The Transition (Under-)Tax

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Abstract

One of the most significant effects of the Tax Cuts and Jobs Act ("TCJA") was shifting the United States from a worldwide tax system to a territorial one: Before the TCJA, U.S. corporations were subject to tax on all of the income they earned, regardless of where they earned it; after the TCJA, U.S. corporations generally will not have to pay U.S. federal income tax on profits earned outside of the United States. The TCJA coupled this permanent shift with a one-time transition tax (the "Transition Tax"). The Transition Tax taxes the trillions of dollars of income that U.S. corporations earned outside of the United States, but which had not yet been subjected to U.S. tax, at a rate of either 8% or 15.5%, depending on how the income was invested.

There is much to criticize about the Transition Tax. In particular, its rate is significantly lower than either the pre- or post-TJCA corporate tax rate (35% and 21%, respectively). This comparatively low rate creates serious equity and efficiency concerns on several fronts: First, this lower tax rate only applies to sophisticated multinational enterprises, and not to wholly domestic U.S. companies. Second, the Transition Tax rate varies depending on how income was subsequently invested. It is a fundamental tenet of modern tax policy that the tax system should not "pick winners and losers," yet the Transition Tax does exactly that. Finally, and most importantly, the Transition Tax rewards tax avoidance behavior, thereby encouraging more tax avoidance behavior in the future. Pre-TCJA, companies kept profits overseas to avoid paying U.S. tax. This behavior was not what Congress desired, intended, or contemplated, and it cost the United States fisc hundreds of billions of dollars. Tax law should not treat those taxpayers who frustrate and undermine the system better than those who do not, yet the Transition Tax does just that.

Happily, there is a straightforward way to ameliorate all of these problems: raise the Transition Tax rate. Doing so could bring the net tax rate imposed on previously untaxed offshore profits to at least 21%, the post-TCJA corporate tax rate. In addition to correcting all of the problems described above, raising the Transition Tax rate would raise hundreds of billions or even

trillions of dollars in revenue which could be used to provide services, reduce the deficit, or cut taxes elsewhere.

I. INTRODUCTION

The Tax Cuts and Jobs Act ("TCJA") has been the highest-profile piece of legislation enacted under President Trump. One of the most significant policy changes that the TCJA effects is shifting the United States from a worldwide tax system to a territorial one:[1] Before the TCJA, U.S. corporations were subject to tax on all of the income they earned, regardless of where they earned it; if Apple sold iPhones in Canada, it would owe U.S. income taxes on its profits, just as if it sold iPhones in the United States. After the TCJA, U.S. corporations generally will not have to pay U.S. federal income tax on profits that they earn outside of

[1] 1 This is an oversimplification. For greater detail, see Part II.B, *infra*.

the United States; Apple's profits from selling iPhones in Canada will be U.S.-tax-free.

The TCJA coupled this permanent shift with a one-time transition tax (the "Transition Tax"). The Transition Tax applies to income earned outside of the United States between 1986 and 2017 that had not yet been subjected to U.S. tax ("Untaxed Offshore Profits"). Untaxed Offshore Profits—totaling roughly $2.6 *trillion*—were taxed at 8% if they were re-invested in illiquid assets (for example, factories), and 15.5% if they were invested in liquid ones (for example, treasury bonds).

The Transition Tax is an extremely important piece of policy. It is—by far—the TCJA's largest revenue-raiser in either business tax or international tax.[2] The Joint Tax Committee estimated that it would raise approximately $340 billion over the next ten years.[3] For reference, this is roughly what the entire corporate income tax raises in a year.[4]

To understand why the Transition Tax was able to raise so much money, despite its relatively low rates, requires some familiarity with the broad strokes of the United States' international tax regime. To oversimplify: The corporate tax generally treats corporations as entities separate from their owners. This means that foreign subsidiaries of U.S. corporations are treated as separate corporations from their parents. Foreign subsidiaries, by definition, are not U.S. corporations. As such, they generally are not subject to any U.S. tax when they earn income outside of the United States.

Not coincidentally, large companies generally structure their affairs so that essentially all of the income they earn outside of the United States is earned by a foreign subsidiary instead of the U.S. parent. For example, when Apple sells iPhones in Toronto, it's not Apple Inc. that makes the sale, but Apple's wholly owned Canadian subsidiary, [Apple Canada LLC]. These subsidiaries'

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[2] The next highest revenue raisers are limiting net interest deductions ($253.4 billion) and modification of NOL deduction ($201.1 billion). J. Comm. Tax'n, Estimated Budget Effects of the Conference Agreement for H.R. 1, the "Tax Cuts and Jobs Act," JCX-67-17, Dec. 18, 2017.

[3] J. Comm. Tax'n, Estimated Budget Effects of the Conference Agreement for H.R. 1, the "Tax Cuts and Jobs Act," JCX-67-17, Dec. 18, 2017.

[4] Total corporate income tax receipts for 2015, the last year for which data is available, were just under $344 billion. http://www.taxpolicycenter.org/statistics/amount-revenue-source. Note also that this number reflects a top corporate income tax rate of 35 percent; post-TCJA, with a top rate of 21 percent, annual corporate income tax revenues may be less.

profits are not wholly outside the U.S. tax net; when a foreign subsidiary pays a dividend to its U.S. parent, that dividend payment is income for the U.S. parent. That income is then subject to tax at the normal corporate rate (35%, pre-TCJA).

But because the U.S. parent controls the foreign subsidiary, it can decide when to have the subsidiary pay dividends and in what amounts. The U.S. parent could defer paying U.S. taxes on its foreign subsidiary's income—potentially indefinitely—simply by not having the subsidiary pay any dividends. This led to a system in which some companies that did not have strong cash needs kept large amounts of their foreign profits in their foreign subsidiaries indefinitely. For example, Apple has funded distributions to its shareholders by issuing (and paying interest on) tens of billions of dollars in bonds, all while sitting on *hundreds* of billions in cash and other liquid assets.[5]

Commentators, as well as politicians, generally agreed that this state of affairs left much to be desired.[6] At the same time, their views varied widely on how the United States and other countries should reform international tax law in response.[7] Taking as given that the United States was moving from a worldwide to a territorial tax system, it makes sense to pair that move with some sort of one-time transition tax on previously earned but not-yet-taxed profits.

Even so, there is much to criticize about the Transition Tax. Corporate finance theorists and Wall Street financiers alike generally assume that profits ultimately make their way to shareholders. This idea underlay the pre-TCJA system; yes, companies could delay paying U.S. tax on overseas income, but profits would eventually be repatriated to the U.S. parent corporation, at which point they would be taxed at a 35% rate.

But the Transition Tax does not tax Untaxed Offshore Profits at either the pre-TCJA corporate tax rate of 35% or the post-TCJA rate of 21%. Instead, it imposes a much lower rate of tax—either 8% or 15.5%, depending on how the Untaxed Offshore Profits were invested. The details of the Transition Tax make the

[5] Cite Apple's $216 billion cash stockpile, billions in bond issuances, and use of the issuance proceeds to pay shareholders.

[6] [Long string cite; *See, e.g.*, Jeff Sommer, *A Stranded $2 Trillion Overseas Stash Gets Closer to Coming Home*, N.Y. TIMES, Nov. 4, 2016, at BU1, *available at* (quoting USC Tax Professor and former JCT chief of staff Edward D. Kleinbard as saying "Everyone agrees that something [has] to be done about this")]

[7] [Long string cite]

discrepancy even worse; the comparatively low tax rate is payable over an eight-year period, without interest, with the smallest payments due in the first five years. This makes the effective rate even lower than the already-low statutory rate—which itself comes after taxpayers have already benefited from years of tax deferral.

The Transition Tax's rate being so much lower than the general corporate tax rate raises both equity and efficiency concerns—it both treats taxpayers with similar incomes differently without justification and encourages socially suboptimal behavior—in multiple ways. First, the Transition Tax's low rate means that U.S. multinationals face a lower tax burden than wholly domestic U.S. companies. The wisdom of encouraging or rewarding U.S. companies for moving their activities abroad is questionable. Moreover, the large multinational enterprises that benefit from the Transition Tax's low rate tend to be more financially sophisticated than most other businesses, raising further equity concerns.

Second, the Transition Tax imposes a lower rate of tax on profits that were reinvested in illiquid assets. It is a fundamental tenet of modern tax policy that the tax system should not "pick winners and losers" by favoring certain investments and penalizing others. Yet by imposing roughly half the tax burden on illiquid investments that it does on liquid ones, the Transition Tax does exactly that.

It is tempting to attribute the lower rate to simple liquidity concerns: a company that invested its profits in treasury bonds could easily sell a portion to pay its Transition Tax liability, but a company that used its profits to build a factory might have more difficulty extracting sufficient cash. This concern for taxpayers' liquidity is understandable; there is wide consensus that policymakers should take taxpayer liquidity issues into account when designing tax laws. However, other features of the Transition Tax address this concern: the Transition Tax is payable over an eight-year period, with the smallest payments due in the first five years, and no interest. Given this payment structure, there is good reason to believe that taxpayers can extract enough cash, even from illiquid assets, to cover their Transition Tax liability. Thus, liquidity does not provide a good countervailing reason for advantaging investors in illiquid assets over more liquid ones.

Finally, and most importantly, the Transition Tax rewards tax avoidance behavior,[8] thereby encouraging more tax avoidance behavior in the future. It was universally acknowledged that companies were keeping profits overseas because doing so enabled them to avoid paying U.S. taxes on those profits. This behavior was not what Congress desired, intended, or contemplated when it designed the tax system, and it cost the United States fisc hundreds of billions of dollars.

To be sure, taxpayers are not obligated to maximize their tax payments. Corporations have obligations to pursue their shareholders' interests within the limits of the law. Multinational companies who structured their affairs to lower their tax bills are not evil, nor are the people who run them. Tax avoidance is legal and expected.

But the case for discouraging tax avoidance does not depend on the morality of tax avoiders. Tax avoidance creates a variety of problems that ripple through the tax system and undermine it. Avoidance behavior may necessitate additional laws restricting taxpayer behavior; these anti-abuse provisions make the tax law more complicated and harder to comply with. Avoidance behavior may require the government to hire more revenue agents, which is costly. The government may need to raise tax rates to make up for revenue lost to avoidance. This raises equity concerns, because the higher rates place tax avoiders in an even better position relative to those who do not avoid taxes, which is unfair. Raising tax rates also raises efficiency concerns, both because higher tax rates may discourage economic activity by those who comply with the law and because higher tax rates increase the benefits of avoidance, thereby encouraging it.

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[8] The tax avoidance behavior in this context is keeping foreign profits offshore. This specific technique generally will not offer tax savings in the future because the TCJA shifts the United States to a territorial tax system. However, tax professionals will undoubtedly absorb the general lesson that large-scale tax avoidance paid off and remember it going forward.
Moreover, it is worth noting that the underlying behavior that enabled this tax deferral is having international operations, real or on paper. It is not obvious that the tax law should be encouraging businesses to increase their profits from foreign activities. The economic ideal of capital export neutrality would hold that tax should not affect investors' decision to invest domestically or abroad; politicians and the public seem to overwhelmingly favor the tax system encouraging investors to invest domestically. There is no widely accepted theory that argues that the tax law should encourage investors to invest abroad instead of domestically.

In short, there is no sensible policy reason for the tax system to treat those taxpayers who frustrate and undermine it better than those who do not. And by taxing Untaxed Offshore Profits at a lower rate than other corporate income, the Transition Tax does just that.

Happily, there is a straightforward way to ameliorate all of these problems with the Transition Tax: raise the rate. Doing so could bring the net tax rate imposed on Untaxed Offshore Profits to at least 21%, the post-TCJA corporate tax rate.[9] This is easy to do even though the Transition Tax is conceived as a one-time tax because, as noted above, the Transition Tax is structured as a series of eight annual payments. Congress could raise the Transition Tax rate by increasing the amount of some or all of these payment obligations or adding new payment obligations in additional years.[10] In addition to correcting all of the problems described above, raising the Transition Tax rate would raise hundreds of billions of dollars in revenue.[11] To address liquidity issues, taxpayers could be allowed to pay the new tax over several years—preferably, but not necessarily, with interest.

This Article proceeds as follows. Part II provides background on the U.S. corporate and international tax systems. It begins with the state of these systems prior to the TCJA and explains how the TCJA changed those systems, with emphasis on the role of the Transition Tax. Part III presents the policy case for raising the Transition Tax rate. Part III also considers potential objections to raising the rate on the Transition Tax, including objections both that such a move creates too heavy a burden on taxpayers and that it lets taxpayers off too lightly. Part IV concludes.

II. BACKGROUND

This section provides the background on U.S. corporate and international tax law necessary to understand the Transition Tax and its role. Subpart A summarizes the key features of the U.S. international tax system prior to the passage of the Tax Cuts and

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[9] There are powerful arguments for raising it higher (see Part [X], infra), but the case for raising it to at least 21% is strongest.

[10] The Transition Tax rate could also be raised after the end of the eight-year period has expired. A new one-time tax on the same income taxed by the Transition Tax is functionally equivalent to raising the Transition Tax rate and legally permissible. See footnote [X], infra, and accompanying text.

[11] This Article takes no view on how such money should be deployed. The basic choices are spending on government programs, deficit reduction, or tax cuts; these options may also be deployed in combination.

Jobs Act ("TCJA"). Subpart B explains the key dynamics that these legal rules put in place. Subpart C then explains how the TCJA changed the U.S. tax landscape.

A. *Pre-TJCA Tax Law*

- U.S. Corporations are treated as separate people for tax purposes.
- They are subject to tax on all of their worldwide income
- Foreign subsidiaries are not U.S. corporations for tax purposes
- Thus, income earned through a foreign subsidiary is not taxable in the U.S. until repatriated.
    - There's also a credit for foreign income taxes paid
    - What counts as repatriation?
        - To oversimplify, bringing it back to the U.S. parent as a dividend, or something economically similar to that
        - Note that repatriation does not mean "investing the money in the United States or U.S. companies or securities." There were lots of ways to invest offshore profits in U.S. assets without triggering U.S. tax liability.
- This enables the possibility of deferral, which is advantageous for both corporations and individuals
- But the underlying assumption of the system is that corporate profits ultimately make their way to shareholders; thus foreign subsidiaries' profits would eventually be repatriated to the U.S. parent corporation (and its shareholders, in turn) as a dividend and trigger U.S. tax. Deferral was available, but ultimately there would be U.S. tax liability.
- In addition, there are some big exceptions to the deferral rules described above, designed to curtail some of the worst avoidance techniques.
    - PFICs, which basically punish people who try to avoid personal taxes this way
    - CFCs and Subpart F, which trump the PFIC rules and apply more often and broadly.
        - The idea is basically to attribute certain types of income earned by certain foreign corporations (those controlled by one or a

few large U.S. shareholders) to the foreign corporation's large U.S. shareholders. That income is included in those large shareholders' income when it is earned, whether or not the foreign corporation has paid a dividend or otherwise distributed the cash to its shareholders.

        - However, the Subpart F regime is complicated and porous. U.S. multinationals have been able to avoid its strictures in many cases, thereby significantly lowering their U.S. tax liabilities.

- Meanwhile, an increasing number of non-U.S. countries adopted territorial tax regimes. This meant they weren't taxing income their companies earned outside of their own borders
- Also, most countries define corporate nationality differently than the United States does, looking to the place of management instead of the place of incorporation. The mismatch of rules creates more options for gamesmanship.
- Mention also the check-the-box rules—entities can generally elect how they want to be treated for U.S. tax purposes.
    - For an entity with multiple owners, this corresponds with choosing between being taxed as a corporation or a partnership.
    - But for an entity that is wholly owned by a single owner, the choice is between being treated as a corporation or being disregarded for federal income tax purposes entirely. This opens up a lot of tax planning opportunities in the international sphere.
- Finally, there are tax treaties. Those basically just give taxpayers more options for structuring to reduce their tax liability, both in the United States and abroad.

B. *Implications of Pre-TCJA Tax Regime*

In the complex thicket of the U.S. international tax system, it is easy to lose the forest for the trees. Thus, it is worth highlighting a few high-level implications of the foregoing.

1. Profit-Shifting and Its Effects

First, under the pre-TCJA regime, where a multinational earned its profits had major implications for its tax liabilities. The major incentives were to shift profits into offshore subsidiaries located in low-tax countries such as Bermuda, Switzerland, and Ireland, and out of higher-tax countries such as the United States, Germany, France, Japan, etc., whenever possible.

Companies can shift profits by changing the situs of real economic activity. For example, a company can choose to build a new manufacturing plant abroad rather than in the United States.

Companies can also employ inter-company transactions that shift profits out of high-tax jurisdictions within the meaning of the tax law, but have little impact on the company's economic activity. Caterpillar Inc., the manufacturer of construction and other heavy equipment, provides a high-profile example. Most of Caterpillar's profits comes not from selling new equipment, but from selling replacement parts for its equipment; sales of parts have accounted for 80% of Caterpillar's profits in some years.[12]

In 1999, Caterpillar implemented a plan to reduce its U.S. tax liability.[13] Prior to that point, the parts business was primarily run out of Morton, Illinois, the site of the company's main parts warehouse;[14] manufactured parts were shipped to Morton, then shipped to customers or dealers.[15] Under this structure, all of Caterpillar's profits from sales of parts were subject to immediate U.S. tax.[16]

Under its new plan, Caterpillar set up a new Swiss entity, "CSARL," to take over the parts business.[17] CSARL became the owner of the parts in the Morton warehouse. When the parts were purchased by a U.S. customer, CSARL sold the part to Caterpillar Inc., which in turn resold the part to the customer. This produced

[12] Reuven Avi-Yonah, Testimony for Hearing on Profit Shifting, U.S. Senate Permanent Subcommittee on Investigations, Apr. 1, 2014.
[13] Id.
[14] Id.
[15] Id.
[16] *Id.* When Caterpillar Inc. sold to customers directly, it straightforwardly had taxable income. When it sold to a foreign subsidiary that in turn resold parts to non-U.S. customers, the foreign subsidiary's profits were captured under the provisions of Subpart F and subjected to immediate U.S. tax. *Id.*
[17] Id. [Explain what a SARL is] CSARL was a corporation for Swiss tax purposes, but a partnership owned by two other Swiss Caterpillar subsidiaries for U.S. tax purposes. *Id.*

income and immediate U.S. tax liability for Caterpillar Inc., just like it did before the new plan was implemented. But when parts were to be sold to a non-U.S. customer, CSARL would sell the parts to an independent dealer, which would in turn resell the parts to the customer. The bulk of the profits went to CSARL, not the dealer. Because CSARL purchased parts from independent suppliers and sold them to independent dealers, CSARL's income from selling parts abroad was not governed by Subpart F.[18] The effective tax rate on CSARL was approximately 4%.[19] From 2000 to 2012, this plan saved Caterpillar almost $2.5 billion in U.S. taxes.[20]

At the same time, the operation of Caterpillar's parts business changed very little. In fact, this was an important feature of the plan from Caterpillar's perspective, as it was loathe to disrupt the business activity that delivered most of its profits.[21] In particular, pre- and post-plan:

- Caterpillar's suppliers shipped parts to Morton; Caterpillar then shipped parts from Morton to the independent dealers, without any involvement by CSARL.[22]
- Caterpillar ran the parts business and maintained the inventory system, except that post-plan it did so as an agent for CSARL.[23]
- CSARL had neither a warehouse nor an inventory management system of its own.[24]
- When CSARL became the nominal owner of all the parts in the Morton warehouse, none of the personnel involved in Caterpillar's parts business were moved to CSARL.[25]

Caterpillar is far from the only company engaged in tax avoidance. A number of other companies, including Alphabet,

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[18] Id.
[19] Id.
[20] Id.
[21] Id. ("[The tax department reimbursed the parts and parts delivery segments of Caterpillar for any added costs resulting from the restructuring. This resulted in maintaining the 'accountable profits' of each segment of the business as if the restructuring had not taken place, which was crucial to achieving cooperation since accountable profits formed the basis for setting compensation levels.")
[22] Id.
[23] Id.
[24] Id.
[25] Id.

employ a tax structure known as the "Double Irish Dutch Sandwich."[26] This structure involves an Irish subsidiary ("Ireland Holdings") that owns a Netherlands BV that in turn owns another Irish company ("Ireland Ltd."). The use of the two Irish companies with a Dutch entity in between them gives rise to the colorful moniker.

The gist of this technique is that the U.S. parent moves valuable intellectual property—in Alphabet's case, the rights to use its search and advertising technology in Europe, the Middle East, and Africa, among other things—to Ireland Holdings. Ireland Holdings then licenses that technology to the Netherlands BV, which in turn licenses the technology to Ireland Ltd. Ireland Ltd. then interacts directly with customers and licenses the technology to other Alphabet affiliates. This combination of activities results in Ireland Ltd. collecting billions of dollars of revenues. In doing so, Alphabet shifts large amounts of profit into Ireland, which has a 12.5% corporate tax rate on resident companies, and out of other jurisdictions with higher tax rates.

The structure reduces this 12.5% tax rate even further, however. Ireland Ltd. makes large, deductible royalty payments to the Netherlands BV under the terms of its technology license, and Netherlands BV makes similar payments to Ireland Holdings under its own technology license. Ireland Holdings is incorporated in Ireland, and thus is an Irish company as far as U.S. tax law is concerned. But it is not an Irish company in the view of Irish tax law; under Irish tax law, a company's nationality is tied to the location of its management, not the jurisdiction of incorporation. Ireland Holdings' management is in Bermuda, making Ireland Holdings a Bermuda corporation for Irish tax purposes. It is also a Bermuda company for Bermuda tax purposes, but Bermuda has no corporate income tax. Netherlands BV—the Dutch Sandwich—exists because Ireland imposes a withholding tax when an Irish company pays royalties to a Bermuda company, but not when an Irish company pays royalties to a company in an EU member state. The Netherlands does not impose a withholding tax on royalties paid to Bermuda companies. Thus, much of the income earned from the exploitation of Ireland Holdings' intangibles is taxed not at Ireland's 12.5% corporate tax rate, but at Bermuda's zero percent corporate tax rate.

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[26] Kleinbard, Stateless Income at 707-08. [Add additional cites to the Kleinbard article (its description is excellent) and others throughout this discussion.] [Add a figure in the text to facilitate explanation?]

Presumably, both the Netherlands BV and Ireland Ltd. elect not to be treated as corporations for U.S. tax purposes. Thus, they are disregarded entities from a U.S. tax perspective; they simply do not exist, and neither do any of the transactions between them. The United States only sees one Irish company, Ireland Holdings, earning profits from the exploitation of intangibles.

Alphabet (Google, at the time) reportedly saved $3.6 billion in taxes from its use of the Double Irish Dutch Sandwich—in one year.[27] That same year, Alphabet's effective tax rate on all of its income outside of the United States was less than 7%;[28] in other years it has been less than 3%.[29] But nothing about the Double Irish Dutch Sandwich is unique to Google's business. It is presumably available to many other U.S. companies, and is reportedly widely used by U.S. companies in the technology sector, including Microsoft, Apple, and Facebook.[30]

But perhaps the most iconic tale of tax avoidance comes from Starbucks. Starbucks' tax structure was so effective that it paid *zero* corporate income tax in the UK from 2010 through 2012.[31] After this was reported, to quell popular outcry, Starbucks decided to *voluntarily* pay the UK £10 million in tax in each of the following two years.[32] That the only reason a coffee company decided to pay tax was that it was embarrassed at how well it had avoided tax lays bare the problematic state of international tax law.

2. Offshore Profits Pileup

The dynamics described above—shifting of profits out of high-tax jurisdictions—led to a large increase in profits for the

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[27] *See* Robert W. Wood, *How Google Saved $3.6 Billion Taxes from Paper "Dutch Sandwich,"* FORBES.COM, Dec. 22, 2016, *available at* https://www.forbes.com/sites/robertwood/2016/12/22/how-google-saved-3-6-billion-taxes-from-paper-dutch-sandwich/#1a2fdd761c19.

[28] *Id.*

[29] Jesse Drucker, *Google 2.4% Rate Shows How $60 Billion Lost to Tax Loopholes*, BLOOMBERG.COM, Oct. 21, 2010, *available at* https://www.bloomberg.com/news/articles/2010-10-21/google-2-4-rate-shows-how-60-billion-u-s-revenue-lost-to-tax-loopholes.

[30] Cite Kleinbard and sources cited therein; Wood, *supra* note 27. Changes to Irish law have presumably made it impossible to set up new Double Irish Dutch Sandwich structures, and the reduction of the structure's benefits starting in 2020. [Cite]

[31] Simon Neville & Jill Treanor, *Starbucks to Pay £20 Million in Tax Over Next Two Years After Customer Revolt*, THE GUARDIAN, Dec. 6, 2012, *available at* https://www.theguardian.com/business/2012/dec/06/starbucks-to-pay-10m-corporation-tax.

[32] *Id.*

subsidiaries of U.S. multinationals. U.S. multinationals generally did not want to repatriate these profits to the United States, as doing so would trigger immediate U.S. tax liability, thereby undoing much or all of the benefit of their complicated tax avoidance strategies.

This meant that profits piled up in U.S. multinationals' foreign subsidiaries. The United States had a one-time tax holiday in 2004, under which eligible foreign profits could be repatriated subject to a tax rate of only 5.25%,[33] reducible even further by foreign tax credits.[34] U.S. multinationals repatriated hundreds of billions of dollars in response.[35] However, the pace of foreign profit accumulation increased in the years following the holiday—perhaps in part because the holiday encouraged shifting profits overseas. By 2017, when the TCJA was passed, the amount of profit earned by foreign subsidiaries but not yet repatriated was estimated at between \$2.4 and \$3 trillion dollars.[36]

Note that this generally did *not* mean that trillions of dollars in cash was trapped offshore. Companies were generally able to invest this money in U.S. banks and U.S. assets, and frequently did so. The U.S. Senate Permanent Subcommittee on Investigations queried 20 U.S. multinationals, with a combined \$538 billion in unrepatriated foreign earnings at the end of the 2010 fiscal year, and found that "almost half (46%) of the funds that the

[33] *See, e.g.*, Repatriating Offshore Funds: 2004 Tax Windfall for Select Multinationals, Majority Staff Report, Permanent Subcommittee on Investigations, U.S. Senate Committee on Homeland Security and Governmental Affairs, S. Prt. 112-27, Oct. 11, 2011 (112th Cong. 1st Sess.), *available at* https://www.gpo.gov/fdsys/pkg/CPRT-112SPRT70710/pdf/CPRT-112SPRT70710.pdf [hereafter, Repatriation Holiday Report]; *see also* Michael Mundaca, *U.S. Dep't of the Treasury, Just the Facts: The Costs of a Repatriation Tax Holiday*, Mar. 23, 2011, https://www.treasury.gov/connect/blog/Pages/Just-the-Facts-The-Costs-of-a-Repatriation-Tax-Holiday.aspx; CHUCK MARR & CHYE-CHING HUANG, CENTER ON BUDGET & POLICY PRIORITIES, REPATRIATION TAX HOLIDAY WOULD LOSE REVENUE AND IS A PROVEN POLICY FAILURE, June 19, 2014, https://www.cbpp.org/sites/default/files/atoms/files/6-19-14tax.pdf; Jeff Cox, *The Last Time Companies Got a Break on Overseas Profits, It Didn't Work Out Well*, CNBC.COM, Apr. 26, 2017, https://www.cnbc.com/2017/04/26/what-happened-the-last-time-companies-got-a-break-on-overseas-profits.html; Amir El-Sibaie, Tax Foundation, *A Repatriation Tax Holiday Sounds Fun, but Comes with a Hangover*, Aug. 14, 2017, https://taxfoundation.org/repatriation-tax-holiday-hangover/;

[34] [Cite]

[35] Repatriation Holiday Report, *supra* note 63, at 1 n.2 (estimating that \$212 billion of the \$312 billion repatriated that year was due to the tax holiday).

[36] Jeff Sommer, *A Stranded \$2 Trillion Overseas Stash Gets Closer to Coming Home*, N.Y. TIMES, Nov. 4, 2016.

corporations had identified as offshore and for which U.S. taxes had been deferred were actually deposited in . . . accounts at US financial institutions" in subsidiaries' names.[37] Similarly, a 2016 Bloomberg investigation found that hundreds of billions of these unrepatriated profits are invested in U.S. government bonds.[38]

3. Inversions

The dynamics described above also created pressure for U.S. multinationals to cease being U.S. multinationals by changing their parent corporation into a non-U.S. entity. There have been several waves of these transactions, known as tax inversions, and regulatory actions in response.[39]

U.S. multinationals faced two chief motivations to invert. The first is that, by shifting the parent corporation to a tax jurisdiction with a territorial system, multinationals could potentially reduce the tax burden on income they earned in non-U.S. jurisdictions from the 35% U.S. rate to zero.[40] The second motivation was that it is easier to shift profits out of the United States when the entity earning those profits is owned by a non-U.S. parent corporation.[41] For many companies, this motivation was as powerful as the first, but it is much less appreciated.

Efforts to invert also establish two other points: Companies did want to repatriate their foreign subsidiaries' profits to their parent corporation; non-repatriation and indefinite deferral was not considered an ideal option. Moreover, multinationals did not have a way to easily repatriate all of their profits without triggering U.S. tax. This lends credence to the view that the pre-TCJA system reflected a view that offshore profits would

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[37] Avi-Yonah & Mazzoni; Senator Carl Levin (D-MI) & Senator John McCain (R-AZ), Memorandum RE Offshore Profit Shifting and the U.S. Tax Code – Part 2 (Apple Inc.), at p. 7 n. 14; Permanent Subcommittee Report; *see also* Stephen E. Shay, *The Truthiness of "Lockout": A Review of What We Know*, 146 TAX NOTES 9, Mar. 16, 2015.

[38] Andrea Wong, *Americans Are Paying Apple Millions to Shelter Overseas Profits*, BLOOMBERG.COM, Dec. 7, 2016, https://www.bloomberg.com/graphics/2016-apple-profits/#methodology. This has the ironic side effect that the U.S. government paid U.S. multinationals over $1 billion in interest payments on these bonds in the five years preceding the passage of the TCJA. Professor Reuven Avi-Yonah analogized this state of affairs, from the government's perspective, as akin to "paying someone to borrow a bike that's actually yours to begin with." *Id.*

[39] [Cites]

[40] This is an oversimplification. [explain and cite]

[41] [Cite]

eventually be repatriated, at which point they would be subject to 35% U.S. tax.

C. *What the TCJA Did*

We now turn to a brief and simplified summary of how the TCJA transformed the U.S. international tax landscape.

1. The Non-Transition Tax Components

The TCJA has four key international provisions in addition to the Transition Tax.

i. Territoriality

- The TCJA is commonly credited with shifting U.S. to a territorial system.
  - That isn't quite right.
  - If a U.S. corporation that owns more than 10% of the stock of a foreign corporation[42] receives a dividend from that corporation, the foreign source portion is deductible from the U.S. corporation's taxable income. The net effect of including the dividend as an item of income and then deducting it has the effect of exempting said income from U.S. taxation.
  - However, direct foreign earnings are generally still taxable. And individuals, corporate shareholders who own less than 10% of an entity, etc., are still subject to tax on dividends from foreign corporations.
  - The upshot is that it's not a truly territorial system.
- Moving to a system in which U.S. multinationals' subsidiaries foreign income is exempt from U.S. tax—as compared to the pre-TCJA system, under which tax on such income was deferred—increases the incentive to engage in tax avoidance by shifting profits overseas. From a taxpayer's perspective, exemption is a more attractive treatment than deferral.
- Therefore—and because there were constraints on what the revenue implications of the TCJA could be—the TCJA includes several provisions to try to limit tax avoidance by multinationals going forward.

[42] This is measured either by voting power or total value of all classes of stock.

ii. Base Erosion Avoidance Tax (BEAT).

- The BEAT is very complicated, but it's basically an alternative minimum tax provision that makes it harder to shift income out of the U.S. into a foreign affiliate. It applies to both U.S. multinationals and non-U.S. multinationals with a U.S. subsidiary.

iii. Global Intangible Low Taxed Income (GILTI)

- GILTI is very complicated, but the gist is that it's a minimum tax on profits that U.S. multinationals earn abroad.
    - It applies to income in excess of a 10 percent return on (essentially) tangible assets, on the assumption (not necessarily correct) that the extra returns are due to intangibles, the taxation of which is a known weak point of the U.S. international tax regime.
    - GILTI is essentially taxed at half of the regular corporate rate, meaning 10.5%, as the post-TCJA corporate tax rate is 21%. This is accomplished via including GILTI in income and then allowing a deduction of 50% of the amount included.
        - The deduction drops to 37.5% of GILTI (three-eighths) in 2026, for a GILTI rate of 13.125%.
- However, a key aspect of GILTI is that foreign taxes are creditable against GILTI at 80 cents on the dollar. So as long as the taxpayer is paying at least 13.125% in income taxes on its GILTI income combined across jurisdictions (16.4% after 2025), it will have no tax liability in the United States under the GILTI provisions.
- One issue with GILTI is that because it is calculated on a worldwide basis, and not on a country-by-country basis, it creates some strange and presumably unintended incentives. Earning income in high-tax jurisdictions (e.g., Germany, Japan, the UK, France) can become more attractive than it was pre-TCJA, because the taxes earned on such income creates tax credits that can immediately reduce the company's tax liability on GILTI earned by subsidiaries in low-tax jurisdictions (e.g., Bermuda, Switzerland, Ireland).[43]

[43] See, e.g., The Games They Will Play.

iv. Foreign-Derived Intangible Income (FDII)

- Unlike the BEAT and GILTI, which are essentially sticks that punish U.S. multinationals for excessive shifting of income out of high-taxed jurisdictions, FDII is a carrot intended to induce multinationals to locate economic activity and income in the United States.
    - The mechanics are again very complicated (and intertwined with GILTI) but the gist is that it provides a low rate on income from exports that is attributed to intangibles. This makes it somewhat like a patent box regime.
    - The FDII rate is 13.125%, compared to the new corporate rate of 21%. Like with GILTI, this low rate is accomplished by including FDII in income and then allowing the taxpayer to deduct 37.5% (three-eighths) of the FDII.
- There is real concern that FDII may be an illegal export subsidy under WTO rules.

v. Overall Picture

The preceding descriptions try to present a high-level map of the international tax landscape post-TCJA. However, a number of caveats are in order. First, many of the new provisions are extremely complicated. Second, there are many technical issues and questions that have not yet been resolved and will require new regulations to address. To some extent, these issues were likely to arise under any version of tax reform, given the complexity of the system. At the same time, the great speed with which the TCJA was assembled and the process through which it was put together (for example, without hearings) seem to have greatly amplified these problems.

Preliminary expectations of the TCJA's anti-abuse provisions are somewhat modest. The CBO predicts that approximately 80% of profit-shifting activities will persist post-TCJA.[44] It is also worth noting that, by lowering the corporate tax rate from 35% to 21%, the TCJA reduces multinationals' incentives for profit shifting and other tax gamesmanship, which

[44] Congressional Budget Office, The Budget and Economic Outlook: 2018-2018, p. 124 & 127 (2018).

could render the CBO's estimate too pessimistic.[45] Nonetheless, a group of prominent tax scholars have argued that the CBO's prediction is an overly optimistic estimate of the TCJA's effects.[46]

To the extent that there are loopholes and unintended opportunities in the TCJA, large multinational enterprises have strong incentives to find and exploit them, and they have access to some of the world's best tax lawyers and accountants to help them do so. Therefore, in an important sense, it's not yet clear exactly what the post-TCJA tax regime looks like and we'll have to wait and see what happens.

2. Transition Tax

The final major international provision of The TCJA is the Transition Tax.

- Explain that and how it works.
    - [Technical details, briefly]
    - Explain Untaxed Offshore Profits and components
    - Explain 8 and 15.5% rates
    - Explain how taxpayers can elect to pay it over an 8-year period
    - Reduced by foreign tax credits
        - Taxpayers get a 22.9% foreign tax credit for foreign taxes paid on income taxed at the 8% rate and a 44.3% foreign tax credit for foreign taxes paid on income taxed at the 15.5% rate.
        - These rates correspond to zero U.S. tax liability for a 35% foreign tax payment (note 35% is the pre-TCJA U.S. corporate tax rate) with smooth scaling up to 8% and 15.5% for 0% foreign tax payments.
- The Transition Tax is really important. Both because of its revenue impact (big in general) and because of the constraints under which the bill was passed. It had to be

[45] The large reduction in the corporate tax rate creates some incentives to shift income from high-earning taxpayers to corporations, but that issue is beyond the scope of this article.

[46] Oh the Games They Will Play ("The effect on profit shifting is likely even smaller, however, since CBO does not take into account investor reactions to the instability of the FDII regime in response to WTO challenges, investor reactions to the political instability of the legislation in general, and tax competition from other countries.").

revenue neutral-ish and the Transition Tax is a big revenue raiser.

- The TCJA's international tax provisions, combined, are scored as net revenue-raisers, but only because of the transition tax; without the transition tax, the TCJA's international provisions would produce a revenue loss.[47]

III. THE CASE FOR RAISING THE TRANSITION TAX RATE

Having explained the broad contours of the U.S. international tax regime both pre- and post-TCJA, we now turn to the reasons why the Transition Tax's low rate raise equity and efficiency concerns. Subpart A explains why the Transition Tax's low rate encourages harmful tax avoidance behavior. Subpart B analyzes the problems of the Transition Tax singling out profits invested in illiquid assets for more positive treatment. These problems can be corrected by raising the tax rate on Untaxed Offshore Profits invested in illiquid assets to the rate imposed on Untaxed Offshore Profits invested in liquid assets. Subpart C explores the efficiency and equity problems caused by the Transition Tax's effectively favoring sophisticated multinational enterprises over other taxpayers. Raising the Transition Tax rate would ameliorate all of these concerns.

Subpart D presents an additional argument for raising the Transition Tax rate. One argument for lower tax rates in general is that taxes distort behavior in undesirable ways. This argument does not apply to the Transition Tax, as Transition Tax liability depends solely on prior behavior. This suggests that the Transition Tax rate should be higher than the rate imposed on corporate income prospectively (35% pre-TCJA, 21% post-TCJA).

Finally, Subpart E considers counterarguments to raising the Transition Tax rate. These include both arguments that raising the Transition Tax rate would be too onerous on taxpayers and that raising the rate would be an insufficient measure.

A. *Incentives for Tax Avoidance*

Section 1 of this Subpart explains why multinational corporations' offshore deferral strategies were so effective in reducing their tax burdens, as well as why the Transition Tax

[47] J. Comm. Tax'n, Estimated Budget Effects of the Conference Agreement for H.R. 1, the "Tax Cuts and Jobs Act," JCX-67-17, Dec. 18, 2017 (putting total revenue raised from the transition tax at $338.8 billion and total revenue raised from international tax reform at $324.4 billion).

under-taxes the income earned pursuant to those strategy. Combined, these two facts show that this specific type of tax avoidance—which Congress, the IRS, and commentators have long been aware of and considered problematic—has been extremely lucrative and an issue of global importance. Section 2 explains why tax avoidance behavior is a problem, and therefore why the Transition Tax's low rate—which incentives that problematic tax-avoidance behavior—should be raised.

1. The Extent of the Giveaway

Before considering how much money U.S. multinationals saved in taxes by utilizing the offshore avoidance strategies described above, it is worth explaining conceptually why deferral is so lucrative. There are three main reasons.

First, there is the time value of money. A basic tenet of finance is that money received earlier is more valuable than money received later. Money received today can be invested, and thereby turned into even more money.[48] Prices generally rise over time, so money received today generally has more purchasing power than money received later—$1 will buy you more today than it will in a year, or a decade. Finally, the future is uncertain; money promised in the future may simply never materialize, but money received today is a sure thing. A bird in the hand is worth more than one in the bush.

The same logic applies in reverse when it comes to making payments instead of receiving them: the later a payor can make a payment, the better for her, as she can keep the money longer and keep it invested during that time. Thus, delaying a tax payment is valuable for this reason.

The exact benefit of deferring a payment depends on both the amount of time the payment is deferred and the returns the payor can get on her money. A large multinational enterprise may not need to access its offshore cash for long periods of time, and thus may be able to defer income for many years or even decades. Assuming twenty years of deferral at six percent annual interest—a reasonable rough estimate of interest rates on investment-grade corporate debt over the last 20 years[49]—the cost of a $1 tax

[48] Equivalently, you can use the money to pay down outstanding debts earlier, saving additional interest payments.
[49] *See* ICE Bank of America Limited U.S. Corporate BBB Effective Yield, *available at* https://fred.stlouisfed.org/series/BAMLC0A4CBBBEY.

payment shrinks to just over 30 cents, effectively cutting the company's tax bill by more than two-thirds.[50]

The second reason why deferral is so lucrative is that it converts annual tax payments on growth each year into one big payment on total growth over a longer period of time. This is extremely valuable and often unappreciated. The reason this is so valuable is because investments earning compound interest grow exponentially over time, and the rate of interest determines the rate of that growth. Taxing returns each year, like an income tax normally does, reduces the effective annual growth rate, while deferring tax until the end of the investment does not.

An example helps illustrate this point. Suppose that you are going to put $1000 into an investment that grows at 10% a year. Assume that the tax rate is 30%, but you can structure your investment so that it is taxed in one of two ways.

Under Option A, you pay tax each year on your profits that year. Your initial investment of $1,000 would earn $100 in the first year.[51] You would owe $30 in tax on that $100,[52] leaving you with $70 of after-tax profits for the year and a total investment value of $1070. The next year, you would earn 10% on that $1070, which would be $107. Your tax bill would be $32.10,[53] leaving you with $74.90 in after-tax profits for the year and a total investment value of $1144.90, and so on in future years. Essentially, the 10% return on your investment each year becomes a 7% return after taxes, because 30% of your gains each year go to the government in the form of tax payments.

Under Option B, you do not pay any taxes until you take your money out of the investment, at which point you pay tax on all of the gains you earned over the lifetime of the investment. So,

[50] The table below shows the percentage savings on deferring a payment a given number of years at various discount rates (i.e., annual returns the payor could earn on her money). At a 10% discount rate, a $1 payment deferred for 30 years costs roughly a nickel.

		Years of Deferral		
		10	20	30
Discount Rate	3%	26%	45%	59%
	6%	44%	69%	83%
	10%	61%	85%	94%

[51] $100 = investment of $1000 * 10% return.
[52] $30 = tax rate of 30% * $100 of income.
[53] $32.10 = tax rate of 30% * $107 of income.

if you initially invested $1,000, you would earn $100 in the first year and would pay no tax initially, leaving with you $1100 total going into year two. In the second year, you would earn 10% returns on the full $1100 value of your investment, giving you $110 in income. None of that growth would be taxed, leaving you with $1210 heading into the third year—though of course you will still owe taxes on your $210 in total profits eventually, and will pay that amount when you close out your investment for cash.

It might seem that these two options will leave you equally well off at the end of your investment, but that is not the case. From an investor's perspective, Option B is far superior. Under the example described above, if the investor takes her money out after thirty years, Option A would leave her with a little over $7,600.[54] Option B, in contrast, would leave her with over $12,500.[55] Option B represents an increase in after-tax returns of almost 75%.[56]

Third, there is option value in being able to control when you will incur a tax liability. Despite the old saw that only death and taxes are certain, clever planners can sometimes find a way to permanently avoid taxation on certain income.[57] For example, for years, certain U.S. multinationals could employ a transaction known as the "Killer B" to bring income earned by foreign subsidiaries back to the U.S. parent without triggering U.S. tax.[58]

[54] The annual after-tax return is 7%. Growing $1000 at 7% each year for 30 years produces a total of $\$1000*(1+7\%)^{30} \approx \$7{,}612$.

[55] Growing $1000 at 10% each year for 30 years produces a total of $\$1000*(1+10\%)^{30} \approx \$17{,}449$. You would then owe approximately $4,935 in tax on your $16,449 in profits (30% tax rate times ($17,449 total cash received – $1000 initial investment)), leaving you with approximately $12,515 after taxes. (Note that numbers do not exactly match due to rounding.)

[56] The after-tax returns of option 1 are ($7612 - $1000) / $1000 ≈ 6.6. The after-tax returns of option 2 are ($12,515 - $1000) / $1000 ≈ 11.5. 11.5 is 74% more than 6.6.

[57] The classic example of this approach is sometimes referred to as "buy, borrow, die." A wealthy individual invests her money in assets, then never sells them, thereby avoiding triggering tax on those investments' increase in value. If she needs money in the interim, she secures it by borrowing it, using the valuable investments as collateral. Then, upon her death, her heirs inherit all of her assets with a fair market value basis, thereby wiping out all of the investments' accumulated gains. See 26 U.S.C. 1014. This technique is not directly available for a corporation because corporations have perpetual legal life and thus do not die.

[58] The name comes from the provision of the Internal Revenue Code that made the technique possible, § 368(a)(1)(B). Section 368 governs tax-free corporate reorganizations; those described in § 368(a)(1)(A) are often referred to as "A reorgs" as a shorthand, those described in § 368(a)(1)(B) are referred to as "B reorgs," and so forth.

IBM alone used this technique to permanently avoid $1.6 billion in U.S. corporate income taxes.[59] The IRS subsequently issued regulations that closed off the Killer B.[60] However, clever tax planners eventually found a way around the new regulations, creating a window of opportunity before the IRS issued more regulations shutting down those new workarounds.[61] Creative tax planners have found other approaches, some of which have, in turn, triggered responses from U.S. tax authorities.[62]

Similarly, sometimes there are even easier ways of lowering one's tax bill. Perhaps the most straightforward approach is to simply wait until the corporate tax rate goes down before triggering a tax liability. For instance, waiting until the tax rate drops from 35% (its pre-TCJA level) to 21% (its post-TCJA level) before triggering liability would reduce one's tax liability by 40%. The United States even had a repatriation holiday in 2004, under which eligible foreign profits could be repatriated subject to a tax rate of only 5.25%, a fraction of the 35% corporate tax rate that otherwise would have applied.[63] This rate was also reducible even

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[59] David Cay Johnston, *I.R.S. Moves to Close Tax Shelter Shortly After I.B.M. Uses It to Save $1.6 Billion*, N.Y. TIMES, June 7, 2007 at C3, *available at* https://www.nytimes.com/2007/06/07/business/07tax.html?ex=1338955200&en=cc9b3f108f4565c9&ei=5124&partner=permalink&exprod=permalink.

[60] *See, e.g.*, IRS Notice 2006-85; IRS Notice 2007-48; Willard B. Taylor et al., Sullivan Cromwell LLP, *Killer B Transactions: IRS Issues Regulations Treating an Acquisition of Parent Shares by a Subsidiary in Connection with a Reorganization as a Distribution*, June 16, 2008, *available at* https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Killer_B_Transactions.pdf.

[61] *See, e.g.*, Jack Cummings & Stefanie Kavanagh, Alston & Bird, *Killing the Killer B: The Treasury and IRS Issue a Sixth Set of Rules on Killer B Transactions*, Dec. 15, 2016, *available at* https://www.alston.com/-/media/files/insights/publications/2016/12/iinternational-tax-advisoryi-killing-the-killer-b/files/view-advisory-as-pdf/fileattachment/killingthekillerb.pdf.

[62] *See, e.g.*, IRS, U.S. Dep't of Treasury, *Treasury and IRS issue Guidance on Abusive Foreign Tax Credit Transactions*, Feb. 17, 2004, *available at* https://www.treasury.gov/press-center/press-releases/Pages/js1177.aspx.

[63] *See, e.g.*, Repatriating Offshore Funds: 2004 Tax Windfall for Select Multinationals, Majority Staff Report, Permanent Subcommittee on Investigations, U.S. Senate Committee on Homeland Security and Governmental Affairs, S. Prt. 112-27, Oct. 11, 2011 (112th Cong. 1st Sess.), *available at* https://www.gpo.gov/fdsys/pkg/CPRT-112SPRT70710/pdf/CPRT-112SPRT70710.pdf [hereafter, Repatriation Holiday Report]; *see also* Michael Mundaca, *U.S. Dep't of the Treasury, Just the Facts: The Costs of a Repatriation Tax Holiday*, Mar. 23, 2011, https://www.treasury.gov/connect/blog/Pages/Just-the-Facts-The-Costs-of-a-Repatriation-Tax-Holiday.aspx; CHUCK MARR & CHYE-CHING HUANG, CENTER ON BUDGET & POLICY PRIORITIES, REPATRIATION TAX HOLIDAY WOULD LOSE REVENUE AND IS A PROVEN POLICY FAILURE, June 19, 2014, https://www.cbpp.org/sites/default/files/atoms/files/6-19-14tax.pdf; Jeff Cox,

further by foreign tax credits.[64] U.S. multinationals repatriated hundreds of billions of dollars that year to take advantage of the low rate.[65]

Finally, all of these benefits feed into each other—there is value in deferring the date of a tax bill, there is value in turning growth taxable annually into growth taxable only upon liquidation, and there is also value in controlling the timing of tax liability. Each of these reasons interacts with the others and increases the benefits of this form of tax avoidance, thereby incentivizing it.[66]

Thus, U.S. multinationals companies who kept their foreign profits parked in their foreign subsidiaries reaped sizable tax benefits for many years. If the TCJA had immediately taxed all Untaxed Offshore Profits at the pre-TCJA tax rate of 35%, these companies would still have been significant net beneficiaries of their tax avoidance activities.

But the Transition Tax did not do this. Instead, it taxed Untaxed Offshore Profits at either an 8% rate or a 15.5% rate, depending on how those profits were invested. This meant *further* savings relative to the 35% corporate tax rate in effect when this income was earned. The Transition Tax rate is also significantly lower than the 21% post-TCJA corporate tax rate imposed on income earned going forward.[67]

In addition, the Transition Tax is payable over an eight-year period, without interest.[68] These payments increase over time, so that the payments made in early years are the smallest and those

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The Last Time Companies Got a Break on Overseas Profits, It Didn't Work Out Well, CNBC.COM, Apr. 26, 2017, https://www.cnbc.com/2017/04/26/what-happened-the-last-time-companies-got-a-break-on-overseas-profits.html; Amir El-Sibaie, Tax Foundation, *A Repatriation Tax Holiday Sounds Fun, but Comes with a Hangover*, Aug. 14, 2017, https://taxfoundation.org/repatriation-tax-holiday-hangover/;

[64] [Cite]

[65] Repatriation Holiday Report, *supra* note 63, at 1 n.2 (estimating that $212 billion of the $312 billion repatriated that year was due to the tax holiday).

[66] There are of course some countervailing reasons not to engage in this type of tax avoidance behavior. For example, if the parent company has immediate cash needs and is unable to borrow money, or can only do so at high interest rates, that would militate in favor of promptly repatriating profits from foreign subsidiaries.

[67] Transition Tax liability is further reduced by foreign tax credits. See Part II.C.2, supra. This is arguably not a further advantage or disadvantage, as the pre-TCJA tax regime also provided a foreign tax credit. The post-TCJA regime does as well.

[68] 26 U.S.C. § 965(h).

made in later years are the largest. This means that the Transition Tax layers additional deferral benefits on top of those taxpayers previously reaped from their initial avoidance behavior. Again assuming a 6% discount rate, this installment payment structure effectively reduces the Transition Tax rate by more than 22%.[69]

2. The Problem of Tax Avoidance

Of course, the extent to which it is bad to encourage tax avoidance depends on how bad tax avoidance itself is.

- From a social welfare perspective, efforts taxpayers undertake solely to avoid paying taxes are pure waste; they are expenditures that shift resources from one spot to another, but do not create any social value.[70]
- Moreover, compliance depends in part on the sense that others are paying their taxes. Most people want to be good, upstanding, contributing members of their community; no one wants to be a sucker. Avoidance encourages others not to pay their taxes, which is problematic.
- Tax revenues that are not collected due to avoidance must be made up elsewhere. That generally means higher tax rates on other taxpayers. This is bad for a variety of reasons.
    - First, it's unfair, because it means that the non-payers get an even better deal than those who are supporting the system and paying their taxes.
    - Second, it's inefficient, because higher rates can discourage economic activity, thereby creating deadweight loss.
    - It's also inefficient for another reason: Perhaps the most fundamental principle of tax policy is to have a broad tax base and a low tax rate. Higher tax rates encourage more taxpayers to engage in tax avoidance activities, shrinking the tax base. This means that the response to avoidance can have a feedback effect; avoidance necessitates higher rates,

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[69] The Transition Tax liability is payable in eight annual payments, with the first 5 each being 8% of total liability, followed by 15%, 20%, and 25%, respectively. Assuming a 6% annual discount rate, see footnotes 49-50 and accompanying text, a $1 Transition Tax obligation has a present value of less than $0.78 if paid in installments.

[70] Qualify re: how, by lowering effective rates, one might encourage more economic activity.

which engenders more avoidance, which in turn necessitates higher rates, and so on.

- Third, avoidance behavior may necessitate additional laws restricting taxpayer behavior. These anti-abuse provisions make the tax law more complicated and harder to comply with. Avoidance can also require the government to expend more resources on enforcement, which is costly.
  - More generally, to the extent that the government expects taxpayers to exert effort to avoid paying taxes, it must draft harsher and more complicated tax laws of all types. This raises the complexity and length of the tax code, and thus the cost of complying with it.

B. *Extra Favorable Treatment of Illiquid Assets*

- "Picks winners and losers"
- Violates horizontal equity because it treats taxpayers with similar incomes differently
- To the extent one wants to distinguish between taxpayers, not at all clear that we should favor those taxpayers who invest in illiquid assets
  - On one hand, perhaps they were engaged in less tax avoidance behavior and had good reasons for keeping profits offshore besides avoiding in taxes
  - On the other hand, not at all clear that U.S. tax law should be kinder to multinationals investing offshore than those investing at home or returning profits to the U.S. parent
- Inefficient because there is some ability to game the system by moving profits to illiquid assets
  - Discuss the rules on how the 8% and 15.5% base are calculated and the room for manipulation
  - Note that there is an anti-abuse rule that targets such gamesmanship. That's good, but there is reason to question how effective it will be.[71]
- Second source of inefficiency: To the extent that taxpayers believe Congress will pass similar provisions in the future, it encourages taxpayers to prefer illiquid investments over more liquid ones.

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[71] See Avi-Yonah & Mazzoni.

    - Not clear that this is a likely outcome.
- Concerns about taxpayer liquidity do not justify the rate preference for illiquid assets.
    - The Transition Tax is payable over an eight-year period, with the smallest payments due in the first five years, and no interest. Given this payment structure, there is good reason to believe that taxpayers can extract enough cash, even from illiquid assets, to cover their Transition Tax liability.
    - The vast majority of the Transition Tax burden falls on a few large multinational companies with lots of cash and lots of access to credit. They should have plenty of liquidity.
    - If liquidity is still a concern, it would be better (more revenue) to allow taxpayers to work out longer-term payment plans, similar to provisions elsewhere in the tax law (see, e.g., offers in compromise) than to just give a rate reduction.
        - Counterargument: Biggest, most sophisticated taxpayers might be able to take better advantage of such a provision, which would raise equity concerns. Response is that those companies bear the lion's share of the tax burden here anyway.

C. *Favoring Sophisticated Multinationals Over Other Taxpayers*

- Equity: favors some taxpayers over others with identical incomes
- Moreover, if you're going to favor some group of taxpayers it's not at all clear that the largest U.S. multinationals are the ones that should be singled out, from either a policy or a political perspective
    - Who thinks Facebook, Apple, or Amazon needs a tax cut?
    - Given the level of populist sentiment that seems to be present in the U.S. these days, this aspect of the Transition Tax seems somewhat incongruous.
    - A cynical response might be that this is simply because these companies are large and powerful. But GILTI and BEAT may not fit with this view.

Plus, because of budget constraints, tax cuts in one place mean surrendering tax cuts somewhere else. There are big and powerful interests on both sides.

- Efficiency: Encourages companies to be more multinational and less domestic. Not at all clear that's a good idea.
    - Since the Transition Tax is retroactive, this effect is more indirect than direct

D. *Incentives for Profits (i.e., Retroactivity)*

A primary argument for keeping income tax rates as low as possible is that taxes discourage economic activity. This creates deadweight losses that benefit no one.

For example, suppose you are willing to pay up to $1000 to have your house painted, and that I am willing to do the job if I receive at least $800. It makes economic sense for you to pay me between $800 and $1000 to paint your house; you would rather have a painted house than the money in question, and I would prefer to have the money than the leisure time.

Now suppose we introduce a 30% income tax. After taxes, I will make, at most, $700 from painting your house.[72] This is less than $800, the minimum payment for which I am willing to do the job. The 30% income tax thus prevents us from consummating a mutually beneficial transaction; you are worse off because your house remains unpainted, and I am worse off because I do not take on a job I would be willing to do in a no-tax world. Crucially, the government is not better off, either—because you do not hire me, I have no income to tax, so it collects no revenue.[73] Together, everyone is worse off.

But this argument does not apply to the income subject to the Transition Tax. Untaxed Offshore Profits have already been earned; absent a time machine, they will remain earned regardless of how high a rate of tax the government imposes on it now.[74]

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[72] You are willing to pay me at most $1000. If I pay 30% income tax, I keep 70% of whatever you pay me. $1000 * 70% = $700.

[73] If one envisions the government as caring at least somewhat about its citizens' well-being, it is affirmatively worse off, as the tax has made two of its citizens worse off while providing the government no compensating benefit.

[74] A caveat is in order. Taxpayers might put in some extra effort to eliminate the income for tax purposes (i.e., find some way to amend their returns), but this would not constitute a real effect as the underlying economic activity would remain unchanged.

Moreover, this point suggests that the Transition Tax rate should be *higher* than the general corporate tax rate on income earned prospectively. Money is fungible; therefore any revenues raised via the Transition Tax can be used to fund reductions in other income taxes that apply prospectively.[75] Reducing such taxes will eliminate some deadweight loss, making everyone better off. Given a choice between taxing prospective profits and profits that have already been earned, the choice seems clear.

This analysis is complicated by the concern that the possibility of future retroactive taxation will influence taxpayers' estimate of prospective tax rates. In other words, if this year's income tax rate is 20%, but taxpayers expect that, in the future, the government will levy an additional 15% tax on income earned this year, taxpayers will make decisions as if this year's tax rate is 35%, not 20%. This will result in a level of deadweight loss commensurate with the higher tax rate.

This concern is a sensible argument against retroactive taxes generally. However, the Transition Tax is clearly a special case. It does not seem likely that a similar scenario will arise in the United States in the foreseeable future. Thus, there is little direct analog for taxpayers to worry about prospectively.[76]

It is possible that raising the Transition Tax will cause taxpayers to raise their expectations of retroactive taxes on all income. But, given the somewhat sui generis nature of the Transition Tax, this seems a significant leap and one that taxpayers are unlikely to infer.

The UK's experience with the Windfall Tax is reassuring in this respect. The Windfall Tax, as discussed previously, was a retroactive, one-time tax on certain companies' income from a specific period. There is no evidence that the Windfall Tax significantly affected taxpayers' expectations with respect to the likelihood of additional retroactive taxation.

[75] Equivalently, it could also be spent on government programs or pay down the deficit. [explain]

[76] To the extent that analogous income exists, it is presumably already favored by the tax code just as Untaxed Offshore Profits were and thus may reflect avoidance behavior. Raising taxpayers' perceptions of the future tax burden on this income might therefore be beneficial on net.

E. *Counterarguments*

This Subpart considers a variety of counterarguments that one might raise against raising the Transition Tax rate.

1. The Case for a GILTI Benchmark

To date, the prevailing narrative on the post-TCJA tax regime is that it is an imperfect territorial system. This fits with much of how the bill was sold by its proponents, as well as a pattern of Republican lawmakers proposing, and conservative tax thinkers advocating for, a territorial system.[77]

But there is a strain of argument that this view is wrong. Under this view, the TCJA should instead be viewed as an imperfect system of immediate worldwide taxation.[78] This would place the TCJA more along the lines of prior Democratic proposals, such as President Barack Obama's Framework for Business Tax Reform.[79]

This view relies largely on the GILTI provisions of the TCJA. As described in Part II.C, supra, the GILTI provisions aim to ensure that income earned by U.S. multinationals' foreign subsidiaries faces a minimum rate of tax *somewhere*. This essentially operates by imposing a 10.5% (13.125% starting in 2026) U.S. tax immediately on the non-U.S. income of U.S. multinationals' foreign subsidiaries.[80] One might argue that the TCJA establishes this rate as the appropriate tax rate for U.S. multinationals' foreign profits.

This argument is problematic.

- Untaxed Offshore Profits were earned during a different tax regime, so to assume that say should be subject to the same tax rate as income earned under the new regime is questionable

[77] [String cite]

[78] Cite to Morse, *see also* Daniel Shaviro, *The New Non-Territorial U.S. International Tax System, Part 2*, TAX NOTES, July 9, 2018, at 171 ("[The TCJA] is best seen neither as making the United States a territorial system, nor as simply repealing deferral"); Reuven Avi-Yonah & Gianluca Mazzoni, BEPS, ATAP, and the New Tax Dialogue: A Transatlantic Competition?, *available at* https://ssrn.com/abstract=3204242.

[79] *See* THE WHITE HOUSE & THE DEP'T OF THE TREASURY, THE PRESIDENT'S FRAMEWORK FOR BUSINESS TAX REFORM 1 (2012) [hereinafter OBAMA PLAN].

[80]

- GILTI represents a minimum tax rate on such income. To argue that it sets the appropriate benchmark rate, period, is misguided.
- The prospective / retrospective issue; as described above, there are sensible reasons to tax prospective income less than retrospective income because of the incentive effects and deadweight loss concerns
- The GILTI regime imposes tax immediately when income is earned. Untaxed Offshore Profits were not subjected to immediate taxation when they were earned. Taxation on such profits was deferred, often for many years, triggering all of the benefits described in Section III.A.1, *supra*. Even accepting the GILTI rate as an appropriate baseline, applying the GILTI rate to Untaxed Offshore Profits would significantly under-tax such income relative to that baseline. Thus, the Transition Tax rate would still have to be higher than the GILTI tax rate.
- GILTI was not implemented in isolation, but as part of a larger statutory scheme. Also have BEAT to reduce base erosion and profit-shifting out of the U.S., FDII to induce leaving more earnings in the U.S.; Untaxed Offshore Profits were earned under, effectively, an altogether different system which had none of these parts.
    - [Also mention change in corporate tax rate and its incentives on shifting profits; yes, think so, in a footnote.]
- Even if one accepts, despite the objections above, that the GILTI rate represents the right benchmark for comparison, the Transition Tax rate on illiquid assets (8%) is still lower than the GILTI rate (10.5% now, 13.125% starting in 2026).

2. The Case for a 0% Benchmark

One might take the previous subsection's GILTI argument further and argue that the proper rate benchmark for Untaxed Offshore Profits is the rate applied to similar income earned post-TCJA—essentially, 0%. Analogizing Untaxed Offshore Profits to offshore income earned post-TCJA is problematic on several levels.

- The prospective / retrospective issue; as described above, there are sensible reasons to tax prospective income less than retrospective income because of the incentive effects and deadweight loss concerns

- The TCJA doesn't just say that U.S. multinationals' foreign profits are no longer subject to tax. It couples this move toward territoriality with a variety of other new provisions designed to discourage companies from engaging in problematic avoidance behaviors.
    - The BEAT makes it harder for companies to avoid taxes by shifting profits out of the United States
    - GILTI similarly imposes an immediate minimum tax on income earned abroad, reducing the incentive to shift profits and economic activity out of the United States
    - FDII lowers the tax burden on economic activity carried out in the United States that generates profits abroad, reducing the incentive to shift profits and economic activity out of the United States
    - [Also mention change in corporate tax rate and its incentives on shifting profits; yes, think so, in a footnote.]
    - Thus, one cannot fairly say that the TCJA reflects a determination that the proper tax rate to be applied to U.S. multinationals' foreign profits is zero percent and this argument therefore fails.

3. The Real Issue Is Unrealized Offshore Profits

One argument against raising the Transition Tax rate is that doing so misses the real issue, which is unrealized offshore profits. Unrealized profits are, essentially, appreciation in property owned by subsidiaries and not yet sold. Estimates suggest that U.S. companies have approximately [$X] trillion in unrealized profits in their foreign subsidiaries—much of it in the form of appreciated intellectual property which was created in the United States, then moved offshore to facilitate tax avoidance activities.[81]

Because they are unrealized, these profits have not yet been taxed in the United States (and likely have not been taxed elsewhere, either). The TCJA's dividend exemption provisions effectively exempt these profits from U.S. taxation going forward.[82] The Transition Tax only applies to realized profits, and not to unrealized investment gains. Thus, one might argue that

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[81] [See generally discussion in Part II.B, *supra*.

[82] This is an oversimplification; see GILTI discussion below.

these profits completely escape U.S. tax liability on a permanent basis, and raising the Transition Tax rate does nothing to address this.

An example helps illustrate the point. If Apple Canada LLC bought a building for $2 million and sold it in July 2017 for $3 million, it would have $1 million in profits. If those profits were repatriated to the United States, they would be subject to U.S. corporate income tax; if they were not repatriated, they would have become subject to the Transition Tax. In contrast, if Apple has not yet sold the building, it has still profited by $1 million but that profit has been subject to neither the U.S. corporate income tax nor the Transition Tax. And, since the TCJA moves the United States to a territorial tax system, that $1 million in profits will *never* be subject to U.S. tax.[83]

One response to this concern is that, when unrealized offshore profits are realized, they may trigger U.S. tax liability under the TCJA's GILTI regime. However, the GILTI rate of (at most) 13.125% is significantly lower than the pre-TCJA corporate income tax rate of 35% or the post-TCJA rate of 21%. Given GILTI's newness, its complexity, and the fact that much depends on future administrative guidance (or perhaps legislative amendment), one might also question whether the GILTI regime will achieve its goals as currently envisioned.

If one is not satisfied by the GILTI response, one way to address the issue of unrealized offshore profits is by having a statutory deemed realization event. This would treat U.S. corporations as if they sold all of the property in their foreign subsidiaries at market prices and impose tax on this deemed income at some specified rate.

However, there are significant problems with such an approach. Many find the idea of taxing unrealized profits unfair or even a disturbing exercise of governmental power. There are also administrative challenges with such a tax: Taxpayers may have problems with liquidity. Because they have not yet sold their appreciated property, they may not have cash to pay their tax liability.[84] Valuation is also a problem, especially for assets that

[83] This is an oversimplification; see GILTI discussion below.

[84] Analogizing to the individual context may be instructive; if your house becomes $20,000 more valuable, that does not mean you have $20,000 cash in your pocket with which to pay any taxes on your gains. Nor can you give the government your spare room.

are not commonly bought and sold—for instance, how much is Apple's patent portfolio worth? These valuation difficulties both make compliance more expensive for taxpayers and make it more difficult for tax authorities to determine whether taxpayers have complied with the law. These dynamics can increase the frequency of disputes between taxpayers and tax authorities, and raise the cost to both parties of resolving those disputes. These problems are why income taxes generally wait for taxpayers to actually sell their assets and realize their gains before taxing them, despite the well-known problems this "realization rule" introduces.[85]

On the other hand, given the TCJA's territorial shift in the U.S. tax system and the circumstances of the pre-TCJA regime under which those profits were accumulated, one might argue that a deemed realization event is neither unfair nor disturbing. There is an argument that liquidity is of little concern in this context, as the tax would fall on large multinationals. Many of these companies have vast stores of cash or other liquid assets, and those that do not likely have easy access to credit. Tax obligations from a deemed realization events can also be made payable in installments. As to valuation, while it would be difficult and costly, it would only have to be done once. Even if the IRS took a conservative view of valuations, thereby letting large amounts of appreciation go untaxed, from the government's perspective that would still be much better than the current approach—not imposing any tax on unrealized appreciation—and would raise tremendous amounts of revenue.

[Analogize to / discuss the U.S. estate tax system, which has all of these problems and addresses them with varying degrees of success]

Alternatively, instead of legislating a realization event, legislation could provide for tax on the built in-gains that existed as of the passage of the TCJA, but impose that tax at the time those assets are sold. This would avoid any potential unfairness in taxing unrealized gains. It would also provide an arm's-length valuation that could be used to mitigate valuation problems and would ensure that taxpayers have cash available to pay any tax liability. At the same time, it would bring a variety of its own administrative complexities, such as the need to determine—

[85] [Cites]

possibly many years in the future—the value of various property at the time of the TCJA's passage.

But wherever one ultimately comes down on the treatment of unrealized foreign profits, this is not a good counterargument to raising the Transition Tax rate. Raising the Transition Tax rate is in no way inconsistent with legislative action targeting unrealized foreign profits; Congress could do both, neither, or any combination of the two. Moreover, objections to specific legislative measures targeting unrealized offshore profits largely do not apply to raising the Transition Tax rate: The profits have already been realized. They have been earned and quantified, so that valuation is not a problem. Taxpayers have received cash, so liquidity is less of a problem and can be addressed in any event by making the Transition Tax payable in installments (as it currently is).

If anything, favoring the taxation of unrealized offshore profits should increase one's support for raising the Transition Tax rate. There is likely to be significant correlation between the amount of a multinational's Untaxed Offshore Profits and the amount of its unrealized offshore profits. Taxing the former would thus have a "rough justice" effect of reaching the latter.

4. The Legal Uncertainty Argument

- One model of tax law and transactions is that the parties come together and make a deal that makes them as well off as possible, subject to the constraints of existing laws.
- Under this model, the government does not get a seat at the table but does set the rules in advance. It must set rules to protect its interests.
- One view is that, to the extent the government's rules fail to protect its interests—if the parties think of something the government did not foresee—then the government has no recourse except to change the rules for future transactions. The die is cast.
- This view emphasizes the value of legal certainty—the importance to the parties of knowing what the rules are in advance and being able to structure their transactions accordingly, and the potential negative consequences of changing the rules.
- There is something to this view.
- But there is also something to be said for a more dynamic worldview in which the government gets the chance to

make moves after the parties take action instead of simply before it.

- Laws have purposes (though it can be hard to tell exactly what those are sometimes).
- Assume that a law has a socially beneficial purpose. If the parties find a way to defeat that purpose while still acting within the letter of the law, there is value in the government taking action to thwart the parties' efforts.[86]
- Moreover, the possibility that the government may take action after the parties act will help deter the parties from acting in ways that violate Congressional intent.
  - This makes it easier to draft statutes and regulations, and to police avoidance etc.
  - But, to the extent that it makes it harder for the parties to know what is permitted, it may raise their costs. This seems particularly likely to be a problem when a law's purpose are unclear.

- In any event, there is ample real-world evidence against the view that the government has no redress against taxpayer actions that violate Congressional intent.
- Many tax judicial doctrines fit this mold, such as step transaction, economic substance, sham transaction, business purpose, doctrine of substance over form, etc.
- There are also a multitude of legislative and administrative provisions that qualify. Of particular relevance for our purposes are the anti-inversion measures and the UK's Windfall Tax.
- [Discuss anti-inversion measures]

In the 1980s and 1990s, the United Kingdom privatized a number of utility companies under the leadership of the Conservative Party. This ultimately fueled a public backlash, as the public believed that the government had sold the state-owned companies too cheaply and then had subsequently been too lax in its regulation, allowing the utilities to reap large profits. After its electoral victory in 1997, the Labour Party enacted the "Windfall Tax", which, for most of the privatized companies, amounted to a tax on certain income they earned in the first four years following privatization.

[86] U.S. v. Bruce example, 18 USC S 1152 and 18 USC S 1153.

- The anti-inversion measures and the Windfall Tax raise all of the issues described above. Neither has led to catastrophe or an appreciable reduction in the rule of law.
- Thus, while this argument has some force, it need not be compelling.
- Moreover, it is worth noting that this argument only goes as far as existing rules go. No laws pre-TCJA said that Congress would not enact a Transition Tax, or what its rate should be.
- At the same time, it is true that corporations did not expect the Transition Tax rate to be as high as it was. There was a thought that it would be lower—see 5.25% Ways and Means Committee Proposal in 2014-ish.
  - And there is certainly a good argument that we don't want to surprise taxpayers and generally upset their expectations.
  - But not all proposals did this. The Finance Committee Proposal of 2014-ish had a 20% Transition Tax rate.
  - More fundamentally, just because big companies expect a particular deal because of their lobbying clout does not mean that they are entitled to it. It's a very bad precedent and problematic principle to enshrine in tax policy.
  - But even if you like that policy, the TCJA violates that in many other places; why special treatment here?
    - Individual taxpayers had an even more well-settled expectation that SALT deductions would be available, but the TCJA capped those.
    - Same point re: Mortgage Interest deduction for HELOs (I think; double-check specifics).
- Finally, it is worth reiterating that a Transition Tax rate of 35% (or 21%) would still leave taxpayers better off than they would be if they had triggered the 35% tax pre-TCJA. They have gotten the advantages of deferral described in Part III.C.1, supra, plus the additional deferral advantages of the Transition Tax's eight-year payment structure.

5. The Illegality Argument

One might be concerned that raising the Transition Tax rate in the manner described above might be beyond Congress' Sixteenth

Amendment power.[87] However, recent Supreme Court precedent suggests that this is not the case.

Raising the Transition Tax Rate is economically equivalent to imposing a new one-time, retroactive tax on the same income covered by the Transition Tax. Thus, raising the Transition Tax rate and such a one-time tax should have the same legal status; if one is permissible, the other should be as well, and vice versa.

In 2013, the Supreme Court considered the United Kingdom's "Windfall Tax," a one-time, retroactive tax on previously taxed income. In PPL Corp. v. Commissioner of Internal Revenue, 569 U.S. _ (2013), the Court ruled unanimously that the Windfall Tax constituted an income tax for purposes of the U.S. foreign income tax credit. In so doing, the Court was untroubled by both the Windfall Tax's one-time nature and its retrospective nature.

Of course, the Sixteenth Amendment's definition of an income tax may not map exactly onto the U.S. foreign income tax credit's definition. It is therefore possible that, *PPL* notwithstanding, a one-time retroactive tax on incomes might be unconstitutional.

However, this is unlikely. A foreign income tax qualifies for a credit "if and only if . . . the predominant character of that tax is that of an income tax in the U.S. sense."[88] Thus, any tax that qualifies under the auspices of the foreign tax credit is likely to qualify as an income tax under the Sixteenth Amendment's definition. More generally, the Sixteenth Amendment is written in expansive terms, conveying Congress a broad power to tax "incomes, from whatever source derived" without limitation.[89] The foreign tax credit rules, in contrast, are full of restrictions designed to protect the federal fisc.[90] Accordingly, to the extent that the two definitions of an income tax diverge, it is likely toward some income taxes qualifying under the Sixteenth Amendment, but not under the foreign tax credit rules.

In sum, it seems hard to construct a hypothetical tax that would constitute an income tax for purposes of the foreign income tax credit but not for purposes of the Sixteenth Amendment. The Court's ruling in *PPL* therefore strongly suggests that raising the Transition Tax is legally permissible.

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[87] [Cite Sixteenth Amendment]
[88] Treas. Reg. S 1.901-2(a).
[89] U.S. CONST. AMEND. XVI.
[90] [String cite]

IV. CONCLUSION

[To Come]