BREAKING OPEN OFFSHORE PIGGYBANKS: DEFERRAL AND THE UTILITY OF AMNESTY

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"Oh no! What have I done? I smashed open my little boy's piggy bank, and for what? A few measly cents, not even enough to buy one beer."
— Homer Simpson

INTRODUCTION

Most U.S. multinationals avoid current U.S. taxation of their foreign business income by accumulating such income in controlled foreign subsidiaries: in essence, their offshore piggybanks.[1] The ability to suspend the taxation of foreign business income in this manner is commonly referred to as "deferral," and it has become an important strategic objective for managers of U.S.-based multinationals.[2] As of the third quarter of 2005, an estimated $650 billion in foreign earnings was held offshore by foreign subsidiaries of U.S. corporations and out of reach of U.S. taxation.[3]

The use of the term "deferral" suggests that U.S. income taxes will eventually be paid on earnings held offshore, and that the problem is thus

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1 *Infra* Part I.A.

2 PRESIDENT'S ADVISORY PANEL ON FED. TAX REFORM, SIMPLE, FAIR, AND PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYSTEM 134 (2005) ("Economists have found that the financial decisions of corporate managers are extremely sensitive to the tax on repatriations . . . .").

3 *See* Jonathan Nicholson, *Group Says $212 Billion in Profits Repatriated So Far, More to Come,* DAILY TAX REP. (BNA), Sept. 6, 2005, at G-2 (citing May 2005 JPMorgan Chase & Co. analysts' estimate of slightly under $650 billion in foreign profits available to be repatriated); *see generally* DAVID L. BRUMBAUGH, CONGRESSIONAL RESEARCH SERVICE REPORT FOR CONGRESS, TAX EXEMPTION FOR REPATRIATED FOREIGN EARNINGS: PROPOSALS AND ANALYSIS, at 8 (2004) (estimating unrepatriated earnings of $639 billion at the end of 2002); Martin A. Sullivan, *Economic Analysis: Data Show Dramatic Shift of Profits to Tax Havens*, 104 TAX NOTES 1189, 1190 (2004) ("The profits of foreign subsidiaries of U.S. corporations in 18 tax havens soared from $88 billion in 1999 to $149 billion in 2002. Total profits of U.S. multinationals' foreign subsidiaries around the world stood at $255 billion in 2002.").

merely a timing issue. However, in some cases U.S. corporations deploy foreign earnings offshore and never repatriate them to the United States. Even if foreign earnings eventually are repatriated, the present value of the deferred tax liability may approach zero. In either case, tax deferral effectively becomes tax "exemption." Current U.S. tax law does proscribe deferral for certain types of passive income earned abroad, but the deferral that remains available for most types of foreign business income nonetheless results in substantial erosion of the U.S. tax base.[4] Between 2007 and 2011, it is likely that $68 billion in tax revenue will be lost as a result of the deferral problem.[5]

Tax evasion is, of course, illegal, but tax deferral as just described is not. Rather, it is an anomaly that arises at the confluence of two fundamental principles of corporate and tax law. The first is that a corporation is an entity separate and distinct from its shareholders that is subject to taxation on its income in the same fashion as an individual.[6] An important corollary of this principle is that shareholders are not liable for the tax imposed on a corporation's earnings, although they *are* required to pay tax on any dividends they receive from the corporation,[7] and on any gain from the sale of the corporation's stock.[8] The second principle underlying deferral is that a corporation is subject to U.S. income taxation only if the corporation was created or organized in the United States.[9] Thus, a U.S. corporation that operates abroad through a foreign subsidiary may defer the imposition of U.S. tax on the subsidiary's foreign earnings so long as the U.S. corporation does not receive a dividend from, or sell the stock of, the foreign subsidiary.

The United States could end deferral and the attendant loss of tax revenue by simply requiring immediate taxation of all foreign business income.[10] For example, foreign subsidiaries of U.S. corporations might be

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4 *See* OFFICE OF TAX POLICY, DEP'T OF THE TREASURY, THE DEFERRAL OF INCOME EARNED THROUGH U.S. CONTROLLED FOREIGN CORPORATIONS: A POLICY STUDY, ix (2000). This Article does not address other types of tax deferral, such as that achieved on the "inside buildup" of life insurance policies, or the investment returns on IRAs, 401(k) plans, and other tax-favored investment vehicles.

5 OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, BUDGET ANALYTICAL PERSPECTIVES, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2007, 287 (2000).

6 *See* I.R.C. § 11.

7 *See* I.R.C. § 61(a)(7).

8 *See* I.R.C. § 61(a)(3).

9 *See infra* Part I.A.

10 Not everyone believes that deferral is a problem. Many economists view U.S. taxation of foreign income as inefficient. *See* Mihir A. Desai & James R. Hines, Jr., *Old Rules and New Realities: Corporate Tax Policy in a Global Setting*, 57 NAT'L TAX J. 937, 957 (2004) (arguing that U.S. taxation of foreign income impairs both the productivity of American firms in the global marketplace and the productivity of investments located in the United States); James R. Hines, Jr., *Corporate Taxation*, *in* INTERNATIONAL ENCYCLOPEDIA OF THE SOCIAL & BEHAVIORAL SCIENCES 2810, 2812 (N.J. Smelser &

treated in the same manner as partnerships, with their earnings passed through to U.S. shareholders and taxed on a current basis.[11] The history of attempts to counter deferral, however, indicates that completely eliminating deferral has not been a politically feasible option.[12] Instead, since virtually the inception of the income tax, the United States has employed a second-best policy of eliminating deferral only on certain passive and highly mobile foreign earnings.[13]

With the enactment of the American Jobs Creation Act of 2004 (the "Jobs Act"), the effort to address the deferral problem took a different approach.[14] The Jobs Act contained a provision that gave U.S. corporations a one-year window during which to repatriate earnings from their foreign subsidiaries at a tax rate that was a fraction of the marginal corporate tax rate normally applicable to dividends paid to U.S. shareholders by foreign corporations.[15] The provision—new Code section 965—was not merely a reduction of the tax rate on foreign-source dividends.[16] Congress intended to encourage U.S. multinationals to *voluntarily* end their deferral of taxation on foreign business income.[17] When viewed in this light, certain characteristics of section 965 make it remarkably similar to another well-known tax collection device—the tax amnesty.

A tax amnesty typically offers a reprieve from some penalty or sanction associated with tax evasion in order to encourage persons who have evaded taxes to come forward voluntarily and pay what they owe.[18] Most

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P.B. Baltes eds., 2001) ("Corporate taxation increases the cost of producing corporate output . . . ."). Recently, there have been renewed calls for the adoption of a "territorial" or "exemption" tax system, which would tax only U.S.-source income of U.S. citizens and residents (including corporations organized in the United States). *See* PRESIDENT'S ADVISORY PANEL ON FED. TAX REFORM, SIMPLE, FAIR, AND PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYSTEM 134 (2005); STAFF OF THE JOINT COMM. ON TAXATION, OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES, JCS-02-05 (Jan. 27, 2005). For a discussion of these proposals, see J. Clifton Fleming, Jr. & Robert J. Peroni, *Exploring the Contours of a Proposed U.S. Exemption (Territorial) Tax System*, 109 TAX NOTES 1557 (2005).

11 *See, e.g.*, Robert J. Peroni, *Back to the Future: A Path to Progressive Reform of the U.S. International Income Tax Rules*, 51 U. MIAMI L. REV. 975, 989 (1997). This approach could be used in conjunction with the shareholder level tax on dividends or could be coupled with dividend tax repeal.

12 *See* Robert J. Peroni, J. Clifton Fleming, Jr., & Stephen E. Shay, *Getting Serious About Curtailing Deferral of U.S. Tax on Foreign Source Income*, 52 SMU L. REV. 455, 470-94 (1999).

13 *See infra* Part II.

14 American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat 1418 (2004).

15 *Infra* Part III.B.

16 *See infra* Part III.B.

17 *See* H. R. Rep. No. 108-548, pt. 1, at 146 (2004) ("The Committee believes that a temporary reduction in the U.S. tax on repatriated dividends will . . . [trigger] the repatriation of foreign earnings that otherwise would have remained abroad.").

18 *See infra* Part IV.A.

tax amnesties are expected to generate significant revenue, are offered for only a limited period of time, and purport to be one-time occurrences—all characteristics shared by section 965.[19] Due to the similarities between tax amnesties and section 965, an analysis of the former should be helpful in assessing the viability of the latter.

This Article explores the problem of deferral, and the use of an amnesty-like provision such as section 965 to address it. Part I summarizes the way that the United States taxes income earned abroad, discusses the underlying structure of corporate and tax law that permits deferral of those taxes, and assesses the cost of the deferral problem. Part II reviews the development of current law limitations on deferral. Part III traces the origins of section 965's approach to dealing with deferral and discusses the provision's mechanics. Part IV reviews some of the history of tax amnesties to develop a theory of the optimal tax amnesty. Part V evaluates section 965 in light of this optimal tax amnesty theory and the Article concludes that, on balance, a provision like section 965 will likely be ineffective in eliminating deferral.

I. THE PROBLEM OF DEFERRAL

A. *U.S. Worldwide Taxation*

The United States imposes residence-based taxation on the income of its citizens and residents, regardless of where that income is earned.[20] "Residents" of the United States is defined to include corporations that are "created or organized in the United States or under the law of the United States or of any State."[21] Thus, a corporation organized in the United States must pay tax on its worldwide income.[22] Such a worldwide system of taxation, however, potentially exposes the income earned by a U.S. corporation operating abroad to double taxation (i.e., the U.S. residence-based tax as

19 *See infra* Parts III.B, IV.A.

20 Residence-based taxation is rooted in the sovereignty of a country over those who are its citizens or who reside within its borders. The United States (and most other countries) also imposes "source-based" taxation on income that has its source within its borders. Like residence-based taxation, source-based taxation derives from a country's sovereignty—in this case sovereignty over its territory and the activities taking place within that territory.

21 I.R.C. § 7701(a)(4). Unless otherwise indicated, all references herein to "I.R.C." and to the "Code" are to the Internal Revenue Code of 1986, as amended.

22 *See* I.R.C. § 11 (imposing tax on the taxable income of both domestic and foreign corporations); I.R.C. § 882 (limiting definition of taxable income for foreign corporations to income derived from U.S. sources and income effectively connected with the conduct of a trade or business within the United States).

well as source-based tax, which is likely to be imposed by the foreign country where the income is earned).[23] Unchecked, such double taxation would bring U.S. investment abroad to an abrupt halt, as combined U.S. and foreign taxes would virtually eliminate any potential profit.

Accordingly, the U.S. tax system has mitigated the risk of double taxation in two ways. First, the United States is signatory to an extensive network of bilateral tax treaties under the terms of which it cedes all or part of its residence-based taxing jurisdiction over foreign business income in favor of the source-based taxation imposed by the treaty partner.[24] Second, and more importantly, the United States grants U.S. taxpayers a credit against their U.S. tax liability for taxes paid to foreign countries.[25] The foreign tax credit is available both for foreign taxes paid directly by a U.S. taxpayer, and for a proportionate share of the taxes paid by a foreign corporation of which the U.S. taxpayer owns ten percent or more of the stock.[26]

If a foreign country imposes income taxation at a rate *lower than* the 35% U.S. rate—say, 15%—the foreign tax credit will result in a U.S. corporation paying a residual tax of 20% to the U.S. Treasury. If the foreign country's tax rate is the *same as* the U.S. rate—35%—the corporation would pay no residual tax to the U.S. Treasury after application of the foreign tax credit. If the foreign jurisdiction's tax rate is *greater than* the U.S. rate, an unlimited foreign tax credit effectively would subsidize the higher tax rate in the foreign country. Thus, the foreign tax credit is limited to that portion of the U.S. tax that is attributable to foreign income.[27] This means that the foreign tax credit applies only to the extent that the foreign tax rate is lower than or equal to the U.S. corporate tax rate. Foreign taxes paid in excess of what may be credited in a given year may be carried back to the

23 *See supra* note 20. In contrast to the U.S. worldwide system, some countries employ *only* source-based "territorial" or "exemption" taxation. Such jurisdictions generally do not tax income received by their residents from sources outside their borders. The member nations of the Organization for Economic Co-operation and Development are evenly divided between the two systems. NAT'L FOREIGN TRADE COUNCIL, THE NFTC FOREIGN INCOME PROJECT: INTERNATIONAL TAX POLICY FOR THE 21ST CENTURY, PART ONE: A RECONSIDERATION OF SUBPART F 103, Tbl. 6-1 (1999). Some countries exempt active foreign source income by statute (such as the Netherlands and France), and others by treaty (such as Canada and Germany). *See* HUGH J. AULT ET AL., COMPARATIVE INCOME TAXATION: A STRUCTURAL ANALYSIS 372-76 (2d ed. 2004). However, most of the important trading partners of the United States have adopted territorial systems. This includes, for example, Canada, The Netherlands, France, and Germany. *Id.* However, Japan and the United Kingdom have worldwide credit systems. *Id.* at 382-83.

24 *See* REUVEN S. AVI-YONAH ET AL., U.S. INTERNATIONAL TAXATION 3 (2d ed. 2005).

25 I.R.C. § 901.

26 I.R.C. § 902.

27 I.R.C. § 904(a).

preceding two years or carried forward to any of the succeeding five years.[28]

Notwithstanding the network of U.S. tax treaties and the availability of the foreign tax credit, many U.S. multinationals believe that the U.S. worldwide tax system prevents them from being globally competitive.[29] Thus, they look for ways to minimize the extent to which their foreign earnings are subjected to current U.S. taxation. The use of controlled foreign subsidiaries is an effective and legal strategy for achieving deferral of U.S. taxation.[30] The following subpart describes the two principles of U.S. corporate and tax law that permit deferral of U.S. tax on the foreign earnings of controlled foreign corporations.

B. *Principles Underlying Deferral*

When investors organize in corporate form under state law, they create a fictional entity that has an identity and existence separate from their own.[31] The newly formed corporation is a "legal or juristic person that has legal personality distinct from the natural persons who make it up . . . ."[32] Under this basic principle of corporate law, corporations have been accorded rights and obligations that are nearly coextensive with those enjoyed by individuals.[33]

The treatment of corporations as separate entities extends to the realm of taxation. Congress has included among a corporation's obligations that of paying income tax on its earnings.[34] Importantly, however, this obliga-

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28 I.R.C. § 904(c).

29 *See, e.g.*, Terrence R. Chorvat, *Ending the Taxation of Foreign Business Income*, 42 ARIZ. L. REV. 835, 837 (2000) ("Those arguing in favor of adopting an exemption system have done so almost entirely on grounds of increasing the 'competitiveness' of U.S. firms. They argue that because our major trading partners have adopted exemption systems and their firms are not subject to tax on a worldwide basis, U.S. firms are at a competitive disadvantage."); Senator Orrin G. Hatch, Speech at the International Taxation Conference (June 5, 2006) ("I am well aware that the U.S. tax system puts multinational firms based in the U.S. at a disadvantage to their European rivals due to our system of worldwide taxation.").

30 As noted above, tax deferral through controlled foreign subsidiaries is not illegal tax evasion. *See* I.R.C. § 7201 (defining tax evasion).

31 BLACK'S LAW DICTIONARY 365 (8th ed. 2004) (defining a corporation as "[a]n entity (usu. a business) having authority under law to act as a single person distinct from the shareholders who own it . . . .").

32 *Id.*; Dartmouth Coll. v. Woodward, 17 U.S. 518, 636, 657 (1819).

33 *See* MODEL BUS. CORP. ACT § 3.02 (2005) (every corporation "has the same powers as an individual to do all things necessary or convenient to carry out its business and affairs . . . .").

34 I.R.C. § 11. The corporate income tax no longer produces a significant portion of U.S. tax revenues. Corporate income tax receipts as a percentage of total tax revenues have dwindled from a high

tion falls to the corporation, and not to the corporation's shareholders.[35] Shareholders are obligated to pay tax only on income they receive from the corporation in the form of dividends, or as gain on a sale of the corporation's stock.[36] This arrangement applies in the same way whether the shareholder is an individual or another corporation. That is, a corporation owning the stock of a subsidiary corporation is not required to pay the subsidiary's income tax. Tax is imposed on the parent corporation only if it receives a dividend from the subsidiary or sells the subsidiary's stock.[37]

The separate tax status of corporations is but one principle underlying the deferral problem. The second principle is the general exemption of foreign corporations from U.S. income taxation.[38] Section 11(a) of the Code purports to impose tax on the taxable income of "*every* corporation."[39] Section 11(d) quickly narrows this sweeping language, however, by limiting the U.S. income taxation of *foreign* corporations to the precincts of section 882.[40] That section provides that foreign corporations are subject to U.S. income taxation only with respect to their income that is "effectively connected with the conduct of a trade or business within the United States."[41] This leaves free of U.S. taxation any income earned abroad by a corporation formed outside the United States. The deferral problem thus arises at

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of 32% in 1952 to 7.4% as recently as 2003. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2007: HISTORICAL TABLES, at 31-32, tbl. 2.2 (2006), *available at* http://www.whitehouse.gov/omb/budget/fy2007/pdf/hist.pdf.

35 *See* I.R.C. § 11.

36 *See* I.R.C. § 61(a)(3), (7) (listing gains from dealings in property and dividends as items constituting income for purposes of taxation); I.R.C. § 301(c) (defining dividends).

37 *See* I.R.C. §§ 301, 316. The tax on corporate earnings and the tax on dividends received by shareholders combine to create the corporate "double taxation" that is at least theoretically imposed on corporate earnings. *See generally* Steven A. Bank, *Corporate Managers, Agency Costs, and the Rise of Double Taxation*, 44 WM. & MARY L. REV. 167, 169 (2002). Not all corporate earnings are taxed twice, however. For example, corporate earnings taxed at the corporate level but used to pay dividends to a tax-exempt shareholder are taxed only once. Earnings used to pay deductible interest to a foreign creditor may not be taxed at all. *See* I.R.C. §§ 163; 881(c).

38 *See* I.R.C. § 882.

39 I.R.C. § 11(a).

40 I.R.C. § 11(d).

41 I.R.C. § 882. Whether a foreign corporation is carrying on a U.S. trade or business is a highly fact-specific determination that turns on whether the foreign corporation carries on a set of business activities in the United States that is "regular, continuous and substantial." Rev. Rul. 88-3, 1988-1 C.B. 268. If a foreign corporation's country of residence has entered into a tax treaty with the United States, then the "U.S. trade or business" provision is replaced by a rule under which the foreign corporation is subject to U.S. taxation on its income that is "attributable to a permanent establishment" in the United States. *See e.g.*, Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and on Capital Gains, U.S.-U.K., arts. 5, 7, July 24, 2001, 2001 WTD 143-14. A permanent establishment generally exists when a foreign corporation has a fixed place of business or a dependent agent conducting activities in the United States. *See id.*

the intersection of the separate status of corporations and the exemption of foreign corporations from U.S. taxation.

Suppose that a U.S. parent corporation with earnings from investments or business activity outside the United States elects to invest, or conduct its business abroad, through a foreign subsidiary. Under the first principle, the U.S. parent is not liable for tax on the earnings of the foreign subsidiary unless and until those earnings are distributed in the form of dividends or the parent sells its stock in the subsidiary.[42] Under the second principle, the United States does not tax the earnings of the subsidiary because of its status as a foreign corporation.[43] Thus, if the subsidiary's earnings are deployed abroad and never repatriated, they will not be subject to U.S. taxation at all. Even if the earnings eventually are repatriated, if the period of deferral is long enough, the investment return on the deferred tax liability may exceed the tax itself, resulting in effective exemption from U.S. taxation.[44]

There is nothing normatively compelling about either of the principles that give rise to the problem of deferral. As to separate entity status, foreign subsidiaries of U.S. corporations could be treated for tax purposes like partnerships, rather than individuals.[45] Partnerships are required annually to determine their items of income, loss and deduction and allocate those items to their partners based on the partners' economic interests in the partnership.[46] The partners then include in income their respective shares of the partnership's net taxable income, but the partnership itself pays no income tax.[47] Historically the treatment of any corporation as a partnership—particularly a publicly traded corporation—was viewed as administratively unfeasible because of the perpetually changing ownership of shares of stock and the multitude of shareholders. Determining each shareholder's allocable share of the corporation's items of income, loss and deduction for the period or periods during the year that the shareholder held stock seemed an insurmountable difficulty.[48] Improvements in technology have largely eclipsed this objection, however.

As to the second principle—the exemption of foreign corporations from U.S. income taxation—other alternatives are also available. First, the

42 *See* I.R.C. § 61(a)(3), (7).

43 I.R.C. § 882.

44 Put another way, depending on after-tax interest rates and the length of the deferral period, the present value of the tax due on ultimate repatriation may approach zero. For example, assuming an after-tax interest rate of 8%, $100 of tax that will not be paid for 30 years has a present value under $10.

45 *See* I.R.C. § 702. For a discussion of this approach, *see, e.g.*, Peroni, *supra* note 11, at 988.

46 *See* I.R.C. §§ 703, 704.

47 I.R.C. § 701.

48 *See infra* notes 112, 120 and accompanying text (discussing the taxation of passive foreign investment companies, which frequently are large and may be publicly traded).

meaning of the term "foreign corporation" could be modified. The Code has always defined a foreign corporation as a corporation that is *not* "created or organized . . . under the law of the United States or of any State."[49] Other jurisdictions, however, have adopted definitions of residence that take into account the place of the corporation's management, its principal business location, or even the residence of its shareholders.[50] Under a "management and control" test, for example, a foreign subsidiary would be considered a U.S. corporation subject to U.S. taxation if management and control effectively were lodged in its U.S. parent.

The U.S. definition of foreign corporation, which focuses on the location of a single, easily manipulated event—the creation of the corporation[51]—does have the virtue of simplicity, but it is subject to exploitation. This was evidenced most recently by a proliferation of corporate "inversion" transactions that U.S. multinationals either considered or completed during the late 1990s and early 2000s.[52] By transferring its foreign assets to a shell parent corporation organized outside the United States, a corporation that inverted was able to effectively "relocate" offshore for U.S. tax purposes while the actual location and operation of its business remained unchanged.[53]

In response, Congress enacted section 7874(b), which effectively resolved the corporate inversion problem by, in some circumstances, treating the foreign "shell" parent of an inverted corporation as a U.S. corporation, notwithstanding that the parent meets the definition of a foreign corporation.[54] This approach might raise complex issues if applied outside the context of abusive inversion transactions, but it illustrates that there are ways to define U.S. and foreign corporations that are less susceptible to manipulation than the United States' place-of-organization rule.

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49 I.R.C. § 7701(a)(4)-(5). Tax jurisdiction based on a corporation's place of organization has been a feature of every U.S. revenue act except the Revenue Act of 1894, which based tax jurisdiction on whether an entity was "doing business for profit in the United States." Revenue Act of 1894, ch. 349, § 32, 28 Stat. 509, 556-57 (1894).

50 AULT ET AL., *supra* note, 23 at 349-50.

51 *See* I.R.C. § 7701(a)(4)-(5).

52 Craig M. Boise & James C. Koenig, *Practical and Policy Considerations in Corporate Inversion Transactions*, CORP. BUS. TAX'N MONTHLY, Sept. 2002, at 3. In an inversion transaction, a U.S. corporation becomes a subsidiary of a newly formed shell corporation in a tax haven jurisdiction. *Id.* at 3, 8. The U.S. corporation then transfers all of its foreign assets to the new shell corporation. *Id.*at 8. The intent is to remove the U.S. corporation's foreign earnings from U.S. taxation, while effecting no meaningful change in its business or operations. *Id.* at 3, 8, 16-17.

53 *Id.* at 3, 8, 16-17.

54 I.R.C. §§ 7701(a)(4)-(5), 7874(b). Section 7874(b) applies to foreign corporations of which 80% or more of the stock is owned by former shareholders of the U.S. corporation that inverted. I.R.C. § 7874(b).

In sum, neither of the principles giving rise to the deferral problem is immutable. With sufficient political will, the United States could eliminate the deferral problem by treating foreign corporations as pass-through entities and thus abridging the principle of the separate tax status of corporations. Alternatively, Congress could resolve to directly tax foreign corporations controlled by U.S. shareholders either: by altering the definition of a "foreign corporation" to take into account substantive factors such as the place of the corporation's management and control; or through legislative fiat, as it did with inverted corporations.

The Kennedy Administration unsuccessfully proposed eliminating deferral more than forty years ago, at a time when the costs of the problem were considered a threat to the economic well-being of the country.[55] Whether a successful campaign to eliminate deferral can be mounted today depends in large part on the public's perception of the costs that deferral imposes on the public fisc.

C. *The Cost of Deferral*

As of the third quarter of 2005, it was estimated that nearly $650 billion in foreign earnings was held offshore by the foreign subsidiaries of U.S. corporations.[56] If this considerable pool of foreign earnings were taxed currently, it would generate significant revenue. One recent study identified 678 corporations (from among all U.S. publicly traded corporations) that reported foreign assets or foreign sales.[57] The 282 firms among this group that actually would have had to pay taxes on repatriated dividends reported an aggregate $318 billion of permanently reinvested earnings eligible for repatriation in 2002.[58] The study concluded that these earnings would have generated incremental tax revenue of $46 billion if they were immediately repatriated.[59] A study by the Office of Management and Budget has estimated that tax revenue lost to deferral by controlled foreign corporations

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55 Ending deferral was expected to have a substantial positive impact on the United State's balance of payments in addition to increasing tax revenues by about $230 million annually. *See* 87 CONG. REC. 16,700 (1962).

56 *See* Nicholson, *supra* note 3, at G-2 (citing May 2005 JPMorgan Chase Bank analysts' estimate of slightly under $650 billion in foreign profits available to be repatriated, and 2003 Congressional Research Service estimate of almost $500 billion).

57 *See* Susan M. Albring et al., *Tax Savings on Repatriations of Foreign Earnings Under the Jobs Act*, 108 TAX NOTES 655 (2005).

58 *Id.* These 282 firms reported a foreign tax rate lower than 35%, which means that foreign tax credits would not completely eliminate U.S. tax liability on repatriated foreign earnings. *Id.*

59 *Id.*

will be $68.5 billion between 2007 and 2011.[60] Of greater concern than the tax revenue that is being lost at present, however, is the much larger potential loss as U.S. multinationals increasingly shift profits offshore. This trend has been particularly pronounced in the pharmaceutical and technology industries. For example, from 1994 through 2003, the share of pharmaceutical companies' profits derived from foreign jurisdictions increased dramatically, from 37.6% in 1994 to over 65% in 2003.[61] By the end of 2003, the top nine pharmaceutical companies alone reported total cumulative, un-repatriated foreign earnings of $102 billion.[62] What may be inferred from this data is that pharmaceutical companies have been using ever more aggressive strategies to shift income outside the United States for tax purposes.[63]

It is their greater concentrations of intangible assets that make it easier for pharmaceutical and technology companies to shift income abroad.[64] One way for a U.S. corporation to move an intangible asset offshore and the income it produces out of the reach of U.S. taxation is to sell the intangible asset outright to a foreign subsidiary. In an outright sale, it is generally difficult to determine the transfer price that should be charged for the intangible asset. The lower the sales price set by the U.S. corporation, the more potential profit is shifted from the United States to the jurisdiction of the foreign subsidiary. To illustrate, imagine USCo develops a software program at a cost of $5 and sells it to an overseas subsidiary for $6. The sale will produce $1 of gain that will be subject to U.S. taxation. If the value of the software is closer to $10 instead of $6, then USCo has successfully transferred $4 of gain outside the reach of U.S. taxation.

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60 OFFICE OF MGMT. & BUDGET, *supra* note 5, at 287, tbl. 19-1 (estimating cost of deferral at $68.5 billion for the period 2007-2011). *See also* Martin A. Sullivan, *Shifting of Profits Offshore Costs U.S. Treasury $10 Billion or More*, 104 TAX NOTES 1477, 1477 (2004) (estimating annual revenue loss from the shifting of profits offshore at $10 billion).

61 Martin A. Sullivan & John A. Almond, *Economic Analysis: Drug Firms Park Increasing Share of Profits in Low-Tax Countries*, 104 TAX NOTES 1336, 1337 (2004). This growth occurred despite the fact that there was no corresponding increase in physical presence in those jurisdictions. *Id.* at 1336.

62 *Id.* at 1338. The trend of increasing foreign earnings among pharmaceutical and technology companies was borne out by the actual repatriation experience under section 965. *See infra* Appendix A. Thirteen of the twenty-nine Fortune 100 companies repatriating foreign earnings under section 965 were either pharmaceutical or technology companies. *Id. See* Appendix A for a list of the Fortune 100 corporations that announced repatriations of foreign earnings under section 965, the amounts repatriated, and the uses made of the repatriated funds. *Id.* The largest single repatriation was Pfizer's $36.7 billion. *Id.* Together, in calendar year 2005, the largest U.S. drug companies repatriated a total of $98 billion of profits from foreign subsidiaries. Martin A. Sullivan, *U.S. Drug Firms Bring Home $98 Billion*, 111 TAX NOTES 284, 284 (2006).

63 Sullivan & Almond, *supra* note 61, at 1336.

64 *See* Harry Grubert & Joel Slemrod, *The Effect of Taxes on Investment and Income Shifting to Puerto Rico*, 80 REV. OF ECON. & STAT. 365 (1998).

The transfer pricing rules of section 482 attempt to police such transfers by granting the IRS broad authority to reallocate income between a parent and its foreign subsidiary where dealings between the two are not at "arm's length."[65] However, the regulations permit taxpayers to choose from among various methods to determine an arm's-length price.[66] This gives taxpayers the ability to select the arm's length price that will maximize the income that may be shifted offshore to take advantage of deferral.[67]

Another way to transfer an intangible asset offshore is to enter into a "qualified cost-sharing agreement" that allocates the income from, and the development costs of, the intangible between the U.S. parent and its foreign subsidiary.[68] On its face, the cost-sharing agreement would appear to minimize the valuation problems inherent in the sale of an intangible asset to a related party. In fact, cost-sharing agreements actually multiply the valuation determinations that must be made under the transfer-pricing rules. To participate in the agreement, the subsidiary first must establish its share of the benefits that reasonably may be anticipated from the agreement.[69] Then, to the extent that existing intangible assets of the U.S. parent are needed for development of the new intangible asset, the foreign subsidiary must compensate the parent with a "buy-in" payment.[70] The buy-in payment must be determined by reference to an arm's length charge for the use of the existing intangible asset.[71] Finally, the parent must determine the subsidiary's share of the ongoing research and development costs related to the intangible asset.[72] Each of these determinations presents the same valuation difficulties as the outright sale situation.[73] Moreover, the rules that govern cost-sharing are riddled with loopholes that have been widely exploited to shift

65 I.R.C. § 482.

66 *Id.*; Treas. Reg. § 1.482-1(e) (2004).

67 *See* Stephen E. Shay, *Exploring Alternatives to Subpart F*, TAXES, Mar. 2004, at 32.

68 Treas. Reg. § 1.482-7 (2005).

69 *Id.* § 1.482-7(f)(3).

70 *Id.* § 1.482-7(g)(1).

71 *Id.* § 1.482-7(g)(2).

72 *Id.* § 1.482-7(f)(2).

73 Treasury has expressed concern about the effectiveness of the transfer-pricing regulations in insuring that buy-in payments are at arm's length. *See Hearings Before the House Comm. on Ways and Means on Corporate Inversion Transactions*, 107th Cong. 73 (2002) (testimony of Treasury Assistant Sec'y for Tax Policy Pamela Olson) ("[Revision of the cost-sharing regulations] will focus initially on the effectiveness of the current rules intended to apply the arm's length standard to taxpayers that contribute to the cost sharing arrangement the right to use existing intangible property. . . .").

U.S. income abroad.[74] In short, section 482 is almost universally viewed as ineffective in addressing transfer-pricing abuses.[75]

How much profit is being shifted abroad through improper transfer pricing is difficult to determine, but one economist has approached the problem by comparing the percentages of a company's sales and assets that are foreign with the percentage of its profits that are foreign.[76] The extent to which the foreign profits percentage exceeds the foreign sales and foreign activity percentages is a rough measure of the profit that has been improperly relocated offshore.[77] Applying this analysis to six of the nine pharmaceutical firms in the Fortune 500 suggests that approximately 23% of their worldwide profits should have been reassigned to the United States.[78] If 23% of the 2005 profits of the Fortune 500 pharmaceutical companies—or $9.8 billion—were taxed at an average rate of 30%, an additional $2.9 billion in tax revenues would be generated in a single year from just nine companies.[79]

In sum, the deferral of taxation on the hundreds of billions of dollars of foreign earnings held offshore by U.S. multinationals generates a significant revenue loss to the U.S. Treasury. In all likelihood, however, the revenue loss will only grow larger as U.S. multinationals increasingly engage in aggressive transfer-pricing strategies that shift an ever larger percentage of profits to lower-tax jurisdictions outside the United States.

II. CURRENT LIMITATIONS ON DEFERRAL

The cost of the deferral problem would be even greater if not for Code provisions that impose some limitations on deferral. Foreign corporations held by U.S. shareholders generate earnings abroad that are of two general types: passive income such as interest, dividends and royalties; and active income generated by business operations. For reasons that are discussed in

74 *See* Martin A. Sullivan, *Economic Analysis: Will Treasury Stop the Outflow of U.S. Intellectual Property?* 97 TAX NOTES 1269, 1269 (2002).

75 *See* Shay, *supra* note 67, at 31 ("The reality is that the IRS is unable to meaningfully audit most transfer prices."); Diane M. Ring, *On the Frontier of Procedural Innovation: Advance Pricing Agreements and the Struggle to Allocate Income for Cross Border Taxation*, 21 MICH. J. INT'L L. 143, 145-46 (2000) ("In the field of international tax, there has developed a national, and even international consensus that traditional mechanisms for administering the law and resolving disputes have virtually collapsed in the area of transfer pricing . . . . The tax system no longer effectively administers these rules.").

76 *See* Martin A. Sullivan, *Drug Firms Move Profits to Save Billions*, 112 TAX NOTES 472, 472 (2006).

77 *See id.*

78 *See id.*

79 *See id.*

this Part, current anti-deferral measures proscribe only deferral of taxation on passive income. The way that the principal anti-deferral regimes work—and how they differ from section 965 in their approach to the deferral problem—can best be understood by briefly reviewing the history of these provisions as they have developed in the tax law.

A. *Accumulated Earnings Tax and Personal Holding Companies*

From the initial enactment of the income tax, Congress recognized the potential for taxpayers to defer tax through the use of controlled corporations. Under the Revenue Act of 1913, individuals were potentially subject to higher tax rates than corporations by virtue of a surtax imposed on individual income in excess of specified income thresholds.[80] Thus, wealthy individuals had an incentive to shift income-producing assets into controlled corporations so income from the transferred assets could accumulate subject only to the lower tax imposed on corporate income. The higher individual surtax rates could be avoided until the income was distributed in the form of dividends.[81]

To prevent this possibility, the income tax has always included provisions designed to discourage the accumulation of earnings within corporations.[82] For example, the Revenue Act of 1913 provided that shareholders could be required to include in income their share of the income of a corporation that was "formed or fraudulently availed of" for tax deferral purposes.[83] The effect of this provision was to preclude deferral of tax on accumulated corporate earnings by treating the offending corporation like a partnership.[84] In 1921, Congress replaced shareholder inclusion of accumu-

80 *See* Revenue Act of 1913, ch. 16, § II.A. subdiv. 2, 38 Stat. 116, 166.

81 This "incorporated pocketbook" scheme was later described in the legislative history of the personal holding company rules, which were enacted as part of the Revenue Act of 1934. H.R. REP. NO. 704, at 11 (1933).

82 *See id.* (describing the "incorporated pocketbook" scheme).

83 *See* Revenue Act of 1913, ch. 16 § II.A., subdiv. 2; Revenue Act of 1918, ch. 18, § 220, 40 Stat. 1057, 1072.

84 *See supra* notes 45-47, and accompanying text. Specifically, the 1913 Revenue Act stated that

> the taxable income of any individual shall embrace the share to which he would be entitled of the gains and profits, if divided or distributed, whether divided or distributed or not, of all corporations . . . formed or fraudulently availed of for the purpose of preventing the imposition of such tax through the medium of permitting such gains and profits to accumulate instead of being divided or distributed. . . .

Revenue Act of 1913, ch. 16, § II.A. subdiv. 2. This language suggests partnership treatment but also may be read as requiring inclusion of a deemed dividend, a slightly different approach that is embodied in the taxation of U.S. shareholders of controlled foreign corporations. *Id. See also* I.R.C. § 951(a)(2) and the discussion *infra* Part III.D.2. The 1918 Revenue Act clarified the partnership treatment intended by the provision, specifically providing that shareholders of corporations formed or availed of to avoid lated corporate earnings with an accumulated earnings tax levied directly on any corporation that was "formed or availed of" to avoid the surtax.[85]

It was difficult, however, for the government to establish the tax evasion purpose required for effective enforcement of the accumulated earnings tax. A taxpayer generally could skirt the tax by making nominal distributions of profits and devising a plausible reason for retaining earnings.[86] Thus, in practice, the accumulated earnings tax was, and continues to be, infrequently imposed.

As a result, in 1934, Congress supplemented the accumulated earnings tax with a surtax imposed on any corporation that met the definition of a "personal holding company," regardless of why the corporation was formed.[87] The Revenue Act of 1934 defined personal holding company as any corporation if 80% or more of the corporation's income was derived from certain passive-type income, and at any time during the last half of the taxable year more than 50% of the stock was owned by five or fewer individuals.[88]

The personal holding company rules marked an important shift in the government's strategy for attacking deferral. The accumulated earnings tax provisions focused on unwarranted accumulations of earnings within a corporation, regardless of whether those earnings represented passive income or active business income.[89] By contrast, the personal holding company surtax applied only to those corporations that derived a substantial percent-

tax were to be taxed in the same manner as shareholders of personal service corporations, which, in turn, were to be taxed in the same manner as members of a partnership. *See* Revenue Act of 1918, ch. 18, §§ 218(a), 218(e), 220. *See also* Henry Ordower, *Revisiting Realization: Accretion Taxation, the Constitution,* Macomber*, and Mark to Market*, 13 VA. TAX REV. 1, 17 & n.65 (1993).

85 *See* Revenue Act of 1921, ch. 136, § 220, 42 Stat. 227, 247. The switch to direct taxation of the corporation stemmed from a concern that the partnership approach was inconsistent with the Supreme Court's decision in *Eisner v. Macomber*, 252 U.S. 189 (1920), which suggested that the Constitution bars the taxation of income before it is realized. *See* H.R. REP. NO. 350, at 12-13 (1921). The current accumulated earnings tax rules impose a 15% tax (for tax years 2003 through 2008) on all earnings deemed by the IRS to have been accumulated in excess of reasonable business needs. *See* I.R.C. §§ 531. To impose the tax, the IRS must prove that the corporation intended to avoid the income tax on shareholders. *Id.* The mere fact that the corporation allowed earnings to accrue in excess of reasonable business needs creates a rebuttable presumption of intent. *Id.* The rules apply to all domestic and foreign corporations except for personal holding companies, passive foreign investment companies, and corporations that are tax-exempt. *Id.*

86 *See* H.R. REP. NO. 704, at 11 (1933) ("By making partial distribution of profits and by showing some need for the accumulation of the remaining profits, the taxpayer makes it difficult to prove a purpose to avoid taxes.").

87 *See* Revenue Act of 1934, ch. 277, § 351, 48 Stat. 680, 751.

88 *See id.* § 351(a). Under current personal holding company rules, the 80% requirement of the first prong has been reduced to 60%. *See generally* I.R.C. §§ 541-547.

89 *See* Revenue Act of 1921, ch. 136, § 220, 42 Stat. 227, 247.

age of their income from passive sources.[90] Of course, this was a response to wealthy individuals' use of controlled corporations to hold income-producing assets, virtually all of which were passive. However, in focusing on ending deferral only for *passive* income rather than for all types of foreign income, the personal holding company rules established a pattern that has been repeated in each subsequent anti-deferral regime that Congress has enacted.

Even as the accumulated earnings tax and the personal holding company rules were restricting *domestic* tax deferral, however, taxpayers were responding with other tax avoidance schemes, most prominently the use of *foreign* personal holding companies.[91] A foreign personal holding company accomplished the same ends as its domestic counterpart, except that it was beyond the reach of U.S. taxation, which extended only to corporations organized in the United States.[92] Consequently, instead of taxing the foreign corporation, the foreign personal holding company rules required each U.S. shareholder to include in income—as a deemed dividend—an amount equal to her share of the net income of any "foreign personal holding company."[93] The rules thus effectively imposed anticipatory taxation on the dividends a U.S. shareholder could be expected to receive from the foreign personal holding company at some future time.[94]

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90 *See* Revenue Act of 1934, ch. 277, § 351, 48 Stat. 680, 751.

91 The foreign personal holding company structure was just one of a host of schemes that used corporations to avoid high tax rates on shareholders' income. In a letter to Congress dated June 1, 1937, President Roosevelt stated:

> The Secretary of the Treasury has given me a report of a preliminary study of income-tax returns for the calendar year 1936. This report reveals efforts at avoidance and evasion of tax liability so widespread and so amazing both in their boldness and their ingenuity that further action without delay seems imperative.

Letter from President Roosevelt to Congress, (June 1, 1937), *reprinted in* REPORT OF THE JOINT COMM. ON TAX EVASION AND AVOIDANCE OF THE CONGRESS OF THE UNITED STATES, H.R. DOC. NO. 75-337, at 1 (1937).

92 *See* I.R.C § 7701(a)(4)-(5). Indeed, in rejecting a direct tax on *foreign* personal holding companies like the one it had imposed three years earlier on *domestic* personal holding companies, the Joint Committee on Tax Evasion and Avoidance cited concerns about Congress's jurisdiction to tax foreign corporations. *See* REPORT OF THE JOINT COMMITTEE ON TAX EVASION AND AVOIDANCE OF THE CONGRESS OF THE UNITED STATES, H.R. DOC. NO. 337, at 17 (1937). Jurisdictional concerns raised by U.S. taxation of foreign corporations do not seem as compelling today. For example, in response to the problem of corporate inversions in the late 1990s, Congress had no difficulty in extending its tax jurisdiction to foreign corporations by treating them as U.S. corporations for tax purposes. *See supra* note 54.

93 *See* Revenue Act of 1937, Pub. L. No. 75-377, § 337, 50 Stat. 813 (1937).

94 The American Jobs Creation Act of 2004 repealed the foreign personal holding company rules because of their complexity and because they overlapped with the controlled foreign corporation regime discussed below. *See* American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat 1418 (2004); H.R. REP. NO. 108-548, pt. 1 (2004).

The foreign personal holding company rules defined a foreign personal holding company as any foreign corporation if 60% or more of its income for the taxable year was foreign personal holding company income.[95] Like the personal holding company rules, the foreign personal holding company rules focused on ending deferral only for passive foreign earnings such as dividends, interest, royalties, and annuities.[96] Thus, the foreign personal holding company regime had no effect on deferral of U.S. taxation on the active foreign business income of controlled foreign corporations.

B. *Subpart F and Controlled Foreign Corporations*

In the decade following World War II, aggressive tax planning increased and international trade expanded.[97] As a result, by the early 1960s, tax deferral had become primarily a problem of multinational corporations shifting profits into subsidiaries organized in tax havens.[98] Deferral always had been available for foreign income actually earned in low-tax jurisdictions, but U.S. multinationals had begun to use tax havens to defer U.S. tax on income from high-tax jurisdictions, as well.[99] The retention of capital offshore had the added effect of exacerbating the United States' balance of payments deficit, and thereby threatening the stability of the U.S. dollar.[100]

In response to these concerns, the Kennedy Administration proposed to (1) end tax deferral altogether in developed countries;[101] and (2) elimi-

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95 I.R.C. § 552 (repealed 2004).

96 I.R.C. § 553 (repealed 2004).

97 *See* DEP'T OF THE TREASURY, THE DEFERRAL OF INCOME EARNED THROUGH U.S. CONTROLLED FOREIGN CORPORATIONS: A POLICY STUDY 8 (2000).

98 *See id.*

99 *See The Message from the President of the United States Relative to Our Federal Tax System*, H.R. DOC. NO. 87-140, at 6-7, 26 (1961), *reprinted in* COMM. ON WAYS AND MEANS, 90TH CONG., 1ST SESS., LEGISLATIVE HISTORY OF H.R. 10650, 87TH CONG., THE REVENUE ACT OF 1962, PART 1, at 146-47, 166 (1967); *The Message from the President of the United States Relative to Our Federal Tax System*, H.R. DOC. NO. 87-140, at 6, 26, (1961) (statement of Douglas Dillon, Sec'y of Treas. of the United States), *reprinted in* COMM. ON WAYS AND MEANS, 90TH CONG., 1ST SESS., LEGISLATIVE HISTORY OF H.R. 10650, 87TH CONG., THE REVENUE ACT OF 1962, PART 1, at 147-48 (1967).

100 *See The Message from the President of the United States Relative to Our Federal Tax System*, H.R. DOC. NO. 87-140, at 6-7, 29 (1961), *reprinted in* COMM. ON WAYS AND MEANS, 90TH CONG., 1ST SESS., LEGISLATIVE HISTORY OF H.R. 10650, 87TH CONG., THE REVENUE ACT OF 1962, PART 1, at 146-47, 169 (1967); *The Message from the President of the United States Relative to Our Federal Tax System*, H.R. DOC. NO. 87-140, at 6, 29 (1961) (statement of Douglas Dillon, Sec'y of Treas. of the United States), *reprinted in* COMM. ON WAYS AND MEANS, 90TH CONG., 1ST SESS., LEGISLATIVE HISTORY OF H.R. 10650, 87TH CONG., THE REVENUE ACT OF 1962, PART 1, at 147-48 (1967).

101 The rationale for ending deferral in developed countries was that stimulating U.S. investment in these countries by permitting deferral would create few additional net exports and therefore would have

nate deferral in all countries for certain types of activities—such as trading, licensing and insurance—that tended to make use of tax havens.[102] The President's first proposal was viewed as over-inclusive because it would have ended tax deferral enjoyed by taxpayers engaged in normal business transactions that had no tax motivation.[103] The second proposal, however, targeted only deferral that was specifically tax-motivated, and ultimately it became the core of a set of provisions Congress enacted in 1962 known as subpart F.[104]

Subpart F provides that every U.S. shareholder of a controlled foreign corporation ("CFC") must include in income its pro rata share of the CFC's "subpart F income."[105] The most important category of subpart F income is "foreign base company income."[106] A major component of foreign base company income is "foreign personal holding company income:" passive income such as dividends, interest, royalties, rents, and annuities that easily may be sourced in tax haven jurisdictions.[107] Although foreign base company income also includes some income that might be considered "active,"[108] subpart F generally followed the pattern established by the personal holding company rules and the foreign personal holding company rules in addressing only deferral of U.S. taxation on passive foreign income of CFCs.

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little impact on the creation of new jobs in the United States. *See Revenue Act of 1962: Hearing on H.R. 10650 Before the H. Comm. on Finance*, 87th Cong. 99 (1962).

102 *See The Message from the President of the United States Relative to Our Federal Tax System*, H.R. DOC. NO. 87-140, at 6, 29 (1961) (statement of Douglas Dillon, Sec'y of Treas. of the United States), *reprinted in* COMM. ON WAYS AND MEANS, 90TH CONG., 1ST SESS., LEGISLATIVE HISTORY OF H.R. 10650, 87TH CONG., THE REVENUE ACT OF 1962, PART 1, at 147-48 (1967).

103 *See* S. REP. NO. 1881, at 359 (1962) ("It is a disservice to place American firms in a position where their freedom to compete is restricted. Contrary to the views advanced by the administration, American business does not go abroad because of a more favorable tax climate, but because on the basis of business judgment, it appears that a profit can be achieved by establishing a foreign operation.").

104 I.R.C. §§ 951-964.

105 I.R.C. § 951(a)(1)(A). U.S. shareholders must also include in income their pro rata share of any increase in the CFC's "investment of earnings in U.S. property." I.R.C. §§ 951(a)(1)(B), 956. This provision prevents a CFC from effectively remitting earnings to a U.S. shareholder on a tax-free basis by means of loans or similar devices.

106 I.R.C. § 952(a)(2).

107 I.R.C. § 954(c)(1)(A).

108 Foreign base company income includes income from certain sales, services and shipping operations that are conducted by a CFC outside its jurisdiction of organization. Although not technically "passive," the income from such activities may be manipulated in the same way as passive income to achieve inappropriate deferral. For example, a U.S. corporation that sells shoes in Germany might interpose a CFC in a tax haven such as the Cayman Islands purely for purposes of coupling deferral of U.S. taxation with low, or no, foreign taxation. Subpart F prevents this gambit by requiring the U.S. corporation to include in its income the income from the Cayman CFC earned outside the Cayman Islands. *See* I.R.C. §§ 952(a)(2), 954(a).

At first blush, subpart F appears to be an effective set of provisions for preventing U.S. shareholders from deferring U.S. taxation of CFC earnings. However, a host of definitions dramatically limits subpart F's scope. First, as noted above, subpart F income is limited to certain kinds of passive and highly mobile income earned by CFCs.[109] Accordingly, U.S. shareholders of a foreign corporation—even one that by virtue of its ownership is a CFC—will not be subject to current taxation under subpart F on the corporation's foreign earnings from most active businesses.

Even if all of a foreign corporation's income is passive, however, subpart F may still not apply to impose current taxation. Under subpart F, a foreign corporation is a "CFC" only if more than 50% of (1) the total combined voting power of all classes of stock entitled to vote; or (2) the total value of the stock of such corporation, is owned by U.S. shareholders.[110] In this instance, characterization of a foreign subsidiary as a CFC may be avoided by insuring that at least 50% of the foreign subsidiary's stock is owned by foreign persons. In such circumstances, U.S. persons owning stock of the foreign subsidiary will enjoy full deferral of U.S. taxation even on the subsidiary's passive foreign earnings.

Finally, the term "U.S. shareholders" includes only those U.S. persons who own, actually or by statutory attribution, ten percent or more of the total combined voting power of all classes of the CFC's voting stock.[111] Thus, a U.S. corporation may still achieve deferral of U.S. tax on even the passive foreign earnings of a foreign subsidiary by simply owning under ten percent of the foreign subsidiary's voting stock.

In short, subpart F is intended to eliminate deferral only with respect to passive-type income earned by foreign corporations controlled by U.S. shareholders. It does even this limited duty rather poorly, however, because it does not end deferral for all foreign corporations with passive income, nor does it impose current taxation on all U.S. persons that are shareholders of foreign corporations. More importantly, subpart F leaves deferral intact for virtually all active foreign business income earned by CFCs.

C. *Passive Foreign Investment Company Rules*

Congress made the passive foreign investment company ("PFIC") rules part of the Code's anti-deferral arsenal in 1986.[112] The PFIC rules

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109 I.R.C. §§ 952, 954.

110 I.R.C. § 957(a).

111 I.R.C. § 951(b).

112 Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986). The PFIC rules may be found at I.R.C. §§ 1291-1298.

impose either current taxation on the U.S. shareholders of any corporation that meets the definition of a PFIC, or an interest charge on the tax that is deferred if immediate taxation is not possible.[113] The PFIC provisions impose immediate taxation only on shareholders of those PFICs that agree to supply an annual information statement containing the shareholders' pro rata share of the PFIC's earnings and certain other information.[114] The shareholders of a PFIC that agrees to supply such information may elect to treat the PFIC as a "qualified electing fund" and be taxed currently on their pro rata portions of the PFIC's earnings.[115]

If a PFIC does not supply information adequate to determine a shareholder's pro rata share of the PFIC's earnings, the shareholder has two options. First, the shareholder may defer payment of tax on the PFIC's earnings until the shareholder disposes of the PFIC stock or the PFIC makes an "excess distribution."[116] At that time, the shareholder must determine his total income on the disposition or distribution, pay tax on that amount at the highest marginal tax rate applicable to him during the period he held the PFIC stock, and pay an interest charge on the amount of tax deferred each year during the period he held the stock.[117]

Alternatively, if the PFIC stock held by the shareholder is marketable—that is, traded on a national securities exchange registered with the SEC or an equivalent exchange or market—the shareholder may elect to be taxed annually on the gain accrued during that year.[118] The effect of this "mark-to-market" election is to treat the shareholder as having sold the PFIC stock at its fair market value at the end of the year.[119] The shareholder then must pay tax on any gain resulting from the hypothetical sale.[120]

The PFIC rules improve on one aspect of the subpart F rules in that they reach all U.S. shareholders of a foreign corporation that meets the definition of a PFIC.[121] Unlike subpart F, there is no threshold percentage

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113 I.R.C. § 1291.

114 *See* I.R.C. §§ 1293(a), 1295(a); Treas. Reg. § 1.1295-1(g) (as amended in 2004).

115 I.R.C. §§ 1293(a), 1295(a).

116 I.R.C. §§ 1291.

117 I.R.C. § 1291(c).

118 I.R.C. § 1296.

119 *See id.*

120 *Id.* Of course, a shareholder's PFIC stock may have declined in value during the course of the year resulting in a loss to the shareholder. In that event, the shareholder is permitted to deduct an amount equal to the lesser of (1) the amount by which the shareholder's basis in the stock exceeds the stock's fair market value (essentially the amount of the loss), and (2) the net amount of gains that the shareholder included in income in prior years under the mark-to-market rules. I.R.C. § 1296(a)(2). Shareholders are required to decrease their PFIC stock basis by the amount of any such deduction, and increase it by the amount of any income inclusion under the mark-to-market rule. I.R.C. § 1296(b).

121 By contrast to its use in connection with CFCs, the term "U.S. shareholder" in the PFIC context simply means a U.S. person who owns stock of a PFIC. *See* I.R.C. § 951(b).

ownership requirement before current taxation is imposed. Second, a foreign corporation may be a PFIC regardless of the number of U.S. shareholders it has. Thus, in expanding current taxation of foreign earnings to all U.S. shareholders of the foreign corporations they cover, the PFIC rules are an improvement on the subpart F regime. However, their focus on passive income means they have no impact on the deferral of U.S. taxation on active foreign business income, which is the source of the current deferral problem.[122]

III. SECTION 965 AS AN ANTIDOTE TO DEFERRAL

A. *Origins of Section 965*

The Code provisions just reviewed represent only a few possible approaches to dealing with the deferral problem along a continuum having the complete elimination of deferral (or full taxation of CFC income) at one end, and the allowance of permanent deferral (or exemption of CFC income from taxation) at the other.[123] The historic U.S. policy toward deferral—from the personal holding company rules through subpart F and the PFIC provisions—has resided somewhere in the middle: eliminating deferral of taxation on a CFC's passive—or subpart F—income, while allowing deferral for a CFC's active foreign business income.[124] One solution to the deferral problem as it exists for active foreign business income is to shift treatment of such income toward the elimination-of-deferral end of the continuum, which implies immediate taxation at full marginal corporate rates.

In January, 2003, President Bush announced a growth and jobs plan that would have done exactly the opposite.[125] The plan, which became part of the House Jobs and Growth Tax Act of 2003 ("Growth Act"), proposed to allow permanent deferral of taxes on all CFC earnings by permitting shareholders to exclude from income all dividends received from foreign

122 The PFIC rules use two tests–an income test and an asset test– for determining whether a corporation is a PFIC. A foreign corporation will be a PFIC if at least 75% of its income is passive income as defined in I.R.C. § 954(c) (generally, income such as dividends, interest, royalties, rents). *See* I.R.C. § 1297(a)(1), (b). Similarly, a foreign corporation will be a PFIC if at least 50% of its assets are held for the production of such passive income. I.R.C. § 1297(a)(2).

123 *See* Shay, *supra* note 67, at 29.

124 *Supra* Part II.B.

125 *See* Press Release, White House, Fact Sheet: President Bush Taking Action to Strengthen America's Economy (Jan. 7, 2003) *available at* http://www.whitehouse.gov/news/releases/2003/01/20030107.html.

corporations.[126] This would have been tantamount to adopting an exemption, or territorial, tax system, thus taxing a CFC's active foreign business income at a rate of zero percent rather than at full marginal corporate rates. Ultimately, the President's dividend exclusion provision was not made part of the Jobs and Growth Tax Relief Reconciliation Act of 2003.[127]

However, even as Congress rejected the full dividend exclusion, new legislation containing a provision derived from an earlier failed Senate amendment to the Growth Act gained momentum.[128] That provision effectively would have taxed CFCs' active foreign business income at a rate of seven percent: greater than the zero rate resulting from deferral, but lower than the full marginal corporate rate.[129] Moreover, the lower tax rate would be available only for earnings repatriated during a temporary window, thus creating an incentive to immediately end deferral on those earnings.[130] U.S. multinationals, particularly those in the powerful pharmaceutical and technology industries, lobbied heavily for the legislation.[131] These companies,

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126 *See* Jobs and Growth Tax Act of 2003, H.R. 2, 108th Cong. § 201 (2003). The Act's provisions were not limited to dividends from foreign corporations. *Id.* Shareholders would have been permitted to exclude dividends received by shareholders from domestic corporations, as well. *Id.*

127 Pub. L. No. 108-27, 117 Stat. 752 (2003).

128 The American Jobs Creation Act of 2003, H.R. 2896, 108th Cong. § 1021 (2003).

129 The rate reduction, which would have been effected by means of a dividend deduction, was based on the Senate's failed amendment of the Jobs and Growth Tax Relief Reconciliation Act of 2003, H.R. 2, 108th Cong. § 531 (2003) (Engrossed Amendment as Agreed to by Senate) (imposing a 5.25% "toll tax" on dividends paid to corporate U.S. shareholders of controlled foreign corporations, in lieu of the corporate tax imposed by I.R.C. § 11). Similar toll taxes were proposed in the Invest in the U.S.A. Act of 2003, S. 596, 108th Cong. (2003); the Homeland Investment Act of 2003, H.R. 767, 108th Cong. (2003); and the Invest in America Act of 2003, H.R. 1162, 108th Cong. (2003).

130 Though accomplished by means of a dividend deduction, the rate reduction was based on the Senate's failed amendment of the Jobs and Growth Tax Relief Reconciliation Act of 2003, which imposed a 5.25% "toll tax" on dividends paid to corporate U.S. shareholders of controlled foreign corporations, in lieu of the corporate tax imposed by I.R.C. § 11. *See* Jobs and Growth Tax Relief Reconciliation Act of 2003, H.R. 2, 108th Cong. § 531 (2003)(Engrossed Amendment as Agreed to by Senate). Similar toll taxes were proposed in the Invest in the USA Act of 2003 (S. 596); the Homeland Investment Act of 2003 (H.R. 767); and the Invest in America Act of 2003 (H.R. 1162).

131 Pharmaceutical and technology companies comprised the majority of the members of a group called the Homeland Investment Coalition, which strongly promoted repatriation legislation. *See* Glenn R. Simpson & Gregory Zuckerman, *Tax Windfall May Not Boost Hiring Despite Claims; Some Companies Plan to Use New Break on Foreign Profits For Debt and Other Needs,* WALL ST. J., Oct 13, 2004, at A1. Corporate members of the Coalition included: Advanced Micro Devices, Inc., Alpharma, Apple, Boston Scientific, Cadence, Dell, Eli Lilly and Company, Guidant, Hewlett Packard, Intel, Johnson & Johnson, National Semiconductor Corporation, Oracle, Qualcomm, Schering-Plough, Sun Microsystems, Texas Instruments, United Technologies, Wyeth and Xilinx. Trade industry association members of the Coalition included AeA (American Electronics Association), Information Technology Association of America, Information Technology Industry Council, Medical Device Manufacturers Association, PhRMA, Semiconductor Industry Association and TechNet. *See also* Press Release, TechNet, TechNet Visits Washington to Outline 2003 National Policy Agenda (Mar. 5, 2003), *available at*

due to their greater ability to shift income offshore, potentially had the most to gain from a reduced rate of taxation on repatriated earnings.[132]

Ultimately, a dividend deduction provision that effectively provided for a temporary tax rate of 5.25% on dividends paid to U.S. multinationals by their foreign subsidiaries was included as new Code section 965 in the American Jobs Creation Act of 2004 (the "Jobs Act").[133] In discussing the reasons for enacting Section 965, the House Committee on Ways and Means concluded that the U.S. system of worldwide taxation discouraged U.S. shareholders of CFCs from repatriating foreign earnings of CFCs: "The Committee observes that the residual U.S. tax imposed on the repatriation of foreign earnings can serve as a disincentive to repatriate these earnings."[134]

As an empirical matter, it is not at all clear that the Committee was correct on this point. A number of economists have concluded that permanent taxes have no effect on repatriation rates.[135] However, the Committee's observation echoed a 2000 Treasury Department Policy Study on the deferral of income earned through CFCs, which reasoned that the use of foreign corporations as deferral vehicles was attributable to "the generally applicable rule of current taxation of worldwide income."[136] Thus, the Ways and Means Committee assumed that a reduction in the rate of tax applicable to repatriated foreign earnings would induce U.S. corporate shareholders of CFCs to voluntarily end deferral of taxation on their CFCs' foreign earn-

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http://www.technet.org/news/release/?postId=6284&pageTitle=TechNet+Visits+Washington+to+Outline+2003+National+Policy+Agenda (TechNet is a national network of 200 CEOs and senior executives in the high technology and biotechnology communities).

132 *See supra* text accompanying notes 61-64. Some commentators suspected that U.S. corporations already had begun building up foreign profits in anticipation of a repatriation amnesty. *See, e.g.*, Sullivan, *supra* note 3, at 1189.

133 *See* American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 422, 118 Stat. 1418, 1514-19 (2004).

134 H.R. REP. NO. 108-548, pt. 1, at 146 (2004).

135 *See, e.g.*, Roseanne Altshuler et al., *Do Repatriation Taxes Matter? Evidence from the Tax Returns of U.S. Multinationals*, (Nat'l Bureau of Econ. Research, Working Paper No. 4667, 1994), *in* THE EFFECTS OF TAXATION ON MULTINATIONAL CORPORATIONS 253, 271 (Martin Feldstein et al., eds., 1995) (concluding that "repatriation taxes do affect dividend repatriation behavior but only to the extent that tax rates vary over time."); BRUMBAUGH, *supra* note 3, at 8 (". . . a temporary cut in taxes on repatriation may stimulate a temporary increase in repatriations but . . . a permanent tax cut . . . will have no effect."). The extent to which taxes affect repatriation also differs as between young and mature foreign operations, with the latter being more likely to increase repatriations as a result of a temporary tax cut. *Id.* at 6-7. *But see* Mihir A. Desai, et al., *Repatriation Taxes and Dividend Distortions*, (Nat'l Bureau of Econ. Research, Working Paper No. 8507, 2001) (concluding that repatriation taxes reduce aggregate dividend payouts from foreign corporations to their U.S. affiliates by 12.8%).

136 *See* DEP'T OF THE TREASURY, THE DEFERRAL OF INCOME EARNED THROUGH U.S. CONTROLLED FOREIGN CORPORATIONS: A POLICY STUDY 3 (2000).

ings:[137] "The Committee believes that a temporary reduction in the U.S. tax on repatriated dividends will . . . [trigger] the repatriation of foreign earnings that otherwise would have remained abroad."[138]

In short, section 965 was at least intended to be a temporary solution to the problem of deferral. It also represented a response to the problem that had not as yet been tested. The following subpart summarizes the key components of section 965 and describes how the provision worked.

B. *Mechanics of Section 965*

Section 965 permitted a corporate U.S. CFC shareholder to deduct from income eighty-five percent of the cash dividends it received from the CFC.[139] Although cast in the form of a deduction, Section 965's effect was to dramatically reduce the effective rate of tax on dividends paid by the CFC to its U.S. shareholders. Thus, for example, in the case of a $100 dividend from a CFC, a U.S. shareholder normally would pay $35 of tax (at the marginal 35% corporate tax rate).[140] If an election were made under section 965, however, $85 of the dividend would be deductible and the U.S. shareholder would be taxed on only $15.[141] The resulting $5.25 of tax on the $15 dividend (again at the marginal thirty-five percent corporate tax rate) would be equivalent to a tax rate of 5.25% on the full $100 dividend. Such a substantial reduction in the effective tax rate on dividends was expected to create a substantial incentive for CFCs to voluntary end deferral and repatriate foreign earnings to their U.S. shareholders.

To insure that U.S. shareholders would be induced to repatriate earnings that otherwise would have been permanently retained offshore—and thus truly break open their CFC piggybanks—the section 965 dividend deduction generally did not apply to the repatriation of a CFC's current earnings.[142] Only "extraordinary dividends"—those exceeding the annual average repatriation level over a specified base period—were eligible for the dividend deduction.[143] Moreover, amounts that otherwise would be in-

137 Here, the Committee was on firmer ground. Temporary tax cuts may have a positive effect on repatriation of earnings, particularly by "young" foreign operations. *See supra* note 135.

138 *See* H.R. REP. NO. 108-548, pt. 1, at 146 (2004).

139 I.R.C. § 965(a)(1). For definitions of "U.S. shareholder" and "CFC" see *supra* discussion Part II.B.

140 I.R.C. § 11(b)(1)(D).

141 *See* I.R.C. § 965.

142 *See* I.R.C. § 965(b)(2).

143 *Id.* The base period consisted of the three taxable years that were left after eliminating from the five most recent taxable years ending on or before June 30, 2003 the years with the highest and lowest repatriation amounts. I.R.C. § 965(c)(2).

cluded in a U.S. shareholder's income as dividend equivalents under subpart F also did not qualify as dividends for purposes of the section 965 deduction.[144]

The amount of CFC dividends that could be deducted under section 965 was limited to the greater of (1) $500 million, and (2) the amount of earnings shown on the U.S. shareholder's "applicable financial statement"[145] as "permanently reinvested outside the U.S."[146] Given the magnitude of deferred earnings, one would have expected the first clause to be of limited utility in capping repatriation.[147] Indeed, it appears that most U.S. corporations that took advantage of section 965 repatriated amounts far in excess of the $500 million limit.[148]

A deductible dividend could be paid by a CFC to its U.S. shareholders during only a one-year time period. A U.S. shareholder could elect to apply section 965 to a single "eligible year" that was either (1) the taxpayer's last taxable year beginning before October 22, 2004, or (2) the taxpayer's first taxable year starting during the one-year period beginning on October 22,

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144 This would include subpart F income inclusions under I.R.C. § 951 and foreign earnings invested in U.S. property under I.R.C. § 956. *See* H.R. REP. NO. 108-755, at 312 (2004) (Conf. Rep.), *reprinted in* 2005 U.S.C.C.A.N. 1341. As discussed in Part I.A, *supra*, a U.S. corporate shareholder receiving a dividend from a CFC or required to include income under I.R.C. § 951 or I.R.C. § 956 would be entitled to a foreign tax credit for its proportionate share of the foreign taxes paid by the CFC on its earnings. Section 965 disallows the foreign tax credit for the deductible portion of any dividend paid by a CFC to its U.S. shareholders. I.R.C. § 956.

145 In the case of a publicly traded U.S. shareholder, the applicable financial statement was the financial statement filed with the Securities and Exchange Commission. I.R.C. § 965(c)(1). For U.S. shareholders not required to file a financial statement with the SEC, the applicable financial statement was one that was prepared in accordance with generally accepted accounting principles and used for purposes of reporting to creditors or shareholders, or for any other substantial non-tax purpose. *Id.* If the applicable financial statement did not show a specific amount of foreign earnings permanently reinvested outside the United States but instead reflected a specific tax liability amount attributable to such earnings, a U.S. shareholder could back into the limitation number by dividing the tax liability amount by the marginal corporate tax rate of 35%. I.R.C. § 965(b)(1)(C).

146 For accounting purposes, a U.S. corporation must record income tax expense for U.S. taxes on the earnings of its foreign subsidiaries when the income is earned, regardless of whether the earnings are repatriated. *See* AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, *Opinion No. 23: Accounting for Income Taxes - Special Areas*, *in* OPINIONS OF THE ACCOUNTING PRINCIPLES BOARD 441, 446 (1972). However, if earnings of a foreign subsidiary are designated as permanently reinvested abroad, the corporation can defer recognizing U.S. taxes in its financial statements until it repatriates the earnings or until it no longer considers the earnings permanently reinvested. *See id.* at 447.

147 One commentator has suggested that the $500 million floor was provided as a concession to companies that may not have designated earnings as permanently invested outside of the United States, even though they would not likely have repatriated such funds absent a provision like section 965. *See* Peter H. Blessing, *Bringing it All Back Home: Repatriations Under the American Jobs Creation Act of 2004*, 105 TAX NOTES 965, 969 (2004).

148 *See infra* Appendix A.

2004.[149] Thus, the last date on which a U.S. shareholder theoretically could have received a deductible dividend was September 30, 2006.[150]

Section 965 required that repatriated earnings be used in accordance with a "domestic reinvestment plan" ("DRIP").[151] The DRIP had to be approved by the U.S. shareholder's president, chief executive officer or comparable officer prior to payment of the dividend, and be subsequently approved by the U.S. shareholder's board of directors, management committee, executive committee, or similar body.[152] Moreover, the DRIP had to provide that the dividend paid by a CFC be reinvested in the United States for specified purposes.[153] A subsequent notice issued by the IRS stipulated that the DRIP be in writing and that it describe specific anticipated investments in the United States.[154] The notice also enumerated various permitted and non-permitted DRIP investments.[155]

The legislative history of section 965 makes it clear that Congress intended the provision to be a one-time affair. As the Conference Committee report stated, "The conferees emphasize that this is a temporary economic stimulus measure, and that there is no intent to make this measure permanent, or to 'extend' or enact it again in the future."[156]

Both the origins of section 965 and its mechanics are similar to another tax administration device: the tax amnesty.[157] Like section 965, tax amnesties generally are designed to induce compliance with particular tax policy norms and are offered for a short period of time.[158] The following Part assesses the use of tax amnesties both within the United States and abroad, and draws on the literature on tax amnesties in developing a theory of what constitutes an optimal tax amnesty.

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149 I.R.C. § 965(f).

150 For a U.S. corporate taxpayer with a fiscal year beginning October 1, the "first taxable year starting during the one-year period beginning on October 22, 2004," would be the fiscal year beginning October 1, 2005 and ending on September 30, 2006. *See id.*

151 I.R.C. § 965(b)(4).

152 I.R.C. § 965(b)(4)(A).

153 I.R.C. § 965(b)(4)(B).

154 I.R.S. Notice 2005-10, 2005-1 C.B. 474.

155 Permitted investments included the funding of worker hiring, training, and other compensation; infrastructure and capital investments, research and development; the financial stabilization of the corporation for purposes of job retention or creation; acquisitions of business entities; advertising and marketing expenditures; and acquisition of rights to intangible property. Non-permitted investments included executive compensation; inter-company distributions, obligations, and transactions; stock dividends and redemptions; portfolio investments in business entities; acquisitions of debt instruments; and tax payments. *See id.*

156 H.R. REP. NO. 108-755, at 256 (2004) (Conf. Rep.).

157 Shay, *supra* note 67, at 37 n.25 ("[H]omeland security repatriation proposals . . . are in the nature of amnesties . . . .").

158 *See* Part IV.A.

IV. TAX AMNESTIES

A. *A Brief History*

The word "amnesty" is derived from a Greek term denoting forgetfulness or loss of memory.[159] Indeed, the English word "amnesia" has the same root. Thus, the grant of amnesty by a sovereign is a willful forgetting, or failing to take notice of, some specified past offense.[160] Generally, an amnesty applies to a group of potential offenders before there has been any determination of actual guilt.[161] Amnesties may be offered for a variety of offenses, although generally they are restricted to political crimes, or crimes against the state.[162] Jurisdictions within the United States have granted amnesties for matters as wide-ranging as overdue library books and fines,[163]

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159 *See Ex parte* Garland, 71 U.S. (4 Wall.) 333, 348 (1866) (noting that the Greek "amnestia" means "oblivion, the state or condition of being forgotten, no longer remembered.").

160 *See* 1 OXFORD ENGLISH DICTIONARY 406 (2d. ed. 1989) (defining amnesty as "an act of oblivion, a general overlooking or pardon of past offences, by the ruling authority."). This notion of forgetfulness goes back at least as far as Mosaic law, which prescribed the observance, every fifty years, of a year of "jubilee," during which slaves were to be freed and debts forgiven. *See Leviticus* 25:8-54.

161 Daniel T. Kobil, *The Quality of Mercy Strained: Wresting the Pardoning Power from the King*, 69 TEX. L. REV. 569, 576-77 (1991). By contrast, a "pardon" typically remits the punishment of a particular individual whose guilt already has been established. *See id.*at 575-76. *See also Garland*, 71 U.S. at 351.

162 *See* RONALD L. GOLDFARB & LINDA R. SINGER, AFTER CONVICTION 350-51 (1973). Much of the recent scholarship on amnesties has been devoted to their role in addressing war crimes committed by rogue political regimes. *See, e.g.*, Leila Nadya Sadat, *Exile, Amnesty and International Law*, 81 NOTRE DAME L. REV. 955 (2006); Michael P. Scharf, *From the eXile Files: An Essay on Trading Justice for Peace*, 63 WASH. & LEE L. REV. 339 (2006); Eric Blumenson, *The Challenge of a Global Standard of Justice: Peace, Pluralism, and Punishment at the International Criminal Court*, 44 COLUM. J. TRANSNAT'L L. 801 (2006). One of the earliest recorded amnesties was that extended in 403 B.C. by Thrasybulus to members of the Thirty Tyrants oligarchy that executed hundreds of Athenians and exiled thousands more during Sparta's rule. *See* William Tieman, *"Cause" in History and the Amnesty at Athens: An Introduction* , 132 TRANSACTIONS OF AM. PHILOLOGICAL ASS'N 63 (2002).

163 A 1983 library amnesty in Philadelphia netted the return of more than 160,000 overdue library books from some 35,000 patrons. *See* Herman B. Leonard & Richard J. Zeckhauser, *Amnesty, Enforcement and Tax Policy* 8 (Nat'l Bureau of Econ. Research, Working Paper No. 2096, 1986).

illegal immigration,[164] illegal or unwanted firearms,[165] and even the theft of street signs.[166]

Of increasing importance both within the United States and around the globe has been the use of amnesties for tax evasion crimes. Tax amnesties vary widely in their particulars, but a typical tax amnesty offers tax evaders a window of opportunity within which to voluntary disclose their evasion in exchange for the reduction or elimination of penalties—either monetary or criminal.[167] Countries in Europe, Latin America, Asia and the Pacific have all employed tax amnesties as part of their fiscal programs.[168] Forty-one of the fifty states and the District of Columbia have implemented some type of tax amnesty program since 1982.[169]

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164 Immigration Reform and Control Act of 1986, Pub. L. No. 99-603, 100 Stat. 3359 (establishing a one-year amnesty period during which illegal immigrants who had lived and worked in the United States continuously since 1982 could apply for lawfully admitted for temporary residence status).

165 A recent day-long amnesty conducted by a town in Nebraska allowed people to turn over unwanted or illegal fireworks and firearms to members of the ATF and the local fire department with no questions asked. Karen Sloan, *Amnesty Brings in Guns, Fireworks, Fearsome Firepower*, OMAHA WORLD-HERALD (Neb.), Mar. 11, 2006, at 3B.

166 Dan McLean, *Merrimack Declares Amnesty for Return of Signs,* NEWHAMPSHIRE.COM, June 13, 2006, at 1, http://www.newhampshire.com/articles/showularticle.cfm?id=58950.

167 *See* Elliott Uchitelle, *The Effectiveness of Tax Amnesty Programs in Selected Countries*, FED. RES. BANK OF N.Y. Q. REV., 48, 48 (1989) ("Most amnesty programs share a common feature—a grace period during which delinquent taxpayers can correct prior infractions of the tax law without incurring penalties normally associated with tax delinquency.").

168 Countries granting tax amnesties include Argentina, Australia, Austria, Belgium, Bolivia, Brazil, Chile, Colombia, Costa Rica, Denmark, Ecuador, Finland, France, Greece, Honduras, India, Indonesia, Ireland, Italy, Malaysia, Mexico, the Netherlands, New Zealand, Norway, Pakistan, Panama, Peru, the Philippines, Portugal, Sri Lanka, Sweden, Switzerland, Uruguay and West Germany. *See* James Alm, *Tax Policy Analysis: The Introduction of a Russian Tax Amnesty* 5-7 (Ga. State. Univ. Int'l Studies Program, Working Paper No. 98-6, 1998), *available at* http://isp-aysps.gsu.edu/papers/ispwp98 06.pdf; Arindam Das-Gupta & Dilip Mookherjee, *Tax Amnesties as Asset-Laundering Devices*, 12 J. L. ECON. & ORG. 408, 409 (1996); Luigi Alberto Franzoni, *Punishment and Grace: On the Economics of Permanent Amnesties*, (Univ. of Bologna Dep't of Econ., Working Paper No. 252, 1996), *available at* http://amsacta.cib.unibo.it/archive/00000778/01/252.pdf; Uchitelle, *supra* note 167, at 48.

169 Arizona's 1982 amnesty was the first to be offered by a state, followed in 1983 by amnesties in Idaho, Missouri, North Dakota and Massachusetts. *See* Federation of Tax Administrators, State Tax Amnesty Programs, (Mar. 2006), http://www.taxadmin.org/fta/rate/amnesty1.html (last visited Dec. 15, 2006) [hereinafter State Tax Amnesty Programs]. The following states have offered an amnesty or amnesties in the years indicated in parentheses: Alabama (1984); Arizona (1982-83, 2002, 2003); Arkansas (1987, 2004); California (1984-85, 2005); Colorado (1985, 2003); Connecticut (1990, 1995, 2002); Florida (1987, 1988, 2003); Georgia (1992); Idaho (1983-84, 2003); Illinois (1984, 2003); Indiana (2005); Iowa (1986); Kansas (1984, 2003); Kentucky (1988, 2002); Louisiana (1985, 1987, 1998, 2001); Maine (1990, 2003); Maryland (1987, 2001); Massachusetts (1983-84, 2002, 2003); Michigan (1986, 2002); Minnesota (1984); Mississippi (1986, 2004); Missouri (1983, 2002, 2003); Nebraska (2004); Nevada (2002); New Hampshire (1997-98, 2001-02); New Jersey (1987, 1996, 2002); New Mexico (1985); New York (1985-86, 1996-97, 2002-03); North Carolina (1989); North Dakota (1983,

The U.S. federal government has never offered a formal tax amnesty, although a number of federal tax initiatives have resembled amnesties. Following World War II, it was the administrative policy of the Internal Revenue Service to provide amnesty from criminal prosecution to taxpayers who voluntarily disclosed their underpayment of taxes.[170] Generally, however, such taxpayers still were subject to any civil penalties or interest that applied with respect to the delinquent taxes. The IRS officially ended the policy in 1952, in part because some taxpayers who received immunity subsequently defaulted on the installment payments of tax liability permitted under the policy and could not be prosecuted.[171]

As the use of tax amnesties around the world—as well as in the United States—has increased, so has the scholarship analyzing them. The tax amnesty literature explores such issues as taxpayer responses to tax amnesty offers,[172] the revenue effects of tax amnesties,[173] and the long-term effects of amnesties on tax compliance.[174] There are a number of potential benefits to a government offering a tax amnesty, but tax amnesties also have drawbacks that may exceed the benefits that they produce. The following subparts assess the utility of tax amnesties by examining the benefits and costs that may be expected from implementation of an amnesty program.

2003-04); Ohio (2001-02, 2006); Oklahoma (1984, 2002); Pennsylvania (1995-96); Rhode Island (1986-87, 1996, 2006); South Carolina (1985, 2002); South Dakota (1999); Texas (1984, 2004); Vermont (1990); Virginia (1990, 2003); Washington D.C. (1987, 1995): West Virginia (1986, 2004); Wisconsin (1985, 1998). *Id.*

170 *See* STAFF OF J. COMM. ON TAXATION, 105TH CONG., TAX AMNESTY 5 (Comm. Print 1998).

171 *Efforts to Reduce Taxpayer Burdens: Hearing Before the Subcomm. on Oversight of the Internal Revenue Serv. of the S. Comm. on Finance*, 98th Cong. 30 (1983) (statement of IRS Comm'r Roscoe L. Egger Jr.) [hereinafter *Efforts to Reduce Taxpayer Burdens*].

172 *E.g.*, Carla Marchese & Fabio Privileggi, *Taxpayers Attitudes Toward Risk and Amnesty Participation: Economic Analysis and Evidence for the Italian Case*, 52 PUBLIC FINANCE/ FINANCES PUBLIQUES 394 (2000) (Neth.), *available at* http://papers.ssrn.com/sol3/Delivery.cfm/99090912.pdf?abstractid=177590&mirid=1.

173 *E.g.*, James Alm & William Beck, *Tax Amnesties and Compliance in the Long Run: A Time Series Analysis*, 46 NAT'L TAX J, 53, 53-54 (1993); Ines Macho-Stadler et al., *Tax Amnesties in a Dynamic Model of Tax Evasion*, 1 J. OF PUB. ECON. THEORY 439, 441 (1999).

174 *E.g.*, Alm & Beck, *supra* note 173, at 53; James Andreoni, *The Desirability of a Permanent Tax Amnesty*, J. PUB. ECON. 45 (1991).

B. *Benefits Associated with Tax Amnesties*

1. Generation of Revenue

One of the principal reasons that governments implement tax amnesty programs is to generate revenue.[175] Tax amnesties do this in several ways.[176] First, and most important, is the collection of taxes on previously undisclosed income.[177] Taxing jurisdictions generally expect a tax amnesty to yield a substantial windfall from the immediate collection of the past-due tax debt of tax evaders.[178] As discussed below, in many cases the revenue generated by tax amnesty programs has been both substantial and far in excess of expectations.

For example, Ireland anticipated raising approximately $50 million from a 1988 tax amnesty that gave delinquent taxpayers ten months to pay back taxes free of penalties, interest and prosecution.[179] When the amnesty concluded, however, the Central Bank of Ireland reported that $750 million had been raised.[180] This represented 2.55% of the country's gross domestic product (GDP) and 158% of its then-current deficit.[181] Even larger amounts were raised by France and India from tax amnesties offered in 1986 and 1981, respectively, although the amounts raised represented a much smaller percentage of those countries' GDP and government deficits.[182] Italy collected revenue of only $5 million and $7 million, respectively, from amnesties introduced in 1994 and 1991, but these amounts still exceeded government forecasts.[183]

In the United States, the tax amnesties extended by the forty-one states that have implemented them as of this writing have generated approximately $5.3 billion.[184] States collecting the largest amounts to date include New York with over $1.23 billion; New Jersey with $822 million, Illinois

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175 *See* Alm, *supra* note 168, at 3.

176 Uchitelle, *supra* note 167, at 48-49 (discussing three of the ways enumerated here).

177 *See* Leonard & Zeckhauser, *supra* note 163, at 8.

178 *See generally* James Andreoni et al., *Tax Compliance*, 36 J. ECON. LITERATURE 818, 853 (1998) (noting the popularity of tax amnesties during the 1980s as a revenue booster for state governments); Uchitelle, *supra* note 167, at 48-49.

179 *See* Uchitelle, *supra* note 167, at 50, 52.

180 *See id.*

181 *See id.*

182 *See id.* at 52.

183 *See* Marchese & Privileggi, *supra* note 172, at 5, 9.

184 *See* State Tax Amnesty Programs, *supra* note 169.

with $692 million, California with $197 million, and Massachusetts with $182 million.[185]

In many cases, these amounts would not otherwise have been collectable by the taxing jurisdiction. Nearly 30% of the revenue collected by New York as a result of its first general amnesty program in 1985-86 was from tax liabilities for which the state had no information.[186] This represented more than $120 million that almost surely would not have been collected absent the amnesty.[187]

Second, a well-managed tax amnesty program can enlarge the tax base by adding to the tax rolls previously delinquent taxpayers who take advantage of the amnesty.[188] These new taxpayers may require closer monitoring, but, to the extent that they become and remain compliant, tax revenues will be greater, thus potentially reducing the need for future tax increases.[189] A 2002 study that examined the subsequent filing compliance of participants in Michigan's 1986 tax amnesty found that about two-thirds of new filers under the amnesty program subsequently filed income tax returns.[190]

Third, governments may use tax amnesties to raise revenue by encouraging the repatriation of capital that is being held abroad illegally. This may lead to the generation of tax receipts either directly from withholding taxes or indirectly from wealth taxes.[191] A 2001 Italian tax amnesty reportedly resulted in the repatriation of over $50 billion and the generation of more than $1.25 billion in additional tax revenues.[192] France's similar 1986 amnesty specifically targeted income that had been illegally transferred abroad by imposing a greatly reduced tax rate on repatriated capital.[193] That am-

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185 *Id.*

186 *See* Bonnie G. Ross, *Federal Tax Amnesty: Reflecting on the States' Experiences*, 40 TAX LAW. 145, 176 (1986).

187 *Id.*

188 *See, e.g.*, Charles W. Christian, et al., *Evidence on Subsequent Filing from the State of Michigan's Income Tax Amnesty*, 55 NAT'L TAX J. 703, 704 (2002) (concluding that Michigan's 1986 tax amnesty added about 5,500 new taxpayers to the state's tax rolls); Leonard & Zeckhauser, *supra* note 163 (noting that one of the main benefits of tax amnesties is that they reduce future non-compliance by adding previously delinquent taxpayers to the tax rolls).

189 Uchitelle, *supra* note 167, at 49.

190 Christian, et al., *supra* note 188, at 704 (concluding that Michigan's 1986 tax amnesty added about 5,500 new taxpayers to the state's tax rolls).

191 If wealth taxes are too high, however, foreign capital is not likely to be repatriated. France's 1982 tax amnesty failed to raise significant revenue from repatriated capital because of the country's high wealth tax rates. France had greater success with a subsequent tax amnesty that was offered in concert with the abolition of the wealth tax. Uchitelle, *supra* note 167, at 48, 52-53.

192 *See* Benno Torgler & Christoph A. Schaltegger, *Tax Amnesties and Political Participation*, 33 PUB. FIN. REV. 403, 403-04 (2005).

193 Uchitelle, *supra* note 167, at 52.

nesty increased France's non-bank private capital inflows by about 400% in 1986.[194]

Fourth, tax amnesties reduce the amount of activity occurring in the underground economy.[195] As this activity shifts into the mainstream economy, it increases both the tax base and future tax revenues.[196] To this end, the Indian government implemented a 1980 amnesty in which it issued special bearer bonds they marketed to tax evaders.[197] The government pledged that funds used to purchase the bonds would be immune from taxation, investigation and prosecution.[198] The effect of the scheme was to permit taxpayers to essentially launder or "whiten" unreported "black assets" back into the mainstream economy.[199] Since 1980, India frequently has considered repeating this approach, and other jurisdictions have adopted comparable programs.[200] This dynamic was the focus of tax amnesties in India in 1980 and 1985-86.[201] The Comptroller and Auditor General of India stated that the objective of the 1985-86 tax amnesty was not only curbing tax evasion, but also "unearthing the considerable amount of black money that is vitiating the nation's economy."[202]

It should be noted that in amnesties like those just described, it may be the concealed assets, whether they be domestic or foreign, that are the target of a tax amnesty, rather than the tax revenue that may be generated by those assets. In other words, the government simply may want to access offshore investment capital or black assets without regard to whether accessing them will generate tax revenues.

194 *Id.*

195 Das-Gupta & Mookherjee, *supra* note 168, at 409.

196 *Id.*

197 *See* Arindam Das-Gupta & Dilip Mookherjee, *Tax Amnesties in India: An Empirical Evaluation* 3 (Ctr. for Institutional Reform & the Informal Sector, Working Paper No. 4, 1995).

198 *Id.*

199 *Id.* at 8; R. T. Naylor, Nathanson Ctr. for the Study of Organized Crime & Corruption, York Univ., *Follow-the-Money Methods in Crime Control Policy* (1999), *available at* http://www.yorku.ca/nathanson/Publications/washout.htm (last visited Dec.18, 2006).

200 *See, e.g.*, P. Vaidyanathan Iyer, *Govt Explores Bonds to Tap Black Money*, REDIFF.COM , June 30, 2004 http://www.rediff.com/money/2004/jun/30bud.htm (last visited Dec. 18, 2006) (reporting that Indian government was "exploring the option of launching long-tenure bearer bonds or infrastructure bonds to unearth unaccounted money and use it to fund the country's development needs."). Argentina implemented a 1987 amnesty that exempted repatriated flight capital from taxation if the money was used for new plant and equipment investments. John Whitelaw, *Argentina Plans Debt Cut, Investment Spur*, CHRISTIAN SCI. MONITOR, Sept. 5, 1986. Belgium enacted a similar amnesty in 1984. Uchitelle, *supra* note 167, at 51-52.

201 GOVERNMENT OF INDIA, REPORT OF THE COMPTROLLER AND AUDITOR GENERAL OF INDIA FOR THE YEAR ENDED 31 MARCH 1989, AMNESTY SCHEME (1985), No. 7 of 1990, New Delhi: Government of India.

202 *Id.*

Indeed, Congress touted section 965's one-year repatriation provision as a temporary economic stimulus that would benefit the economy without regard to the tax revenue expected to be generated by repatriation.[203] Section 965 was expected to result in increased worker hiring and training, development of business infrastructure, expansion of research and development, new capital investments, and job retention and creation through the financial stabilization of U.S. corporations.[204]

2. Encourage Future Compliance

Another benefit frequently associated with tax amnesties is that they may encourage those who are not currently compliant with the law to become compliant in the future.[205] When the government establishes a penalty for a violation of its norms—such as tax evasion—the intent is to deter individuals from evading taxes. Behavioral economics posits that an individual will weigh the costs of compliance with the law against the costs of violating it.[206] If the costs of violating the law exceed the costs of compliance, the individual presumably will comply with the law and the penalty will have served its deterrent function.

If the penalty fails to deter an individual from evading taxes, however, its continued existence has only two residual effects. The first is to generate revenue in the form of a payment to the state if the tax evader is caught. The second is to encourage continued noncompliance by the tax evader.[207] In order to become voluntarily compliant, a tax evader must pay the penalty in addition to the tax owed and any accumulated interest. Because this is the same set of costs the taxpayer will bear if her tax evasion is discovered, she will be better off not disclosing her tax evasion so long as the probability of discovery is under 100%.

In an amnesty, the state forfeits a penalty that fosters continued noncompliance and, in exchange, adds to the tax rolls a previously noncompliant taxpayer who is expected to generate a future stream of tax revenue. Stated in economic terms, absent its deterrent effect, a penalty creates a

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203 H. R. REP. NO. 108-548, pt. 1, at 152 (2004) ("The Committee believes that a temporary reduction in the U.S. tax on repatriated dividends will stimulate the U.S. domestic economy by triggering the repatriation of foreign earnings that otherwise would have remained abroad. The Committee emphasizes that this is a temporary economic stimulus measure.").

204 *See* I.R.C. § 965(b)(4)(B) (describing permissible objectives of the "domestic reinvestment plan" required for the tax-favored repatriation of offshore earnings under section 965).

205 Alm, *supra* note 168, at 3.

206 *See* STAFF OF J. COMM. ON TAXATION, 105TH CONG., TAX AMNESTY 9-10 (Comm. Print 1998).

207 *See* Leonard & Zeckhauser, *supra* note 163, at 8-9.

deadweight loss represented by the delta between the present value of the collected penalty, on the one hand, and the present value of the tax revenue lost by the penalty's suppression of future compliance, on the other. By removing or mitigating the penalty, an amnesty eliminates the deadweight loss associated with that penalty.[208]

3. Signal Changes in Rules or Enforcement

A third benefit of amnesties in general is that they may ease the transition to a new legal regime or signal an impending change in enforcement activities. Thus, for example, governments frequently grant amnesties for illegal immigrants in conjunction with new immigration laws, or the heightened enforcement of existing immigration laws.[209] The Immigration Reform and Control Act passed by Congress in 1986 coupled an amnesty for certain illegal immigrants with new civil and criminal penalties for employers knowingly hiring undocumented immigrants.[210]

With respect to taxes, in 1961 the IRS installed new data processing equipment that likely would have made it more difficult to evade taxes.[211] The IRS issued a news release at the time suggesting to taxpayers that it might be prudent to voluntarily disclose any underpayments of tax.[212] The news release, although stopping short of offering amnesty, stated that the chances of criminal prosecution following such a voluntary disclosure would be low.[213]

The use of amnesties as a transition measure frequently is justified on equity grounds. That is, where there has been lax or ineffective enforcement of a rule for an extended period of time, society may come to view violation of the rule as warranting something less than the full penalty at-

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208 A deadweight loss or "excess burden" generally is defined as a loss to one person that is not offset by a gain to another. RICHARD A. IPPOLITO, ECONOMICS FOR LAWYERS 70 (2005). A classic illustration of deadweight loss is gift-giving, which generally produces a loss to the gift-giver (equal to the cost of the gift) that is not fully offset by the gain to the recipient (equal to the recipient's subjective valuation of the gift). Joel Waldfogel, *The Deadweight Loss of Christmas*, 83 AM. ECON. REV. 1328 (1993).

209 *See, e.g.*, Gary P. Freeman, *Can Liberal States Control Unwanted Migration?* 534 ANNALS AM. ACAD. POL. & SOC. SCI. 17, 23 (1994).

210 Immigration Reform and Control Act of 1986, Pub. L. No. 99-603, 100 Stat. 3359 (1986). *See also* Susan González Baker, *The "Amnesty" Aftermath: Current Policy Issues Stemming from the Legalization Programs of the 1986 Immigration Reform and Control Act*, 31 INT'L MIGRATION REV. 5 (1997).

211 STAFF OF J. COMM. ON TAXATION, 105TH CONG., TAX AMNESTY 5 (Comm. Print 1998).

212 *Id.*

213 *Id.*

tached to it. Subsequently shifting to a more harsh view of the offense and imposing the full penalty may strike some as inequitable.[214]

The IRS's 2003 Voluntary Offshore Compliance Initiative ("VOCI") illustrates this aspect of amnesty. Beginning in 2000, the IRS had issued a series of "John Doe" summonses to a variety of financial and commercial businesses and, as a result, had identified taxpayers who had used offshore payment cards or other offshore financial arrangements to hide their income.[215] Before proceeding with prosecutions based on the information it had gathered, the IRS announced the VOCI, under which the Service agreed to waive criminal prosecution for eligible, participating taxpayers.[216] Taxpayers who did not participate in the VOCI were subject to payment of taxes, interest, penalties and potential criminal prosecution, as well.[217] Thus, the IRS's offer of amnesty from criminal prosecution helped to facilitate a shift to rigorous prosecution of tax evaders who had used offshore accounts.

C. *Costs Associated with Tax Amnesties*

Although a tax amnesty may generate significant revenue in the short term, the measure of a tax amnesty's effectiveness is the extent to which it shifts collections upward over the long-term, not the amount it yields on a one-time basis.[218] Tax amnesties frequently have been criticized as likely to actually reduce tax compliance for a variety of reasons. Obviously, an amnesty is of little use if the cost of the additional short-term revenue is an overall reduction in tax compliance.[219] The following are some of the ways that tax amnesties potentially may be detrimental to compliance.

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214 *See* Leonard & Zeckhauser, *supra* note 163, at 6. On the other hand, it may be just as inequitable to taxpayers who have complied with the rule to impose less than the full penalty on those who failed to comply.

215 I.R.S. News Release IR-2003-5 (Jan. 14, 2003), *available at* http://www.irs.gov/newsroom/article/0,,id=105689,00.html (last visited Dec. 18, 2006).

216 *Id.*

217 *Id.*

218 *See* Leonard & Zeckhauser, *supra* note 163, at 19.

219 Leo P. Martinez, *Federal Tax Amnesty: Crime and Punishment Revisited*, 10 VA. TAX REV. 535, 555 (1991).

1. Undermine Perceived Fairness of the Tax System

Tax amnesties frequently are criticized on the grounds that they may engender a perception among taxpayers that the tax system is unfair.[220] The economic literature on the effect of taxpayer attitudes on tax compliance indicates that taxpayers are more likely to voluntarily comply with tax laws when they believe that the tax system itself is fair and that other taxpayers are complying.[221] Thus, a tax system—such as that of the United States—that relies on voluntary compliance is particularly sensitive to perceptions of inequity.

Tax amnesties may be viewed as unfair because they offer the tax evader a benefit that is withheld from the person who has complied with the tax law and paid her taxes. This is particularly true where the government waives interest owed on delinquent taxes, as well as penalties. In such cases, the tax evader has benefited from his evasion to the extent of the interest he earned or could have earned on the unpaid taxes during the term of his delinquency. By contrast, the compliant taxpayer has already forfeited the interest she could have earned on taxes that were paid when due.

If the government waives only penalties (or criminal prosecution), then it is more difficult to view the tax evader as having received a benefit that the compliant taxpayer is denied. To be sure, the tax evader is absolved of the obligation to pay a penalty, but this benefit is not denied to the compliant taxpayer; she simply has no need for a penalty waiver since her compliance avoided the imposition of a penalty in the first place. Nevertheless, the compliant taxpayer may feel she was duped into compliance by what turns out to be the government's empty threat to impose a penalty.[222] More broadly, some may view waiving penalties as denying society the right to impose punishment on tax evaders, whether for retributive or rehabilitative purposes.[223]

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220 *See Efforts to Reduce Taxpayer Burdens*, *supra* note 171, at 31 ("[H]onest taxpayers may perceive an amnesty as 'special treatment' for dishonest taxpayers, and therefore unfair, inequitable, and contrary to IRS' policy of administering the tax laws uniformly.").

221 *See, e.g.*, Steven M. Sheffrin & Robert K. Triest, *Can Brute Deterrence Backfire? Perceptions and Attitudes in Taxpayer Compliance*, *in* WHY PEOPLE PAY TAXES: TAX COMPLIANCE AND ENFORCEMENT 193, 214 (Joel Slemrod ed., 1992). A 1984 study commissioned by the IRS evaluated attitudes condoning tax cheating as one measure of compliance with the tax system. When taxpayers were asked to assign weights to various reasons that "other people" cheat on taxes, one of the factors most responsible for cheating was the perception that the tax system is unfair. *See* YANKELOVITCH, SKELLY, & WHITE, INC., TAXPAYER ATTITUDES STUDY FINAL REPORT 62 (1984).

222 *See* Leonard & Zeckhauser, *supra* note 163, at 13.

223 *See id.*

2. Diminish Perceived Seriousness of Tax Evasion

A further concern about tax amnesties is that when an amnesty is offered, some may see government as signaling to society that it does not take seriously the honest reporting and payment of tax liabilities. If society truly views tax evasion as a grave offense, one would expect the government to impose the maximum penalty. Forgiving tax evasion may make it appear to be a less significant offense.[224] This, in turn, may lead to more tax cheating on the margins, as those who previously were compliant may feel justified in taking greater liberties with the income and deductions they report.

The extent to which a tax amnesty diminishes the perceived seriousness of tax evasion in this regard depends, in large part, on whom the government permits to participate in the amnesty. If the government offers amnesty to those previously identified as tax evaders, the government may be viewed as not treating tax evasion seriously.[225] By contrast, where the government has not identified a person as having evaded taxes, there might not be an opportunity for prosecution absent the taxpayer's voluntary disclosure of evasion. Hence, an offer of amnesty in this circumstance does not imply government indifference to the crime of tax evasion.

A related concern is that enacting a tax amnesty may signal to taxpayers that the government is unable to enforce tax compliance. As a result, a taxpayer may conclude that the probability of her tax evasion being detected and punished is sufficiently low to make attempting to cheat worthwhile. To counter this possibility, a government offering amnesty would be well-advised to couple the amnesty with a very public campaign of stepped-up tax enforcement.

3. Create Expectations of Repetition

The implementation of a tax amnesty is likely to establish an expectation that a government will offer one or more amnesties in the future.[226] Given the experience with tax amnesties both in the United States and abroad, the expectation is warranted. Italy has conducted more than a dozen

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224 *See id.* at 14.

225 Alm, *supra* note 168, at 2. *See also* George Guttman, *IRS Tax Amnesty,* 22 TAX NOTES 1361, 1365 (1984).

226 STAFF OF J. COMM. ON TAXATION, 105TH CONG., TAX AMNESTY 11 (Comm. Print 1998).

tax amnesties.[227] Ireland conducted five amnesties in a six-year period and Argentina has offered six amnesties over a forty-year period.[228]

The experience in the United States also indicates that once a government has offered a tax amnesty there is a strong likelihood that it will repeat the offer. Of the 41 states that have offered tax amnesties since 1982, 31 have offered at least one subsequent tax amnesty, with Louisiana extending four separate amnesties, and a half-dozen more states extending three amnesties.[229]

Economists have noted that the expectation of future amnesties may create an entirely unintended incentive structure.[230] A tax evader may decide to forego participation in the first amnesty offered if he believes that another amnesty will be available in the foreseeable future.[231] Worse, a taxpayer who currently is in compliance may be encouraged to begin evading taxes if she believes that another amnesty will be offered and that her tax evasion will not be detected until it is.[232]

Thus, a proliferation of amnesties generally is associated with an overall reduction in tax compliance. Italy's multiple amnesties have been blamed for its low overall level of tax compliance.[233] The same is true of Argentina, where a businessman was quoted as saying, "I just throw my tax assessment away every year, I prefer to pay when the government offers a tax amnesty. It's lot cheaper that way."[234] Ireland's frequent amnesties have produced successively decreasing revenue, which suggests that repeated amnesties decrease taxpayer expectations that tax laws will be enforced.[235]

In the United States, Connecticut's first tax amnesty, in 1990, generated \$54 million.[236] A second amnesty five years later generated only \$40.9 million.[237] Of particular interest, however, was the fact that 219 participants in the second amnesty had also participated in the first amnesty.[238] Together, the 219 participants accounted for 4.5% of the revenues collected in

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227 *Id.* at 33.

228 *Id.* at 32-33; Tyler Bridges, *In Argentina, There's Nothing Certain About Taxes*, WASH. POST (Jan. 26, 1988) at C1.

229 *See* State Tax Amnesty Programs, *supra* note 169.

230 *See* Alm et al., *infra* note 263, at 24.

231 *See* STAFF OF J. COMM. ON TAXATION, 105TH CONG., TAX AMNESTY 11 (Comm. Print 1998).

232 *See Efforts to Reduce Taxpayer Burdens*, *supra* note 171 (statement by IRS Commissioner Roscoe L. Egger Jr.) ("[I]nstituting one amnesty might encourage the belief that the offer would be repeated in the future, leading to non-compliance in the interim.").

233 STAFF OF J. COMM. ON TAXATION, 105TH CONG., TAX AMNESTY 33 (Comm. Print 1998).

234 *In Argentina, Tax Evasion is a National Sport*, 38 TAX NOTES 636 (1988).

235 STAFF OF J. COMM. ON TAXATION, 105TH CONG., TAX AMNESTY 32-33 (Comm. Print 1998).

236 *Id.* at 30.

237 *Id.*

238 *Id.*

the 1990 amnesty and 10.3% of the revenue collected in the subsequent amnesty.[239] The inference is that having participated in one amnesty, taxpayers began to engage in strategic behavior in anticipation of the second amnesty.[240]

D. *A Theory of the Optimal Tax Amnesty*

The experiences of various jurisdictions with tax amnesties and the analysis provided by the literature provide a framework for constructing a tentative theory of the optimal tax amnesty. Such a framework should be helpful in evaluating amnesty-like provisions such as section 965. An optimal tax amnesty would possess a combination of characteristics that would take advantage of the benefits associated with amnesties while minimizing their associated costs. Drawing on the insights from Part IV.B and C, this subpart attempts to identify that combination of characteristics.

1. Transition to Reform

To achieve an optimal tax amnesty, governments should couple the amnesty with tax reforms designed to discourage those who take part in the amnesty from repeating the behavior that the amnesty seeks to remedy.[241] After all, if the incentives within the tax system that prompted the tax delinquency remain in place following the amnesty, there is minimal likelihood that tax evaders will change their behavior over the long-term.[242] As a result, any short-term revenue gains realized as a result of an amnesty will be offset by losses engendered by continued future tax evasion.

On a less intuitive level, however, it also turns out that tax amnesties combined with reform of legal or administrative tax rules actually produce greater short-term revenues than tax amnesties without such reforms.[243]

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239 *Id.* at 30-31.

240 *See id.* at 31.

241 William M. Parle & Mike W. Hirlinger, *Evaluating the Use of Tax Amnesty by State Governments*, 46 PUB. ADMIN. REV. 246 (1986) (citing John Mikesell, *Tax Amnesties as a Tool for Revenue Administration*, 57 ST. GOV'T. 114 (1984)).

242 *Id.* at 247.

243 Ines Macho-Stadler et al., *Tax Amnesties in a Dynamic Model of Tax Evasion*, 1 J. OF PUB. ECON. THEORY 439, 441 (1999) (asserting that it is a "well-known fact that no taxpayer would participate in *pure or partial amnesties* (where fines alone, or part of them, are forgiven) if no parameters change permanently between the reporting of taxes and the declaration of an amnesty. . . . [P]ure or partial amnesties by themselves do not have any effect on the economy, neither transitory nor permanent (no one participates). These types of amnesties can only be successful if some other parameter is modified, such as tougher enforcement . . . .").

This is likely because the prospect of real reform in the tax rules spurs greater participation in tax amnesties as tax delinquents contemplate a more difficult legal environment in which to evade taxes. An empirical examination of tax amnesties offered by American states in 1983 and 1984 found that states that raised the most revenue implemented significant tax reforms in conjunction with their amnesties.[244] By contrast, the failure of Argentina's 1987 amnesty to generate significant revenue was largely attributed to the fact that it was not offered in conjunction with an increase in enforcement activity or any reforms of that country's fiscal system.[245]

2. Signaling Greater Enforcement

A tax amnesty also should signal, and be combined with, significantly heightened government efforts to enforce compliance with existing (or newly reformed) tax rules. In fact, to the extent that tax amnesties are successful it generally is difficult to determine whether that success is attributable to the amnesty, to the threat of enhanced enforcement efforts, or to the enhanced enforcement efforts themselves.[246] Almost without exception, states that have offered amnesties have done so as part of a comprehensive effort to improve tax enforcement and voluntary tax compliance.[247] These efforts have included increased civil and criminal penalties for tax evasion and delinquency,[248] stricter enforcement activities,[249] and new computers and technology.[250]

Moreover, heightened tax enforcement efforts should be highly publicized in order to raise awareness among taxpayers and obtain the maximum

244 Parle & Hirlinger, *supra* note 241, at 246. States raising the most revenue were Illinois ($154 million), California ($144 million), and Massachusetts ($84 million). *Id.* at 251. In conjunction with its amnesty, Illinois increased civil penalties by 50% and increased criminal penalties as well, effective the day following the amnesty period; California's amnesty was part of a comprehensive program to improve long-term compliance with state tax laws; and Massachusetts made tax evasion a felony as part of its amnesty. *Id.* at 249.

245 *See* Alm, *supra* note 168, at 5.

246 *See* Leonard & Zeckhauser, *supra* note 163, at 25.

247 *See* Federation of Tax Administrators, State Tax Amnesty Programs, Research Report No. 133, at 13, Tax News Today, (July 30, 1990), LEXIS 90 TNT 157-61 (1990).

248 In states including Alabama, California, Georgia, Illinois, Massachusetts, New York and Pennsylvania. *See* Parle & Hirlinger, *supra* note 241, at 249 tbl.2; STAFF OF J. COMM. ON TAXATION, 105TH CONG., TAX AMNESTY 23-29 (Comm. Print 1998); Christian, et al., *supra* note 188, at 706.

249 In states including California, Georgia, Massachusetts, Michigan and New York. *See* Parle & Hirlinger, *supra* note 241, at 249 tbl.2; STAFF OF J. COMM. ON TAXATION, 105TH CONG., TAX AMNESTY 23-29 (Comm. Print 1998); Christian, et al., *supra* note 188, at 706.

250 In states including California, Georgia, New York and Pennsylvania. STAFF OF J. COMM. ON TAXATION, 105TH CONG., TAX AMNESTY 23-29 (Comm. Print 1998).

signaling benefit.[251] For example, in the months leading up to California's 1984-85 amnesty, the State projected a tough and high-profile image on tax enforcement by publicizing criminal tax prosecutions and arrests, publicly seizing boats and luxury cars, and auctioning unusual seized property.[252] California's amnesty was considered a success. The State collected the fifth highest revenue total among states offering tax amnesties.[253]

Similarly, New York widely publicized the increased enforcement measures that accompanied its 1985-86 amnesty in an effort to tell taxpayers that "the rules of the tax evasion game" had changed.[254] The State retained an advertising agency to develop bus and subway advertisements and radio and television commercials, and tax officials gave over 550 interviews, speeches and presentations on the amnesty.[255] New York's amnesty was even more successful than California's, with the highest total tax revenue collected in any state tax amnesty.[256]

3. Uniqueness

For a variety of reasons, the optimal tax amnesty should be offered only once. First, evidence from both international amnesties and amnesties offered by the states indicates that repeated amnesties generate successively smaller amounts of revenue. Ireland's 1993 amnesty did not come close to repeating the runaway success of that country's 1988 amnesty.[257] Revenue collections from Italy's more recent amnesties also have not met expectations. It was predicted that the country's 1982 amnesty would generate tax revenue of $4.6 billion, but actual collections amounted to under $700,000.[258] India and Argentina have experienced similar reduced tax collections from successive amnesties.[259]

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251 *See, e.g.*, Leonard & Zeckhauser, *supra* note 163, at 32 ("[T]he effect of amnesties seems to lie mainly in the fact that they are publicized . . . and that they permit the curtain to be raised on a new enforcement regime.").

252 STAFF OF J. COMM. ON TAXATION, 105TH CONG., TAX AMNESTY 26 (Comm. Print 1998).

253 *Id.*

254 *Id.* at 24.

255 *Id.*

256 *Id.*

257 *Id.* at 33. *See supra* text accompanying note 181.

258 STAFF OF J. COMM. ON TAXATION, 105TH CONG., TAX AMNESTY 33 (Comm. Print 1998).

259 Uchitelle, *supra* note 167, at 48, 51 (noting that an amnesty offered by India in 1981 did not raise as much as the government anticipated nor did it succeed in widening the tax base, in part because it was the fifth in a series of amnesties and there was little incentive to participate, especially when there was a good possibility that "the government would offer other, possibly more attractive, amnesties in the future."); Alm, *supra* note 168, at 5 (noting that the failure of Argentina's 1987 tax amnesty was due, in large part to the fact that Argentine had offered amnesties on several occasions in the past).

In the United States, New York's 1985-86 amnesty, which collected over $400 million in revenue, was followed ten years later by an amnesty that collected only $277 million.[260] The State Comptroller characterized the second amnesty as "ill advised" and a "disappointment."[261] Similarly, Connecticut's first amnesty in 1990 raised $54 million, but a second amnesty in 1995 generated under $41 million.[262]

Moreover, the negative consequences associated with amnesties tend to be magnified with each successive amnesty that is offered. Specifically, multiple amnesties greatly increase perceptions of unfairness, diminish the perceived seriousness of tax evasion, and distort incentives in a way that reduces tax compliance.[263] A 1990 behavioral experiment supports this view. The study concluded that the average level of compliance generally falls after an amnesty is given, and that this decline is most likely a result of taxpayer expectations of future amnesties, or the "anticipation effect."[264] Even if a government does not repeat a tax amnesty, merely discussing or debating its reenactment is likely to raise expectations of an amnesty and may well produce a consequent reduction in tax compliance.[265]

Uniqueness is perhaps the most difficult characteristic to achieve. The appeal to legislators of the short-term revenue that amnesties may generate frequently overpowers notions of sound tax policy. The only way to counter the compulsion to repeat an amnesty would be to bar such action by legislation. Georgia, for example, legislatively mandated that its first amnesty in 1992 would be its only one.[266] Whether this proscription was effective is not clear. One would assume that a future legislative majority would be perfectly capable of rolling back such a mandate. Moreover, at the federal level, an attempt to bar future tax amnesties might be both legally impossible and unconstitutional.[267]

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260 STAFF OF J. COMM. ON TAXATION, 105TH CONG., TAX AMNESTY 23-25 (Comm. Print 1998).

261 *Id.* at 26.

262 *Id.* at 30-31.

263 *See* James Alm et al., *Amazing Grace: Tax Amnesties and Compliance*, 43 NAT'L TAX J. 23, 34 (1990) ("The expectation of an amnesty . . . significantly reduces compliance."); Uchitelle, *supra* note 167, at 48, 49 ("Citizens may come to expect their governments to offer periodic tax amnesties. These expectations can decrease the incentives to pay taxes routinely and lead eventually to an increase in the number of tax evaders. Moreover, if amnesties make evasion seem forgivable, they may reduce voluntary compliance over the long run."); Leonard & Zeckhauser, *supra* note 163, at 13 (noting that the "perceived likelihood of repetition" may encourage evasion).

264 *See* Alm et al., *supra* note 263, at 24.

265 STAFF OF J. COMM. ON TAXATION, 105TH CONG., TAX AMNESTY 12 (Comm. Print 1998) ("[M]ere discussions of amnesties in advance of an amnesty will also likely raise expectations that an amnesty will occur, thus potentially inducing greater noncompliance in advance of an amnesty.").

266 *See* Christian, et al., *supra* note 188, at 704 fn.6.

267 *See infra* notes 294, 295 and accompanying text.

4. Fairness

An optimal tax amnesty should be designed to minimize perceptions of unfairness, which could infect attitudes about the tax system and reduce the tax collections from a fully functioning system of voluntary compliance. Since some may view tax amnesties as giving the tax evader a benefit not given to the compliant taxpayer, an optimal tax amnesty should offer only those minimal concessions required to insure a reasonable level of participation in the amnesty. Thus, ideally, governments would only waive criminal prosecution. Waiving penalties may be seen as denying society the right to impose punishment on tax evaders, and thus should be undertaken only if necessary to secure adequate participation.[268]

As noted earlier, tax amnesties may diminish the perceived seriousness of tax evasion, particularly if government offers amnesty to those previously identified as tax evaders.[269] In such cases, there is no question as to whether the evader would have been detected; the government already has expended resources in uncovering the evasion. Amnesty offered at this juncture suggests that the government does not consider tax evasion a serious offense. Thus, an optimal tax amnesty would not be offered to known tax evaders or those who are under investigation for tax evasion.[270]

Apart from insuring that the substantive terms of the amnesty are as fair as possible, a government offering a tax amnesty should consider taking affirmative steps to assure the public the amnesty is fair. Governments may achieve this by informing taxpayers that the amnesty's outcome will be a more equitable distribution of the tax burden because the program will bring delinquent taxpayers into compliance.[271] In addition, a government implementing a tax amnesty might justify the amnesty to taxpayers on the grounds that the imposition of harsh penalties after a period of lax en-

268 In the United States, amnesty relief generally is limited to waiver of penalties. *But see* Macho-Stadler et al., *supra* note 173, at 414 (noting that the 1984 Illinois tax amnesty waived 50% of the accrued interest in addition to penalties). In addition to the waiver of penalties, tax amnesties in other countries often include the waiver of interest, all or part of the tax liability, and even civil and criminal liabilities. *See* STAFF OF J. COMM. ON TAXATION, 105TH CONG., TAX AMNESTY 32 (Comm. Print 1998).

269 *See* Alm, *supra* note 168, at 2; Guttman, *supra* note 225, at 1365.

270 Questions as to what constituted being under investigation and whether a disclosure was voluntary and timely were heavily litigated in the IRS's 1945-52 amnesty. *See* Guttman, *supra* note 225, at 1365. Relevant considerations in this regard include how far the audit or investigation has progressed, whether the taxpayer was aware of the investigation, and whether participation in the amnesty may be permitted after an audit or investigation fails to disclose any tax evasion. *Id.*

271 *See* Parle & Hirlinger, *supra* note 241, at 247 (stating that proponents of amnesty generally state that "the ultimate effect of the program will be a more equitable distribution of the tax burden as delinquents are brought into the system.").

forcement is inequitable and that therefore something less than the full penalty should be imposed.[272]

5. Revenue Indifference

Finally, an optimal tax amnesty should not be relied upon to raise revenue. Despite the several ways in which tax amnesties may generate short-term revenue, they may well result in a net revenue loss over the long term.[273] First, the short-term revenue obtained in connection with a tax amnesty may be much lower than initially expected. This is particularly true where the amnesty program follows one or more previous amnesties, is poorly designed, or is not well-publicized.[274] Amnesties in North Dakota, Idaho, Texas, Kansas and Missouri each collected under $1 million.[275]

Second, the revenue collected through an amnesty might well have been collected even without the amnesty. Thus, while nearly 30% of the revenue collected by New York as a result of its 1985-86 amnesty program was from tax liabilities for which the state had no information, the remaining 70% likely would have been collected anyway.[276] In fact, in most cases, the revenue generated by tax amnesties merely represents the accelerated collection of taxes that already have been identified as accounts receivable or that otherwise are known to the taxing authorities.[277]

A 1990 study evaluating state tax amnesties found that those states that included accounts receivable and other known amounts in their amnesty programs generated an average of $11.09 per capita, compared to $0.77 for states offering amnesty programs limited to non-filers.[278] Thus, in many instances, the only short-term gain resulting from a tax amnesty will be the time value of taxes received voluntarily before they would otherwise have been collected, and any saved collection resources.[279]

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272 *See* Leonard & Zeckhauser, *supra* note 163, at 8.

273 *See supra* Part IV.C.3.

274 *See supra* notes 257-262 and accompanying text.

275 Alm et al., *supra* note 263, at 34.

276 *See* Ross, *supra* note 186, at 176.

277 *See* John L. Mikesell, *Amnesties for State Tax Evaders: The Nature of and Response to Recent Programs*, 39 NAT'L TAX. J. 507 (1986) (finding that tax amnesties generating the highest revenues included amounts already identified by the state and likely to be collected without an amnesty).

278 *See* Federation of Tax Administrators, State Tax Amnesty Programs*,* Research Report No. 133, at 3, Tax News Today, (July 30, 1990), LEXIS 90 TNT 157-61 (1990).

279 A $100 tax liability identified as an account receivable but collected through a tax amnesty a year earlier than otherwise would be the case will net the government only the market rate of interest that could be earned over a twelve-month period on $100.

Further, whatever short-term revenue gains are realized from a tax amnesty also will be reduced to the extent that the amnesty carries with it a waiver of penalties, which is the central attraction of most tax amnesty programs. To the extent that the taxing jurisdiction offers additional incentives, such as the waiver of interest or even the tax itself, the jurisdiction can expect to see its net revenue collection reduced even further.[280] Of course, penalty and interest waived constitute foregone revenue only if they would have been collected without an amnesty. As the discussion above suggests, however, a substantial portion of amnesty-generated revenue would have been collected in any event.

Finally, short-term revenue gains may simply be overset by long-term losses resulting from the deleterious effects of amnesty. A comprehensive 1995 study that evaluated Indian amnesties offered between 1965 and 1995 found that for all but a single amnesty, the adverse indirect effects overwhelmed the direct amnesty receipts.[281] In the United States, an early study of state tax amnesties concluded that states that offered amnesties had only slight, short-term increases in tax revenue relative to non-amnesty states.[282]

In short, given the equivocal evidence that tax amnesties actually generate revenue over the long-term, an optimal tax amnesty should not be employed principally as a means to raise revenue.

V. CODE SECTION 965 AND OPTIMALITY

Having articulated an optimal tax amnesty theory based on empirical assessments of a variety of tax amnesty programs, it remains to evaluate section 965 under that optimal tax amnesty theory. Of course, unlike tax amnesty programs, section 965 addressed legal deferral rather than illegal tax evasion.[283] At first glance, this distinction seems important because tax amnesties are thought of as employing a "stick" (i.e., the threat of criminal prosecution or imposition of penalties for those who *do not* participate in the amnesty), while a provision like section 965 appears to wield only a

280 In tax amnesties in the 1980s, New Mexico and Mississippi waived all interest on delinquent taxes, while Illinois, Iowa, Kentucky and Maine waived 50% of such interest. *See* Federation of Tax Administrators, State Tax Amnesty Programs*,* Research Report No. 133, at 3, Tax News Today, (July 30, 1990), LEXIS 90 TNT 157-61 (1990).

281 *See* Das-Gupta & Mookherjee, *supra* note 198, at 411.

282 *See* Leonard & Zeckhauser, *supra* note 163, at 19-23 (stating that tax revenue gains of amnesty states grew faster than tax revenue gains of non-amnesty states by a percentage point during the amnesty period, and by a half-percentage point in the two-year period following the amnesty).

283 *See supra* Part III.B.

"carrot" (i.e., reduction in the rate of tax applicable to repatriated earnings).[284]

On closer reflection, however, the stick is likely to have potency only in a world where certainty of enforcement approaches 100%. Given that most taxing jurisdictions operate with perennially constrained budgets for tax audit and enforcement activities, the stick might appropriately be fashioned to more closely resemble a carrot (i.e., waiver of criminal prosecution or application of a penalty for those who *do* participate in the amnesty). In other words, both section 965 and tax amnesties offer incentives to compel a particular behavior. Thus, the theoretically optimal tax amnesty provides an apt framework for evaluating a provision like section 965.

This Part assesses section 965 by reference to each of the characteristics of the optimal tax amnesty identified in Part IV and concludes that section 965 is not likely to solve the problem of deferral.

A. *Transition to Reform*

As discussed in Part IV.D.1 above, an optimal tax amnesty should be coupled with tax reforms designed to discourage those who take part in the amnesty from repeating the behavior that the amnesty seeks to remedy. Thus, an amnesty-like provision such as section 965, which is directed at ending deferral, should be implemented in connection with, and provide a transition toward, a policy of currently taxing the active foreign business income of CFCs. The tax reduction that provided an incentive for U.S. multinationals to repatriate earnings under section 965 would have operated with even greater force if it were introduced contemporaneously with the elimination of deferral.[285] Unfortunately, the amnesty-like relief offered by section 965 did not accompany specific tax provisions aimed at reforming U.S. tax policy regarding deferral.

Given the entrenchment of the deferral privilege within U.S. international tax policy, it is hardly surprising that section 965 did not herald its repeal. But section 965 may itself represent a transition toward reform of the taxation of the foreign earnings of CFCs. As noted in Part II.A., the alternatives for addressing deferral reside along a continuum having the complete elimination of deferral (or full taxation of CFC income) at one end, and the allowance of permanent deferral (or exemption of CFC income

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284 *Supra* Part III.B.

285 Of course, this assumes that the elimination of deferral would be retroactive. If, in eliminating deferral, Congress were to tax currently the earnings of CFCs from prior years, then a provision like section 965 would be an effective transition rule. If the elimination of deferral were only prospective, however, then no transition relief would be necessary.

from taxation) at the other. U.S. policy toward deferral has been a compromise that eliminates deferral of taxation on a CFC's passive—or subpart F—income, while allowing deferral for a CFC's active foreign business income.[286]

As a part of subpart F, Section 965 employs the language of U.S. shareholders and CFCs. However, instead of distinguishing—as the rest of subpart F does—between active and passive income, section 965 presents a compromise based on a distinction between full taxation and exemption. In effect, electing to suspend deferral subjects all foreign earnings—both active and passive—to full taxation, which is then mitigated by the deduction available under section 965. The effective rate of tax then falls between full corporate rates and the zero rate of tax implied by exemption.

By preserving the electivity of the decision to repatriate, section 965 reinforced subpart F's allowance of tax deferral on active business income, while simultaneously making it likely that at least some U.S. shareholders of CFCs would voluntarily end deferral on such income.[287] Of course, to the extent that deferral is a problem of foregone tax revenue, it is resolved only in part by dramatically reducing the tax rate on repatriated earnings. Foreign corporations may be induced to repatriate earnings, but the resultant diminutive tax collections make ending deferral in this manner a very Pyrrhic sort of victory.

A more serious question regarding section 965's usefulness as a transition to reform is whether it effectively could be employed again. The more frequently amnesties are offered, the more amnesty begins to resemble a permanent rule and the less effective it becomes at creating behavior-altering incentives.[288] This is particularly true in the case of section 965, which is, in essence, a tax reduction aimed at encouraging repatriation. Repatriation taxes affect dividend repatriation behavior only to the extent that tax rates vary over time.[289] Thus, a temporary cut in taxes on repatriation may stimulate a temporary increase in repatriations but a permanent tax cut will have no effect.[290]

In summary, section 965 diverged from the optimal tax amnesty because it was not offered as part of a package of tax reforms that would

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286 *Supra* Part II.B.

287 *But see* Charles I. Kingson, *The Great American Jobs Act Caper*, 58 TAX L. REV. 327, 388 (2005) ("New section 965 goes beyond sanctioning deferral of low-taxed foreign earnings until repatriation. It sanctions exemption of such earnings by reason of repatriation.").

288 *Supra* Part IV.C.

289 Altshuler et al., *supra* note 135.

290 *See id.* BRUMBAUGH, *supra* note 3, at 8 ("[A] temporary cut in taxes on repatriation may stimulate a temporary increase in repatriations but . . . a permanent tax cut . . . will have no effect."). *But see* Desai, et al., *supra* note 135 (concluding that repatriation taxes reduce aggregate dividend payouts from foreign corporations to their U.S. affiliates by 12.8%).

eliminate the behavior for which amnesty was being offered—namely, deferral. Section 965's compromise between full taxation on the one hand, and exemption on the other, however, does represent a decidedly different approach to dealing with deferral than the compromise between passive and active income currently found in subpart F. Nonetheless, because an optimal tax amnesty should be a unique, one-time event, Section 965 offers little in the way of a long-term solution to the deferral problem.

B. *Signaling Greater Enforcement*

Because section 965 did not portend reform of the rules that permit the deferral of active foreign business income of CFCs, it had no signaling effect to taxpayers in this regard. Nor did Section 965 signal a change in enforcement with respect to preventing deferral. In the first place, absent an accompanying reform of the rules, deferral of active foreign business income by CFCs remains legal. The passage of section 965 could not, therefore, have signaled more vigilant enforcement of laws prohibiting deferral, because no law prohibits it.

Second, even with respect to illegal transfer pricing, which has greatly augmented the magnitude of the deferral problem, there were no publicly announced efforts to step up enforcement in connection with section 965's offer of repatriation amnesty. In fact, the industries having the greatest concentrations of intangible assets and, thus, the best opportunity to illegally shift income offshore, were the biggest beneficiaries of section 965.[291]

C. *Uniqueness*

Congress clearly indicated that it expected section 965 to be a one-time provision. As the Conference Report states: "The conferees emphasize that this is a temporary economic stimulus measure, and that there is no intent to make this measure permanent, or to 'extend' or enact it again in the future."[292] Whether or not this will be the case remains to be seen, but there are skeptics and they have reason to be doubtful that Congress will not again enact a repatriation tax amnesty.[293]

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291 *See infra* Appendix A. *See supra* notes 131-132 and accompanying text. Indeed, the largest U.S. drug companies repatriated a total of $98 billion of profits from foreign subsidiaries in calendar year 2005. *See* Sullivan, *supra* note 62, at 284.

292 H.R. REP. NO. 108-755, at 314 (2004) (Conf. Rep.); H.R. REP. NO. 108-548, pt. 1 (2004) (Conf. Rep.).

293 *See, e.g.*, Sullivan, *supra* note 62, at 284 ("But there is no reason—except shame—to keep Congress from breaking that promise. So don't be surprised if lobbyists soon start making a case for a

First, notwithstanding the caveat in the Conference Report, Congress stopped short of including language in section 965 that would have precluded the statute from being extended or enacted again in the future. Even if Congress had done so, however, it is unlikely that such a provision would withstand constitutional scrutiny. Legislative attempts to bind a successor legislature generally are regarded as "inconsistent with the democratic principle that present majorities rule themselves."[294] Indeed, existing Supreme Court precedent appears to regard as axiomatic the principle that a legislature may not enact "entrenching" rules (i.e., rules that that are binding against subsequent legislative action in the same form).[295]

Second, Congress previously has enacted tax legislation that was intended to be temporary but that became rooted in the Code. For example, the "temporary" research credit—like section 965—was intended to be a provisional boon to an ailing economy. The credit was enacted in 1981 and was set to expire at the end of 1985.[296] More than twenty years later, however, the "temporary" credit remains part of the Code.[297] More generally, the prolific use of "extenders" and "sunsets" in tax legislation since the late seventies has produced dozens of provisions that appeared temporary when enacted but are likely to remain in force long after their initial expiration.[298]

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repeat of the allegedly unrepeatable Jobs Act."); Kingson, *supra* note 287, at 388 ("Although the conferees emphasize that this is a one-time provision, any teenager knows what 'just this once' means."); Lee A. Sheppard, *Do-It-Yourself Repatriation*, 105 TAX NOTES 282, 287 (2004) (predicting that Section 965 will become a permanent feature of future tax "extenders" bills).

294 Michael J. Klarman, *Majoritarian Judicial Review: The Entrenchment Problem*, 85 GEO. L.J. 491, 508 (1997).

295 *See* United States v. Winstar Corp., 518 U.S. 839, 872-74 (1996); John C. Roberts & Erwin Chemerinsky, *Entrenchment of Ordinary Legislation: A Reply to Professors Posner and Vermeule*, 91 CALIF. L. REV. 1773 (2003). *But see* Eric A. Posner & Adrian Vermeule, *Legislative Entrenchment: A Reappraisal*, 111 YALE L.J. 1665 (2002) (arguing that entrenchment is both constitutionally permissible and, in appropriate circumstances, normatively attractive). This concern is not necessarily present for states that enact amnesties. For example, Georgia legislatively mandated that its first amnesty would be its only one. *See* Christian, et al., *supra* note 188, at 704.

296 *See* STAFF OF THE J. COMM. ON TAXATION, 97TH CONG., GENERAL EXPLANATION OF THE ECONOMIC RECOVERY TAX ACT OF 1981 17 (Comm. Print 1981) (reflecting Congress's concern that "the performance of the economy had fallen far below its potential."). Section 965 and the research credit are similar in several respects. Just as Congress believed section 965's lower dividend tax rate was needed to trigger repatriation in the face of residual U.S. taxation, so Congress believed that the research credit was needed to "overcome the reluctance of many ongoing companies to bear the significant costs . . . incurred to initiate or expand research programs in a trade or business." *Id.* at 120. And just as section 965 favored only "extraordinary dividends," the research credit was available only for "increases in qualified research expenditures." *Id.*

297 I.R.C. § 41.

298 *See generally* Rebecca M. Kysar, *The Sun Also Rises: The Political Economy of Sunset Provisions in the Tax Code*, 40 GA. L. REV. 335, 359 (2006) (noting that according to a 2003 Congressional

Experience indicates most governments have not been able to withstand the temptation to reenact tax amnesties. Most foreign countries that have implemented tax amnesties have done so more than once; the experience in the United States has been similar.[299] It is likely that Congress will face substantial lobbying pressure to reenact section 965. In fact, the Tax Relief Coalition, a group that claims to represent more than 1.8 million businesses in the United States, began lobbying Congress to make section 965 permanent within a year of its enactment and well before the opportunity to repatriate foreign earnings under that provision had expired.[300]

D. *Fairness*

An optimal tax amnesty would avoid taxpayer perceptions of unfairness by waiving only criminal prosecution for tax evasion (rather than penalties or interest) and not allowing amnesty to those already under investigation for tax evasion. Applying these criteria to a provision like section 965 is difficult because although tax evasion is illegal, tax deferral is not. Thus, corporations avoiding U.S. tax on foreign earnings by retaining those earnings in foreign subsidiaries do not face criminal prosecution or pay penalties or interest for their actions.

Nonetheless, the taxpaying public may still perceive section 965 as an unfair giveaway to corporations. The American Jobs Creation Act of 2004 and section 965 became law at a time of deep, lingering skepticism about the integrity of American corporations. Following the Enron bankruptcy November 2001, Wall Street was severely shaken by an unprecedented string of new accounting fraud scandals involving publicly traded corporations.[301] After a brief period of relative calm, another wave of scandals broke in 2005 involving the widespread corporate practice of backdating stock option grants in order to enrich corporate executives.[302]

Research Service report, in the twenty-five years that extenders had then been in use, Congress had allowed only one to expire).

299 *Supra* Part IV.C.3.

300 *See* Letter from Tax Relief Coalition to Congress (Oct. 21, 2005), *available at* http://www.freedomworks.org/informed/issues_template.php?issue_id=2384 (noting 2006 expiration of section 965 and urging Congress to make it permanent). The American Jobs Creation Act of 2004 (and section 965) was signed into law in October, 2004. American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat 1418 (2004).

301 *See* Craig M. Boise, *Playing With "Monopoly Money": Phony Profits, Fraud Penalties and Equity*, 90 MINN. L. REV. 144 (2005). More than fifty major publicly traded corporations were under investigation for accounting fraud and other financial misdeeds in 2002 alone. *See* Gary Stoller, *Funny Numbers*, USA TODAY, Oct. 21, 2002, at B3.

302 As of this writing, over 80 companies are under investigation by the SEC for stock option backdating, with the FBI conducting 45 criminal probes and the IRS examining 40 cases. *See* Bloom-

In this environment, the taxpaying public is likely to take a dim view of a Code provision that grants a huge tax break to U.S. multinationals that have been holding hundreds of billions of dollars of foreign earnings offshore in order to avoid U.S. taxes. The director of Citizens for Tax Justice, an organization that purports to "give ordinary people a greater voice in the development of tax laws" described section 965 as "[giving] money to corporations in return for corporate contributions."[303] The former chief of staff of President George W. Bush's Council of Economic Advisors was quoted as saying about section 965 "you might as well have taken a helicopter over 90210 [a Beverly Hills Zip code] and pushed the money out the door."[304] Although anecdotal, these statements suggest that to the extent taxpayers are aware of section 965, they will not view it as fair.

Apart from insuring substantive fairness, the government offering the optimal tax amnesty also would take steps to assure the public of its equity. Congress clearly did this by requiring that taxpayers use foreign earnings repatriated under section 965 for a purpose likely to be viewed as imminently fair by most taxpayers: the creation and retention of jobs. However, it is now apparent that the number of jobs likely to be created by section 965 was grossly overestimated.[305] Worse, a number of corporations repatriating foreign earnings reported using the cash to finance the elimination of American jobs.[306]

On balance, it is likely that section 965 did little to enhance taxpayer perceptions that the tax system is fair, and may actually have damaged voluntary compliance as a result.

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berg News, *More Than 100 Firms Afflicted with Options Woes*, CHI. TRIB., Aug. 11, 2006, at C5; Eric Dash, *I.R.S. Reviewing Companies in Options Inquiries*, N.Y. TIMES, July 28, 2006, at C1.

303 Michelle Leder, *The $104 Billion Refund*, SLATE, Apr. 13, 2006, *available at* http://www.slate.com/id/2139782.

304 Allen Sloan, *Ford Takes a Tax Holiday For "Jobs Creation"*, WASH. POST, Jan. 25, 2006, at D2.

305 Foreign earnings repatriated under section 965 were expected to generate thousands of new U.S. jobs; some estimates ran into the hundreds of thousands. *See, e.g.*, Allen Sinai, *Macroeconomic Effects of a Temporary Reduction in the Tax Rate on Repatriation of Foreign Subsidiary Earnings*, AM. COUNCIL FOR CAP. FORMATION CTR. FOR POL'Y RES. (Oct. 21, 2003) (predicting that section 965 would create 666,000 by the second year after enactment). There were skeptics, however. The chairman of New York Investment Company, Holland & Co. remarked, "Selling the bill based on an increase in jobs is symptomatic of the political silly season." Glen R. Simpson & Gregory Zuckerman, *Tax Windfall May Not Boost Hiring Despite Claims — Some Companies Plan to Use New Break on Foreign Profits For Debt and Other Needs*, WALL ST. J., Oct 13, 2004, at A1. Even before the President signed the American Jobs Creation Act and section 965 into law, it had become apparent that the legislation would produce, at best, only a fraction of the number of new jobs that it had been expected to generate. Prominent Wall Street economist Allen Sinai, one of the bill's biggest backers, slashed his estimate of the new jobs that would be created to 50,000 only days after Congress passed the AJCA. *See id.*

306 *See infra* Appendix A.

E. *Revenue Indifference*

The final characteristic of the optimal tax amnesty is that it should not be relied upon to raise revenue. Assessing section 965 in this regard is complicated by the fact that it resembles a type of tax amnesty for which there are two potential measures of revenue generation. Governments generally implement tax amnesties in order to raise tax revenue from previously unreported income. As noted in Part IV.B.1, however, a tax amnesty also may aim primarily to induce repatriation of offshore capital, with the generation of tax revenue being of secondary importance. Thus, there are two potential measures of revenue generation—repatriated dividends, and the taxes collected on repatriated dividends—to consider in determining what Congress relied on section 965 to achieve.

It is clear from the legislative history of section 965 that Congress principally expected the provision to stimulate investment in research and development, infrastructure, and job retention and creation.[307] Through the end of the 2005 calendar year, foreign subsidiaries of U.S. multinationals repatriated approximately $217 billion.[308] By mid-2006, it was estimated that foreign subsidiaries taking advantage of section 965 ultimately would repatriate between $300 and $400 billion in total.[309] Thus, section 965 appears to have achieved the objective of generating substantial onshore divi-

307 *See* H.R. Rep. No. 108-548, at 146 (2004) ("The Committee believes that a temporary reduction in the U.S. tax on repatriated dividends will stimulate the U.S. domestic economy by triggering the repatriation of foreign earnings that otherwise would have remained abroad."); I.R.C. § 965(b)(4)(B).

308 *See* BD. OF GOVERNORS OF THE FED. RESERVE SYS., FEDERAL RESERVE STATISTICAL RELEASE: Z.1, FLOW OF FUNDS ACCOUNTS FOR THE UNITED STATES 13 tbl. F.7 (June 8th, 2006), *available at* http://www.federalreserve.gov/releases/z1/20060608/z1.pdf (last visited Dec. 18, 2006). The last date on which a U.S. shareholder theoretically could have received a deductible dividend was September 30, 2006. *See* I.R.C. § 965(f).

309 *See* Gertrude Chavez-Dreyfuss, *U.S. Earnings Repatriation Unlikely to Boost Dollar*, REUTERS (Oct. 25, 2005), *available at* http://today.reuters.com/business/newsarticle.aspx?type=tnBusinessNews &storyID=nN25552048 (last visited Dec. 18, 2006) (estimating repatriation flows will total $300-400 billion); Am. Shareholders Ass'n, *ASA Repatriation Scorecard: $217 Billion Repatriated Back to America, At Least Another $100 Million On Its Way*, 1, 1 (Mar. 20, 2006) (citing Int'l Strategy & Inv. Group, *ISI Portfolio Strategy Report*, 1, 3 (Mar. 3, 2006)), http://www.americanshareholders.com/news/asa-rep ats-03-20-06.pdf (estimating total repatriation of $325 billion). These values exceeded the expectations of at least one analyst who projected that only about 35-48% of the roughly $420 billion in foreign earnings eligible for repatriation would find their way back to the United States. *See* Elliot Blair Smith, *Tax Breaks Let Firms Repatriate Profits*, USA TODAY, Jan. 11, 2005, at 1B. *See infra* Appendix A for a list of the Fortune 100 corporations that reported repatriating foreign earnings under section 965 and the amounts that they had repatriated as of this writing.

dend flows, notwithstanding that a substantial percentage of U.S. multinationals did not take advantage of the provision.[310]

But apart from securing foreign earnings to jumpstart investment in the domestic economy, section 965 was also expected to generate tax revenues. It is not yet clear what the impact of section 965 will be in this regard, but there have been several estimates of the potential windfall resulting from implementing section 965. Goldman Sachs initially estimated that the U.S. Treasury would reap $2.8 billion in tax collections.[311] A study analyzing the potential tax savings under section 965 for corporations reporting eligible foreign earnings concluded that those firms would pay total incremental tax of $7 billion if they repatriated their foreign earnings.[312] Figures quoted on the Senate floor were as high as $12 billion.[313]

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310 For a variety of reasons, many companies simply opted not to repatriate earnings. Xerox, for example, indicated it did not perceive any "material benefit" from section 965 and thus would not likely send any of its foreign earnings home. *See* Don Durfee, *Out of Exile*, CFO MAG., July 1, 2005, *available at* http://www.cfo.com/article.cfm/4124842/c_4125297?f=magazine_alsoinside. In some cases, companies preferred the potential returns on investment opportunities in emerging markets abroad to opportunities in the United States. *Id.* General Electric chose to continue to deploy all but $1.2 billion of its estimated $14 billion in foreign earnings abroad rather than repatriate them. *Id.*

In other cases, the tax treatment of a particular industry made repatriation under section 965 difficult. For tax years beginning after December 31, 1998, financial services income was specifically excluded from the definition of "foreign personal holding company income" on which U.S. shareholders of controlled foreign corporations are currently taxable. *See* I.R.C. § 954(c), (h). Before January 1, 1999, however, banks were unable to defer taxation on financial services income earned by their subsidiaries, and thus typically repatriated those earnings. The resulting high base period dividend threshold made it difficult for controlled foreign subsidiaries of banks to pay the "extraordinary" dividends given favorable treatment under section 965. Nonetheless, financial institutions benefited greatly from section 965 by providing the liquidity necessary for repatriation of earnings by corporations that were able to take advantage of the provision. *See* Blessing, *supra* note 147, at 965 (describing section 965 as a "bonanza for bankers of every stripe.").

Where a U.S. corporation shared ownership of a controlled foreign corporation with a significant minority shareholder (as in a joint venture situation), the minority shareholder might have objected to the use of cash to pay a dividend. The 5.25% tax paid on the repatriated dividends, although significantly lower than the otherwise applicable 35% rate, would still have reduced earnings per share and potentially affected a corporation's stock price. *See* Lee A. Sheppard, *Repatriation Provision Not Beneficial to All Comers*, 105 TAX NOTES 1323 (2004). Still other companies may simply have found compliance with the restrictions on uses of the repatriated earnings more trouble than they were worth. *See* Don Durfee, *Out of Exile*, CFO MAG., July 1, 2005, *available at* http://www.cfo.com/article.cfm/4124842/c_4125297?f=magazine_alsoinside.

311 *See* Smith, *supra* note 309, at 1B.

312 *See* Albring et al., *supra* note 57, at 655. The study identified 678 corporations (from among all U.S. publicly traded corporations) that reported foreign assets or foreign sales in 2002. *Id.* Of those firms, only 282 reported a foreign tax rate lower than 35% (firms with foreign tax rates higher than 35% would not benefit from section 965; they would receive a full foreign tax credit and thus would not, in any event, pay any incremental U.S. tax on dividends). *Id.* These 282 corporations reported an aggregate $318 billion of permanently reinvested earnings eligible for repatriation. *Id.* Assuming application of a

Whatever the precise amounts, these figures represent only the short-term revenue likely to be raised by section 965. They do not account for the loss of revenue that otherwise would be collected on repatriated foreign earnings taxed at normally applicable rates. In other words, as is the case with all amnesties, section 965 accelerated the collection of future tax revenue into the amnesty period. However, because section 965 taxed repatriated dividends at a rate that was much lower than the normal rate, it will have produced a net present value increase to government revenues only if the amount of tax collected during the amnesty period is higher than the present value of future tax revenue generated from repatriated dividends taxed at normal rates.[314]

In sum, with respect to revenue effects, section 965 comes close to tax amnesty optimality because it principally was intended to stimulate domestic investment, as opposed to raising tax revenues. Nonetheless, the deferral problem is, first and foremost, a problem of deferred tax revenue, and a solution that forfeits most of that revenue is open to serious criticism as a matter of tax policy.

CONCLUSION

The deferral of U.S. taxation on the foreign earnings of U.S. multinationals operating through controlled foreign subsidiaries represents a significant loss of tax revenue. That loss will continue to grow in magnitude with the globalization of U.S. business, and, in particular, the foreign expansion of the pharmaceutical and technology sectors, which are uniquely situated to exploit the weak U.S. transfer-pricing regime. The legacy of the various anti-deferral regimes implemented since the inception of the income tax is a set of compromises that proscribes deferral for passive and highly mobile types of income, but permits it for active foreign business income.

By contrast, section 965 represented a novel approach to dealing with the deferral problem in that it sought to encourage a voluntary end to deferral by temporarily reducing the tax rate applicable to repatriated dividends. As in the case of the tax amnesties it resembles, the success of a provision

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foreign tax credit based on a 20% foreign tax rate, the study derived a 2.25% effective incremental U.S. tax rate on repatriated earnings. *Id.*

313 150 CONG. REC. S3527-3528 (daily ed. Apr. 1, 2004) (statement of Sen. Smith).

314 *See* Albring et al., *supra* note 57, at 655, n.2. Of course, if U.S. multinationals would never have repatriated foreign earnings absent the incentive offered by section 965, then the revenue generated by the provision is a net windfall to the U.S. Treasury. *Id. See also* Altshuler et al., *supra* note 135 (concluding that "repatriation taxes do affect dividend repatriation behavior but only to the extent that tax rates vary over time.").

like section 965 depends on balancing costs and benefits of tax amnesties in a way that preserves the perceived integrity and fairness of the tax system.

Section 965 diverged from tax amnesty optimality, however, by virtue of not being part of a package of tax reforms that would end deferral, the problem for which amnesty was the proffered solution. Nor did section 965 signal a change in enforcement with respect to preventing either deferral or the illegal transfer pricing that has most significantly increased the deferral problem. In fact, section 965 provided the greatest benefit to the industries having the largest concentrations of intangible assets and, thus, the best opportunity to illegally shift income offshore.

Moreover, section 965 almost certainly did damage to public perceptions of fairness in the tax system by selling its provisions as “job creation” while ultimately benefiting even those corporations that used repatriated earnings to eliminate American jobs. In the end, many taxpayers who were aware of section 965 viewed it as a corporate giveaway.

Whether section 965 represented a unique event, or merely the first in a series of frequently repeated amnesty-type repatriation incentives, remains to be seen. However, experience suggests that reenactment of section 965 is almost inevitable. Moreover, it is doubtful that Congress has the ability to structurally restrain the enactment of future amnesties given current legislative entrenchment jurisprudence. Already there have been calls to make section 965 permanent, and given the lobbying muscle of the industries that benefited most from the provision, it seems likely that pressure to reenact section 965 will grow over the next several years. Reenacting section 965 would severely undercut any benefits that might have been gained from its initial passage.

Finally, consistent with the optimal tax amnesty, section 965 was not enacted principally to generate tax revenue. Instead, Congress was primarily motivated by a desire to create an infusion of capital into the U.S. economy in the form of repatriated foreign earnings without regard to the tax revenue generated.[315] Nonetheless, in the final analysis, this may have been the chief shortcoming of section 965. Deferral is a problem precisely because of the substantial tax revenue from the foreign earnings of U.S. multinationals that is forfeited while those earnings remain offshore. Section 965’s proposed solution salvages only a nominal portion of this lost tax revenue at the price of reinforcing the legitimacy of the deferral privilege.

Given the hazards they create, Congress would be well-advised to abandon the use of amnesty-like provisions for any purpose other than to provide transition relief in connection with the complete elimination of deferral. As the experience with section 965 indicates, such provisions may

315 *See supra* Part III.A.

well break open offshore piggybanks, but they do so in exchange for what, in terms of tax revenue, may be only a "few measly cents."

APPENDIX A

2006 FORTUNE 100 RANK	COMPANY (USE OF REPATRIATED FUNDS)	AMOUNT
4	Ford Motor (10,000 jobs cut in 2005; additional layoffs of 30,000 or more)	Approx. $850M
5	General Electric	$1.2B
10	International Business Machines (IBM)	$9.5B
11	Hewlett Packard (possible $200M debt reduction; cut 15,300 jobs)	$14.5B
14	Verizon Communications	$2.2B
17	Altria Group	$6B
24	Pfizer (acquisitions; 20 factory closings)	$36.7B
25	Boeing	$426M
26	Proctor & Gamble (acquisition of Gillette; cut 5-6,000 jobs at Gillette)	$7.2B
28	Dell (acquire manufacturing facility)	$4.1B
30	Johnson & Johnson	$10.8B
34	Dow Chemical	Up to $2.5B
36	Morgan Stanley	$4B
39	United Technologies	$500M
46	Safeway	$73M
49	Motorola (compensation to non-executive employees, research, marketing, and pension plan payments; cut 750 jobs)	$4.6B
50	Intel (research and development; capital expenditures)	$6.2B
53	Merrill Lynch & Company	$1.8B
54	Walt Disney	Not specified
57	Caterpillar	$500M
61	PepsiCo (possible acquisition of French company Danone; cut 250 jobs)	$7.5B
66	DuPont	$9.1B
70	International Paper	$2.1B
75	Honeywell International (cut 2,000 jobs)	$2.2B

2006 FORTUNE 100 RANK	COMPANY (USE OF REPATRIATED FUNDS)	AMOUNT
84	Merck (cut 7,000 jobs)	$15.9B
91	Cisco Systems	$1.2B
92	Coca-Cola	$6.1B
93	Bristol-Myers Squibb	$9B
100	Abbott Laboratories (fund pension obligations)	$4.3B

Sources: *Abbott Expects Jump In '06 Earnings; Numbers Aggressive One Analyst Cautions*, CHI. TRIB., Dec. 16, 2005 at C3 (Abbott Laboratories); A*erospace Manufactures Report Results*, N.Y. TIMES, July 21, 2005, at C4 (Honeywell International); Michael Arndt, *Profits Head Homeward, But Where Are the Jobs?*, BUS. WEEK, Aug. 1, 2005, at 34 (Pfizer, Johnson & Johnson, Bristol-Myers Squibb); Boeing Co., Form 10-K (fiscal year ended Dec. 31, 2005), *available at* http://www.sec.gov/Archives/edgar/data/12927/000119312506040952/d10k.htm (Boeing); Don Durfee, *Out of Exile*, CFO MAG., July 01, 2005, *available at* http://www.cfo.com/article.cfm/4124842/c_4125297?f=magazine_alsoinside (Dell); Global Business Briefs, WALL ST. J., May 13, 2005 (International Paper); Leonard Grimando, *Ratings Implications Of Earnings Repatriations Under The American Jobs Creation Act*, Standard & Poor's Research Service, June 26, 2006 (General Electric, IBM, Hewlett Packard, Verizon Communications, Altria Group, Pfizer, Proctor & Gamble, Johnson & Johnson, Dow Chemical, Motorola, Intel, Merrill Lynch & Company, PepsiCo, DuPont, International Paper, Honeywell International, Cisco Systems, Coca-Cola, Bristol-Myers Squibb); Mike Hughlett, *Motorola Plans to Repatriate $4.4 Billion*, CHI. TRIB. Aug. 11, 2005 at C3 (Motorola, Caterpillar); Dori Levanoni & Ghene Faulcon, *A Flow of a Different Color*, FX MONITOR (Mar. 2005), *available at* www.firstquadrant.com (Safeway); Katherine Reynolds Lewis, *Job Benefits From Overseas Tax Breaks Hard To Find*, NEWHOUSE NEWS SERV., Dec. 19, 2005, *available at* www.newshousenews.com/archive/lewis121905.html (Hewlett Packard, Proctor & Gamble, Intel, Merck); *Morgan Stanley Reports Fourth Quarter and Full Year Results*, BUS. WIRE, Dec. 20, 2005 (Morgan Stanley); Press Release, The Walt Disney Company Reports Results For The Fourth Quarter and Fiscal Year 2005, Nov.17, 2005, available at www.corporate.disney.go.com/investors/quarterly_earnings/2005_q4.pdf (Walt Disney); James Politi & Lina Saigol, *Dealmakers Eye Repatriated Funds*, FIN. TIMES (London), Mar. 29, 2005, at 23 (United Technologies); John Schmeltzer, *Money Washes Ashore, Not Jobs; Act Gives U.S. Firms Billions In Tax Breaks to Bring Profits Home; Critics Say Jobs No Certainty*, CHI. TRIB. May 22, 2005, Zone C, at 1 (Hewlett Packard, Abbott Laboratories); Allen Sloan, *Ford Takes a Tax Holiday For "Jobs Creation"*, WASH. POST, Jan.25, 2006, at D2 (Ford Motor Company); Andrew Ward, *Buoyant PepsiCo to Repatriate Dollars 7.5bn*, FIN. TIMES (London), July 25, 2005, at 25 (PepsiCo).