Conclusion

In the years after the publication of Cooper’s article in 1977, Congress plugged many of the estate and gift tax loopholes that were exploited by wealthy taxpayers of that generation. In recent years, Congress has not attended to new avenues of estate and gift tax avoidance. Like Jack Nicholson returning home to his dying father in *Five Easy Pieces*, if Cooper returned home to the estate and gift taxes of 2014, he would find them in need of major surgery to ensure their survival. These “five easy pieces” of estate and gift tax reform are offered here as initial steps to restore the estate and gift taxes to health.

Addressing International Income Inequality in a Time of Crisis

By Karen B. Brown

Karen B. Brown is the Donald Phillip Rothschild Research Professor of Law at George Washington University, where she teaches federal income, corporate, and international taxation. She would like to thank Paul L. Caron; the Pepperdine University School of Law; its dean, Deanell Tacha; the Pepperdine Law Review; and Tax Analysts for the opportunity to participate in the symposium “Tax Reform in a Time of Crisis.” This article is dedicated in loving memory to her father, Kenneth A. Brown Sr., the smartest and most loving man she’s ever met, a devoted father, and true friend to all in need, who loved God with all of his heart.

In this article, Brown urges the United States not to undertake major tax reform without considering the impact on more vulnerable economies, especially those in the Caribbean.

This article was presented on January 17 at a symposium in Malibu, Calif., sponsored by Pepperdine University School of Law and Tax Analysts. Twenty of the nation’s leading tax academics, practitioners, and journalists gathered to discuss the prospects for tax reform as it is affected by two crises facing Washington: dangerously misaligned spending and tax policies, resulting in a crippling $17.4 trillion national debt; and the IRS’s alleged targeting of conservative political organizations. A video recording of the symposium is available at http://new.livestream.com/pepperdinesol/taxreform.

Copyright 2014 Karen B. Brown. All rights reserved.

In today’s global marketplace, there is fierce competition among countries for investment capital to fuel economic growth. Even among the highly developed, high-income economies of many of the OECD member states (including the United States), political leaders feel pressure to implement or shore up policies to attract or retain increasingly peripatetic multinational enterprises. Increased investment by businesses in the form of infrastructure (for example, bricks-and-mortar locations for production), research and development of intellectual property, organizational and management expertise, etc., is equated with exports of goods and services, creation of jobs, and technological innovation and dominance. Not surprisingly, tax law has figured prominently in efforts to provide investment-friendly locales. Not long ago, to stem
corporate flight (also known as inversions), Congress created a tax amnesty that allowed U.S. companies to repatriate millions of dollars held offshore in controlled foreign subsidiaries, and to do so at a reduced rate of 5.25 percent (down from a top rate of 35 percent). Although Congress also put in place legislation designed to increase the tax costs of future expatriations, some members at the same time urged lowering the top corporate tax rates to allow U.S.-based companies to compete on the same footing as those in lower-tax jurisdictions. Other high-income countries, such as Canada and Japan, have lowered their corporate tax rates to well below the top U.S. rate. Some, such as the United Kingdom, have worked to mitigate tax laws that have caused its companies to move to friendlier (from legal and tax standpoints) locales. In the United States — the last country that taxes on a worldwide basis — tax reformers have announced a willingness to consider, as a part of overall tax reform, a shift to a territorial regime that would exempt many types of foreign-source income from taxation. That change would be part of an effort to increase the competitiveness of U.S.-based corporations.

The move from an efficiency-based paradigm (capital export neutrality) to one focused on competitiveness could be predicted after the OECD issued its 1998 harmful tax competition report in which it did not target the practice of any country that collects significant revenues from tax imposed on income but imposes a generally applicable effective tax rate that is lower than another country (for example, Ireland, which announced the move to a competitive 12.5 percent rate at that time).1 An intervening economic crisis and the increased drive of multinational firms to improve the bottom line by reducing costs of production, including tax costs, have placed considerable pressure on the governments of even relatively high-income countries to find sufficient revenue to maintain an infrastructure that supports the social welfare and other needs of their constituents.

The price of the ensuing rate competition for investment and business has led to base erosion, as corporations employ sophisticated strategies to exploit the gaps between the laws of the multiple countries to achieve self-help tax minimization.2 Although the United States has been one of the last holdouts in those “rate wars,” maintaining its top statutory corporate tax rate of 35 percent, there are numerous tax reform proposals to couple reduction of that top rate with overhaul of the international tax system. This article urges that the United States not undertake major tax reform without considering the impact on more vulnerable economies. Although many regions merit attention, the article focuses on the member nations of the Caribbean community. That community remains fragile after the 2008 world economic crisis. Its proximity to the United States, a location of strategic importance, and a strong tradition of trade accords in the form of the Caribbean Basin Initiative (put in place under President Reagan and strengthened under subsequent administrations) make it an ideal economic development partner.

The call for an overhaul of the U.S. tax system with a view toward facilitating a path for investment in the Caribbean region revives a longstanding question whether tax laws should be used to provide incentives for investment. That is especially true for the United States. It purportedly has crafted its regime to remove tax rates from the equation multinationals use to determine where investment will be located. Departing from the economists’ dream scenario — a tax code that promotes production at the most efficient levels — to pursue any other goal may invite controversy. However, it is clear that Congress has already veered onto that road. With the many exceptions to the capital export neutrality paradigm, the system provides incentives to invest in low-tax jurisdictions, like Ireland and the Netherlands, through convoluted corporate structures such as “Double Dutch Sandwiches” and the like. Attracted by infrastructure in place, sophisticated legal systems, and other benefits of a highly structured and stable society, multinationals relocate to more highly developed countries that offer the additional advantage of a lower-than-U.S. tax rate. That leaves little room for developing countries, such as those in the Caribbean, to construct successful strategies for attracting U.S. investment dollars. A desire to rectify

---

1OECD, “Harmful Tax Competition: An Emerging Global Issue,” at 20 (1998) (“it is not intended to explicitly or implicitly suggest that there is some general minimum effective rate of tax to be imposed on income below which a country would be considered to be engaging in harmful tax competition”).

2See, e.g., OECD, “Addressing Base Erosion and Profit Shifting” (2013). Base erosion occurs when multinationals do any of the following: use mismatches in the international treatment of (Footnote continued in next column.)
global inequality may impel a hard look at the role of tax policies in discouraging real investment in the Caribbean.

The time has come for the higher-income nations to consider the ways in which their internal tax laws disable revenue-raising capacity in the developed world. If high-income nations are reluctant to embrace the idea that tax laws may have a role in disrupting social injustice, they must at a minimum acknowledge the part those laws play in contributing to income inequality in poorer nations, which the tax neutrality principles many countries have adopted to promote worldwide efficiency or welfare have done nothing to ameliorate. In the case of the United States, the international tax regime provides for deferral of tax on offshore earnings of wholly owned foreign subsidiaries, features lax transfer pricing and ineffective cost allocation rules, and allows cross-crediting of foreign taxes to enable inappropriate reduction of domestic-source income, all of which provide a disincentive to invest in developing countries. Instead of being an impetus for investment in the developing world, those rules have encouraged resort to low- or no-tax jurisdictions in the developed world.

The call to the United States and other high-income nations to use their tax regimes to facilitate investment in developing countries, however, is met with a familiar objection: The tax laws are neutral and should not be used to target investment activity. An additional response relates to the fear that tax breaks fashioned to encourage investment in the developing world will lead to a “race to the bottom,” as countries compete to lower rates. Considering the serious need of many developing regions, studies of ways in which to provide investment incentives and protect the integrity of the host nation are much needed, because alternatives — such as direct aid from the developed to the developing world — have failed to reach minimal goals established in the U.N.’s 2012 Millennium Development Goals.

United States and the Caribbean

The Caribbean is the 19th largest market for U.S. exports. For 2011-2012, the region accounted for 1.4 percent of total U.S. exports. The total value of U.S. exports to Caribbean countries was $19 billion in 2012, an increase of $311.5 million from the previous year and an increase of $1.2 billion since 2010. In 2010 the value of U.S. exports to the Caribbean grew 27.6 percent (exceeding the growth rate for total global exports, which was only 19.8 percent).

In 2012, regarding all countries in the Caribbean region other than Aruba, Guyana, and Trinidad and Tobago, the United States had a trade surplus. High value exports, like oil, methanol, and valuable natural minerals, from these three nations account for the excess value of imports to the United States over exports from the United States.

Special tax rules apply to the costs of attending business meetings or conventions in a country eligible for Caribbean Basin beneficiary status in order to encourage convention business in the region. The more stringent requirements applied to foreign convention expenses for attendance outside the region do not apply.

Other programs supporting the region provide trade preferences, including duty-free treatment for some goods exported from the area. Those preferences were enhanced beginning in 2000 through new initiatives under the Clinton, Bush, and Obama administrations. Additional preferences have been extended to Haiti in the aftermath of the earthquake for some types of apparel and other products.

There has been a downward trend in aid to the region. Amounts budgeted by the Obama administration for humanitarian aid and economic development have dropped in recent years by more than 20 percent.

Reform Proposals

Recent reform proposals calling for a shift from worldwide taxation to territoriality would not remove the incentive to take advantage of the attractive tax minimizing structures that accompany establishment of subsidiaries and other forms of

A similar complaint has been registered regarding the impact of environmental regulatory failure on the developing world. See, e.g., Steven Lee Myers and Nicholas Kulish, “Growing Clamor About Inequities of Climate Crisis,” The New York Times, Nov. 17, 2013, at A1 (noting that, after devastating natural disasters, developing nations are demanding compensation from developed nations responsible for degradation of the environment by production and consumption practices). This article focuses on the beneficiary nations of the Caribbean Basin Initiative: Aruba, the Bahamas, Barbados, Belize, the British Virgin Islands, the Organization of Eastern Caribbean States, Guyana, Haiti, Jamaica, and Trinidad and Tobago.


For those three nations, high-value exports like oil, methanol, and valuable natural minerals account for the excess value of imports to the United States. 10th Report, supra note 5, at 21-63.

10th Report, supra note 5, at 21-63.

See section 274(h)(1).

10th Report, supra note 5, at 3-10.

Id. at 4-6.
investment in low-tax regimes in the developed world. One of the most prominent of the territoriality plans, that of House Ways and Means Committee Chair Dave Camp, R-Mich., is worthy of examination.12

A snapshot of the Camp proposal is that it would move to a territorial tax regime for foreign-source income other than passive income. Dividends paid to a U.S. parent of an offshore controlled subsidiary would be eligible for a 95 percent dividends received deduction. Combined with a proposed reduction in the top statutory corporate tax to 25 percent, that would result in a tax rate of 1.25 percent (a 25 percent tax on 5 percent of the repatriated dividends). The plan is much like the so-called tax amnesty in the temporary section 965, described above, which offered an 85 percent deduction for dividends paid by a controlled foreign corporation to the U.S. parent under circumstances calling for reinvestment of the repatriated funds. Economic analysis of the effects of the 2004 repatriation holiday found no effect on domestic investment and a decrease in U.S. jobs, although billions of dollars were brought back to the United States.13

A territoriality regime of the type proposed by Camp adds an additional injury because it rewards investment through foreign subsidiaries in low-tax developed countries with a low rate on repatriated funds, without according any compensation to developing countries for impairment to their revenue-raising strategies. At a minimum, dedication of a portion of that revenue from repatriated earnings to assist developing countries in crafting sound and competitive regimes should be discussed. Reform that provides no benefit (and possible detriment) to the U.S. economy cannot be worthwhile. When reform that is harmful to the United States also fails to consider the interests of a strategic trading partner in a region of economic need, it should be reevaluated.

Other proposals aim to strengthen the U.S. regime by tightening deferral rules and simplifying the foreign tax credit, such as those circulated by former Sen. Max Baucus in the fall of 2013. While they may expand the reach of U.S. tax, the proposals place developing nations in the position of employing only unilateral strategies to attract investment, when multilateral approaches developed in partnership with the United States and other higher-income nations may be more effective. Because of that weakness, the United States should consider proposals involving a complete restructuring of the U.S. international tax regime. Worldwide formulary apportionment, of the variety advanced by professor Reuven S. Avi-Yonah and others, holds particular promise to accord a role to the developing nation in fashioning its own system.

A version of formulary apportionment described by Avi-Yonah resembles the residual profit-split transfer pricing method and would require cooperation by the major tax authorities of the world.14 Under that plan, worldwide expenses would be subtracted from worldwide income and a portion of that net income allocated pro rata to all jurisdictions in which the multinational incurred expenses. The residual profit remaining would be allocated on the basis of destination of sales into the jurisdiction.

Possible pitfalls include the need for virtual worldwide collaboration among taxing authorities and pressure to devise allocation of expense and destination of sales rules that resist easy manipulation by taxpayers. However, the proposal is worthy of further exploration because it might allow developing nations to act in tandem with the higher-income nations to secure a tax base.

