 200,000 employees.[200]
d. Juniper Networks repatriated $3 billion in overseas cash and announced plans to buy back $2 billion in shares.[201]
e. Verizon repatriated $4 billion in foreign earnings and plans to invest in its own investment fund and boost contributions to employee pension plans.[202]
f. Alphabet, the parent company of Google, does not plan to change any of its investment goals and strategies despite the repatriation break.[203]

In addition to the one-time repatriation tax, companies such as the ones listed above also aim to benefit from the GILTI rules in repatriating their overseas earnings. Once the one-time repatriation tax lapses, GILTI essentially cuts the U.S. corporations' tax on foreign earnings by half at 10.5%, compared to the domestic 21% tax rate.[204] This is detrimental for most small- and medium-sized companies, which primarily make their money in the United States.[205] Instead of boosting domestic investments, both the one-time repatriation tax and the new international tax provisions effectively work to increase the income of the corporate

197. *Id.*
198. Drew Hansen, *By Tripling Its Stock Buybacks, Apple Robs Workers and the Economy*, FORBES (Aug. 1, 2018), https://www.forbes.com/sites/drewhansen/2018/08/01/triple-stock-buybacks-apple-workers-economy/#1769769e808e.
199. Ali Longwell, *How U.S. Tech Firms Are Spending Their Newly Repatriated Cash*, SDXCENTRAL (May 20, 2018), https://www.sdxcentral.com/articles/news/how-u-s-companies-are-spending-their-newly-repatriated-cash/2018/05/.
200. *Id.*
201. *Id.*
202. *Id.*
203. *Id.*
204. Natalie Kitroeff, *Tax Law May Send Factories and Jobs Abroad, Critics Say*, N.Y. Times (Jan. 8, 2018), https://www.nytimes.com/2018/01/08/business/economy/gop-says-tax-bill-will-add-jobs-in-us-it-may-yield-more-hiring-abroad.html.
205. *Id.*

shareholder, and incentivize companies to send jobs overseas to reduce their effective tax rates.[206]

2. Small Businesses Get Hurt the Most

Prior to the TCJA, large U.S. technology corporations, such as eBay, Cisco, and Google, had an average effective tax rate of below 20%.[207] The TCJA introduced the GILTI minimum tax to mainly target companies that sheltered their earnings abroad.[208] However, the 10.5% GILTI minimum tax has created an apparent disadvantage for startups and small businesses while these technology giants are expected to benefit the most out of the TCJA's GILTI rules.

Many large multinational corporations, including Apple, Microsoft, and Google, make much of their earnings abroad.[209] The 10.5% GILTI minimum tax reduces these companies' effective tax rates by half, compared to domestic startups that mostly make their money in the United States.[210] This creates an "uneven playing field" where domestic startups and small business are taxed at 21%, while large multinationals get a lower tax rate via the GILTI minimum tax.[211]

The unequal treatment of domestic and multinational corporations is more prominent in the technology industry that has now been at the forefront of the U.S. economy for decades.[212] Rising inequality among startups and tech giants is destined to slow down innovation in the economy, as the technology giants become more cash rich under the various repatriation breaks provided by the TCJA. As they become cash rich, they become even more capable of increasing their control over the market through strategic acquisitions and investments in domestic startups

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206. *See* Richard Phillips, *New Legislation Aims to Change Tax Law Provisions That Incentivize Outsourcing*, INST. ON TAX'N AND ECON. POL'Y (Nov. 29, 2018), https://itep.org/new-legislation-aims-to-fix-tax-law-provisions-that-incentivizes-outsourcing-and-moving-profits-offshore/ (discussing General Motors' plans to lay off 14,000 U.S. workers to focus on manufacturing SUVs and other vehicles that are primarily produced outside the United States).

207. Douglas MacMillan, Richard Rubin & Jay Greene, *Tax Plan Strikes at Tech Giants' Foreign Profits*, WALL ST. J. (Dec. 18, 2017), https://www.wsj.com/articles/tax-plan-strikes-at-tech-giants-foreign-profits-1513613403.

208. Briefing Book, *Key Elements of the U.S. Tax System*, TAX POL'Y CTR., https://www.taxpolicycenter.org/briefing-book/what-global-intangible-low-taxed-income-and-how-it-taxed-under-tcja (last visited May 8, 2020); *see also* Kyle Pomerleau, *What's Up with Being GILTI?*, TAX FOUND. (Mar. 14, 2019), https://taxfoundation.org/gilti-2019/.

209. Farhad Manjoo, *What the Tax Bill Fails to Address: Technology's Tsunami*, N.Y. TIMES (Dec. 20, 2017), https://www.nytimes.com/2017/12/20/technology/tax-bill-technology.html?action=click&module=RelatedCoverage&pgtype=Article®ion=Footer.

210. *Id.*

211. *Id.*

212. *See id.*

and small businesses.[213] On the other hand, the reduced cash available to startup companies is detrimental to boosting innovation and competition in the U.S. economy. Given that some of the large technology giants have used their billions in repatriated cash on strengthening their respective balance sheets, the unequal treatment under the TCJA creates uncertainty in meeting one of the Act's central goals, namely to boost U.S. job growth.

V. PROPOSAL

The TCJA has done little to address the inverter, tax haven, and the jobs loopholes discussed under the old tax laws. Instead, it benefits the wealthy with significant tax breaks rather than being the promised source of relief to middle-class and low-income households. Further, the Congressional Budget Office expects the TCJA to increase the country's deficit by approximately $1 to $2 trillion over ten years.[214] This deficit is largely due to an estimated $1.65 trillion reduction in revenues from taxes during nearly the same period.[215] Many of the revenue issues are attributable to the huge repatriation breaks offered to corporations.[216] The favorable tax rates afforded to multinational corporations have created an apparent unequal treatment of large corporations relative to startups and small businesses.[217] Large multinational corporations have benefited by bringing home large chunks of foreign earnings that have been invested in boosting their own value. Furthermore, the lack of reinvestment of foreign repatriated earnings in U.S. product development has circumvented the TCJA's goal of boosting investments in the U.S. economy and creating jobs within the country, as there is little to no evidence of such investments made by the repatriating companies since the TCJA was enacted.

In light of the issues highlighted above, some of the TCJA's provisions that incentivize inversions, induce the use of tax havens, and fail to boost domestic jobs could be strengthened with the suggestions below.

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213. *See* Joanna Glasner, *How tax changes may impact US startups*, TECHCRUNCH (Dec. 9, 2017), https://techcrunch.com/2017/12/09/how-tax-changes-may-impact-us-startups/.

214. *See* Briefing Book, *How Did the TCJA Affect the Federal Budget Outlook?*, TAX POL'Y CTR., https://www.taxpolicycenter.org/briefing-book/how-did-tcja-affect-federal-budget-outlook (last visited May 8, 2020).

215. *Id.*

216. *See Offshore Earnings Are Flowing into Stock Buybacks*, *supra* note 136.

217. *See* Manjoo, *supra* note 209.

A. Closing the Inverter Loophole

The introduction of BEAT under the TCJA was seen as a significant step in eliminating corporate inversion activity. The various thresholds instituted under BEAT were far too high to incur any tax liability on foreign earnings, meaning the target corporations went largely unaffected by the anti-inversion measures under the TCJA.[218]

Lowering BEAT's $500 million average earnings threshold would automatically broaden its target base of multinational corporations that would incur liability on their excess foreign earnings.[219] BEAT should also include cost of goods sold while calculating liability.[220] This change would effectively prevent the large technology giants from avoiding BEAT liability by classifying IP-related foreign royalties as cost of goods sold.

In addition, lawmakers should redefine what constitutes a "foreign corporation" under the TCJA.[221] Under the TCJA, a foreign corporation should include those that are managed, controlled, or owned by a U.S. parent.[222] Broadening the definition of a foreign corporation will help reduce anti-inversion activity and help keep goods and services and intangible assets created by U.S. companies within the country.

B. Closing the Tax Haven Loophole

Both GILTI and FDII create confusion regarding which provision is applicable to a U.S. corporation's foreign earnings. However, the key difference between GILTI and FDII is that GILTI imposes a 10.5% minimum tax, whereas FDII imposes a slightly higher 13.125% tax.[223] The disparity between these provisions leaves room for corporations exploiting GILTI to lower their effective tax rate on foreign earnings by expanding their tangible asset base abroad.

To close this loophole, the first step should be to equalize the two provisions by raising the GILTI minimum tax to 13.125%.[224] Second, U.S. corporations should instead be taxed on a per-country basis. Under a per-country approach, U.S. corporations would pay taxes based on the

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218. *See* Phillips, *Understanding and Fixing the New International Corporate Tax System*, *supra* note 159, at 10-11.

219. *Id.*

220. *Id.* at 10-11.

221. *Id.* at 10.

222. *Id.* (suggesting that U.S. lawmakers "should prevent a company from becoming foreign through a merger if it continues to be managed and controlled in the United States or if a majority of the U.S. company's shareholders own the resulting company.").

223. *Id.* at 3 tbl. 1.

224. *See* Phillips, *Understanding and Fixing the New International Corporate Tax System*, *supra* note 159, at 9.

country in which they generate income.[225] This idea was previously proposed in Congress, and it marks a complete reform to prevent U.S. corporations from keeping their earnings in offshore tax havens.[226] Lastly, companies should not be allowed to use their foreign tax credits from high-tax jurisdictions to offset their GILTI liability on earnings generated in low-tax jurisdictions.[227] These measures would significantly increase the difficulty in shifting profits abroad and raise revenue for the government to facilitate job growth in the country.

Another measure to close the tax haven loophole could be to adopt a "combined reporting" system.[228] This system is already in place in several states.[229] It requires U.S. corporations to disclose their profits attributable to each state in which they perform activities.[230] This approach could be modified to apply to a U.S. corporations' worldwide income, where companies must disclose their profits attributable to each country in which they exist.[231] The combined reporting approach could be modified further to pay attention to a U.S. corporation's activity in offshore tax havens.[232] Companies could then be taxed based on their income in each tax haven where they perform activities. Adding this approach to the current legislation would increase transparency and minimize the incentive of U.S. corporations to move to tax havens abroad.

C. Closing the Jobs Loophole

One of the perceived negative implications of the TCJA is the rise in income inequality between the large tech giants and the smaller startups and businesses who make most of their money in the United States. To address this inequality, the TCJA must expand the protections currently afforded to small businesses and startups in order to boost innovation and job growth in the country.

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225. *Id.*

226. *See Rep. Peter DeFazio Introduces Legislation to Help Stop Moving US Jobs Overseas*, U.S. CONGRESSMAN PETER DEFAZIO (Jun. 6, 2018), https://defazio.house.gov/media-center/press-releases/rep-peter-defazio-introduces-legislation-to-help-stop-multinational.

227. *See* Richard Phillips, *New Legislation Would Close Significant Offshore Loopholes in the Tax Cuts and Jobs Act*, INST. ON TAX'N AND ECON. POL'Y (Jun. 6, 2018), https://itep.org/new-legislation-would-close-significant-offshore-loopholes-in-the-tax-cuts-and-jobs-act/.

228. Richard Phillips & Nathan Proctor, *A Simple Fix for a $17 Billion Loophole: How States Can Reclaim Revenue Lost to Tax Havens*, INST. ON TAX'N AND ECON. POL'Y 1 (Jan. 17, 2019), https://itep.org/a-simple-fix-for-a-17-billion-loophole/.

229. *Id.* (discussing that twenty-seven states and the District of Columbia have incorporated "combined reporting" systems).

230. *Id.*

231. *See id.* at 2 (suggesting a worldwide combined reporting known as "complete reporting").

232. *See id.*

The TCJA should offer the QBI deductions as a permanent provision to flow-through entities. Under the current legislation, QBI deductions are temporary and expire by the end of 2025.[233] This potentially raises uncertainties with the QBI deduction's longevity, and its purported benefits offered to flow-through entities. Such entities may thus consider reorganizing into a C corporation, who are imposed with a "21 percent tax rate without an expiration date" under the TCJA.[234] Moving to a C corporation structure is expensive and unnecessary for many flow-through entities.[235] Making QBI deductions permanent would restore some parity in the tax treatment of corporations and flow-through entities under the TCJA, as small businesses do not have to reconsider their entity structure. Further, this would avoid a potential drain on the economy by exploiting the one-sided benefits currently offered to C corporations.

VI. CONCLUSION

The TCJA has left a lot to be desired. It has failed to address the three big loopholes: the inverter, tax haven, and the jobs loophole, and has instead incentivized corporations to shift their profits and investments abroad. The inadvertent effect of the TCJA is that U.S. corporations will continue to shift profits overseas while simultaneously becoming cash rich through the various repatriation breaks offered to them. A majority of the issues emanating from the TCJA result from a lack of guidance to the taxpayers on navigating the newly introduced provisions under the Act. Accordingly, lawmakers should strive to make the necessary tweaks to fulfill the "rocket fuel" promise of the TCJA, and help boost innovation and job growth while keeping much of its valuable goods, services, and intangible assets within the country.

233. *Tax Reform: Which Changes Are Temporary vs. Permanent?*, MITCHELL WIGGINS, https://mwcpa.com/tax/tax-reform-which-changes-are-temporary-vs-permanent/ (last visited Apr. 27, 2020).

234. 1800Accountant, *Rethinking Your Business Entity Choice in Light of the TCJA*, SMALLBIZCLUB (Mar. 15, 2019), https://smallbizclub.com/startup/making-your-business-official/rethinking-your-business-entity-choice-in-light-of-the-tcja/.

235. *See id.*