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ARTICLE: Avoiding Double Taxation and Expatriation: A Comprehensive Solution to FATCA and Corporate Inversion

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TEXT:
[*596] I. Introduction: A Scenario

Imagine this. You live and work in the United States for Samsung, a Korean company. Samsung would like to send you abroad to London for a week so that you can present and sell Samsung's newest and most advanced smartphone to retailers. While in London, you will be staying in a Marriott hotel, paid for by Samsung. Fortunately, you experience success while abroad, selling so many smartphones that your supervisor, traveling with you, decides to give you a bonus of £ 300 cash and a day off to enjoy the city. You do so by meeting up with an old friend of yours who moved from the United States to London last year to open his own restaurant. Your friend's restaurant has proven to be very successful and, accordingly, your friend plans to remain in London permanently to run his business--he does not ever intend on returning to the United States. You spend £ 100 at his restaurant, drinking several glasses of wine imported from California in the process. The next day, you convert the remaining £ 200 to U.S. dollars and return home.

Perhaps the last thing on your mind through this scenario is income taxation. However, the changing dynamics of U.S. and [*597] international law are making income taxation ever more complex and relevant to personal and business decision making. [n1] You may be surprised to learn that the Marriott and the company that sold the California wine both likely owe income taxes not just in the United Kingdom, where these transactions took place, but also in the United States, since they are each U.S. companies. [n2] Samsung, meanwhile, owes nothing in U.S. taxes, even though it does have locations within the United States, and even though its U.S. employees conducted these transactions, because it is a Korean corporation. [n3] And while it may not be shocking to learn that you, a U.S. citizen, owe income taxes to the United States on your entire £ 300 bonus (despite the fact that it was wholly earned and partially spent abroad), it may be quite surprising that your expatriate friend who owns the restaurant in London will probably owe income taxes in both the United Kingdom and the United States, even though he permanently moved to the United Kingdom and his restaurant is located in the United Kingdom. [n4]

[*598] Why would the Marriott and the California-based wine company owe U.S. income taxes on income earned in the United Kingdom? Presumably, they have concrete and long-term business arrangements in the United Kingdom; these are probably not isolated transactions. Likewise, why would your friend who owns the restaurant in London owe income taxes to the United States? He moved to London to open a business and he has no intentions of ever returning to the United States--he is domiciled in the United Kingdom. [n5] The short and simple answer to both of these questions, to be explored in more detail below, is relatively straightforward: the United States, unlike most other countries, [n6] requires both its individual citizens and its corporations to pay income taxes on all income, regardless of whether that income is earned within the borders of the United States or in a foreign country. [n7] Moreover, international law is both permissive and conducive to this system of [*599] taxation.

This taxation scheme has not changed recently, [n8] so why are these issues being discussed now? The answer is that new laws and developments are rendering these issues more and more relevant--and contentious. Regarding the taxation of individual U.S. citizens earning income abroad, the implementation of the Foreign Account Tax Compliance Act ("FATCA"), [n9] which was passed in 2010 but went into effect in July of 2014, is transforming the dynamics of the United States' ability to enforce its rules internationally. In addition to new regulations and requirements, FATCA imposes a rather controversial (and extraterritorial) provision that mandates foreign financial institutions ("FFIs"), [n10] that is, financial institutions situated outside of U.S. jurisdiction, to report all information about accounts held by U.S. persons to the United States. [n11] If FFIs fail to comply, they become subject to a thirty percent tax on all "withholdable payments." [n12] The United States is largely able to [*600] enforce this permeating law through treaties that require participating nations to ensure that their financial institutions are, in fact, reporting on U.S. accounts. [n13] While the intent behind FATCA was not malicious, [n14] it is having disastrous effects, leaving thousands of expatriates without any ability to own bank accounts or consume any sort of financial services abroad, [n15] placing a heavy burden on expatriates, FFIs, and the Internal Revenue Service ("IRS") to process the new reporting requirements, [n16] and leading to a record-breaking number of citizenship renunciations. [n17]

Concerning the taxation of U.S. corporations earning income abroad, the relevancy and contentiousness of the issue has grown recently due to the proliferation of a phenomenon commonly referred to as corporate inversion. [n18] Corporate inversion is a paper-only transaction that takes place when a U.S.-based multinational corporation relocates abroad--and outside of U.S. jurisdiction--by either reincorporating in a foreign country or merging with a foreign [*601] company. The principal objective of an inversion is to help the U.S. corporation avoid U.S. taxation on income earned abroad. As soon as a corporation reorganizes elsewhere, the United States has no legal grounds to tax the corporation's income earned outside of the United States. [n19] While the United States may attempt to forge bilateral and multilateral treaties to develop a basis for enforcement and discouragement of these types of transactions, [n20] such efforts have generally been unsuccessful and foreign countries may have incentives to avoid entering into such agreements. [n21] The vast expansion of the use of inversions, and thus the growing importance of the matter, is apparent in the numbers: prior to 2004, there were fewer than thirty total inversions, but since 2004, over forty-seven U.S. companies have inverted; [n22] since 2011 alone, twelve large U.S. companies have inverted; [n23] as of August 2014, fourteen major inversion deals were completed or were in the works. [n24] Furthermore, over the course of ten years, corporate inversions are estimated to cost the United States approximately twenty billion dollars in lost revenue. [n25] The mechanics of inversions are explored [*602] below.

The troubles that have accompanied the taxation of American citizens and corporations on income earned abroad have inspired a number of proposals aimed at fixing the underlying causes of these problems. These proposals range from adopting a residence-based taxation system (a system that does not tax foreign earnings at all) to an overhaul in the rates and reporting requirements on foreign-generated income that Americans must abide by, among others. [n26] This Comment will present and analyze the major and most feasible proposals that are aimed at large-scale solutions.

While practicable proposals to solving these issues do exist, in this Comment I propose a different approach: a tax system based entirely upon "actual residency" and international cooperation. For individuals, actual residency refers to domicile--where one lives combined with where one intends to remain permanently. [n27] For corporations, actual residency refers to "primary place of management and control," [n28] a concept commonly used in bilateral tax treaties with regard to corporations, [n29] which looks to where the day-to-day strategic, operational, and financial management of the company is located. [n30] Simply put, the actual residency test calls for the taxation on income earned abroad to continue for both individual citizens and corporations, so long as actual residency (domicile or management/control) is within the United States. If actual [*603] residency is outside of the United States, income earned abroad should not be subject to U.S. income tax. Place of citizenship or incorporation is irrelevant. For example, a citizen living abroad with an intent to remain abroad permanently will not have to pay U.S. taxes on her income solely because she is a U.S. citizen. Contrarily, a citizen (or noncitizen) domiciled in the United States that is merely traveling abroad with an intent to return to the United States at some point will have to pay U.S. taxes on her income earned abroad. Likewise, a corporation that reincorporates and actually relocates its significant management and strategic operations abroad will not be subject to U.S. taxation on income earned abroad. However, a corporation that merely "relocates" elsewhere by virtue of a merger or reincorporation, but still handles its major management operations (for all intents and purposes) within the United States, will be required to pay U.S. taxes on worldwide income. International cooperation will be key to the test's implementation, as the United States cannot single-handedly enforce these new guidelines, and because this change would have major effects worldwide. The goal of the actual residency test is to discover where citizens and corporations are truly located, and subject to U.S. taxes only those who derive a sufficiently large advantage from their status as U.S. citizens and corporations (those who live and/or operate in the United States). It also renders more difficult the avoidance of U.S. tax obligations, which today could be achieved merely via citizenship renunciation or reincorporation abroad. Overall, the actual residency test would maximize fairness and equity while generating a great deal of revenue and preserving the general policy goals of the current U.S. taxation scheme. The actual residency test also abides by international law and would likely be welcomed by the international community, [n31] in turn making international cooperation with this approach both more feasible and more administrable. Of course, income earned within U.S. borders should continue to be taxed by the United States, as it is now.

Following this Introduction, Part II of this Comment will provide a more detailed focus on individual international taxation [*604] and FATCA. It will discuss the background and history of the policy, FATCA's intricacies and provisions, international implications, strengths and weaknesses, and proposals. Part III will follow suit with a similar discussion of the phenomenon of corporate inversion, including background, history, structure of the transactions, international effects, and proposals aimed at solving the problem. In Part IV, I will attempt to bring together these issues that initially appear distinct, explaining why they are in some regard "two sides of the same coin," so to speak. I will follow by discussing my proposal, one based on actual residency and international cooperation, to solve both of these issues and leave all parties, including U.S. citizens and companies, as well as the international community at large, better off.

II. FATCA

A. Background of Global Citizenship Taxation

Generally speaking, being a citizen of a particular country not only entitles a person to certain rights and privileges, but also places obligations and duties upon the person. [n32] The United States has made a policy decision to use citizenship as grounds for income taxation, regardless of where taxable income is generated. [n33] For most U.S. citizens, global taxation may be inconsequential, as most reside and earn income within the United States. [n34] However, for U.S. citizens that live and work abroad, this means paying income taxes in more than one jurisdiction, dealing with burdensome filing requirements, and several other impediments [n35]--all without deriving the core benefits of citizenship (or, at least, deriving only relatively insignificant benefits).

Most countries do not consider citizenship in imposing taxation, [*605] instead opting for a system that bases taxation solely upon where income is earned. [n36] The United States, however, has been taxing worldwide income since as early as 1861. [n37] The policy behind the taxation was not only to raise revenue, but also to have citizens residing abroad compensate the country for their failure to effectively contribute to the Union. [n38] These citizens were thus taxed at higher rates than citizens living in the country. [n39] Three years later, the disparity in tax rates was eliminated, though Congress continued to apply taxes to "every person residing in the United States, or [to] any citizen of the United States residing abroad . . . ." [n40]

In a 1913 Act, Congress chose to continue using this approach, taxing "every citizen of the United States, whether residing at home or abroad" on "the entire net income" arising or accruing from all sources. [n41] The key difference between that law and today's law, however, was that a citizen then was presumed to abandon her citizenship if she resided abroad for an extended period of time (essentially becoming domiciled in a foreign nation), unless she overcame a presumption of abandonment with "satisfactory evidence." [n42] Non-payment of taxes, interestingly enough, was a [*606] factor indicating abandonment of citizenship. [n43] In other words, moving abroad and failing to pay U.S. taxes meant forfeiting citizenship and, thus, the elimination of any obligation to pay U.S. taxes.

The U.S. Supreme Court paved the way for today's global taxation approach in two key rulings. In Cook v. Tait, [n44] the Court recognized the legality of subjecting U.S. citizens living abroad to the same taxation as those residing in the United States. [n45] Later, in Afroyim v. Rusk, [n46] the Court rendered the ability to legally skirt the requirement to pay taxes on income earned abroad (by simply not paying them) [n47] more difficult, ruling that the Fourteenth Amendment provided that a person may not lose citizenship merely by way of some particular action (or inaction) in which the person does not manifest an express intent to forfeit citizenship. [n48] To eliminate the obligation to pay taxes on worldwide income, a person must act to intentionally repudiate citizenship. [n49]

[*607] B. Double Taxation and Its Solutions: Exclusions, Foreign Tax Credits, and Income Tax Treaties

One of the main issues with taxing American citizens earning income abroad is that these citizens are likely already subject to taxation in the foreign country where their income was earned. This gives rise to double taxation, an occurrence in which the same income is taxed twice by two separate governments. [n50] Several reforms have been implemented to deal with this issue, including foreign tax credits, exclusions, and income tax treaties. These reforms have made a tremendous difference on net taxes owed; in 2009, for example, after accounting for foreign tax credits and exclusions, only about nine percent of U.S. taxpayers abroad owed U.S. taxes. [n51] Each of these reforms will be reviewed.

1. Foreign Tax Credits

One method of avoiding double taxation is the foreign tax credit, introduced by Congress in the Revenue Act of 1918. [n52] The goal of the tax credit was to prevent the inequity that double taxation of foreign source income would cause. [n53] Although they have changed significantly since 1918, foreign tax credits are still used today. [n54] Like other income tax credits, foreign tax credits reduce the amount of tax owed on a dollar-for-dollar basis. [n55] This is distinct from deductions, which merely reduce taxable income, not taxes owed directly. [n56]

Essentially, foreign tax credits allow taxpayers to wholly subtract from U.S. tax liability any amount that is paid in foreign income tax to a foreign government. [n57] There are some limitations. [*608] One limitation is that, if the credit is elected, the taxpayer cannot claim deductions for other foreign taxes. [n58] The foreign tax credit applies only to "creditable" foreign income taxes, and generally sales, property, and excise taxes are not creditable. [n59] Another limitation is that the credit must be proportional to the actual U.S. income as foreign taxable income is to total worldwide taxable income. [n60] Lastly, the foreign tax credit cannot reduce tax on income earned in the United States, regardless of how foreign governments choose to treat that income. [n61]

A simple illustration of foreign tax credits, for a better understanding, is as follows: Bob, a U.S. citizen living and working in Italy, has a gross income [n62] of $ 100,000 in 2014. All of Bob's income was earned in Italy. Under these facts, Bob has $ 100,000 subject to income taxation in the United States and $ 100,000 subject to income taxation in Italy. [n63] If Italy's tax rate for Bob is thirty percent, [n64] Bob will owe Italy $ 30,000 in taxes (thirty percent of $ 100,000). Assuming no limitations apply, and that the income discussed here is eligible for a full foreign tax credit, Bob will thereafter be able to deduct the amount of his tax liability to the United States by $ 30,000. If Bob's tax rate in the United States is thirty-five percent, meaning he would otherwise owe $ 35,000 (thirty-five percent of $ 100,000) to the United States, Bob now owes the United States just $ 5000 ($ 35,000 of U.S. tax liability minus $ 30,000 of Italian tax liability, deducted because of the foreign tax credit). The impact of the foreign tax credit could be noted by the fact that without the credit, Bob would owe a total of $ 65,000 in taxes on his $ 100,000 income ($ 30,000 to Italy and $ 35,000 to the United States). Instead, his total tax liability is [*609] $ 35,000.

As this example illustrates, if the U.S. taxes income at a higher rate than the foreign government, foreign tax credits work to limit a taxpayer's total tax liability to what she would otherwise owe the United States. Conversely, if the United States taxes at a lower rate than the foreign government, foreign tax credits eliminate any U.S. tax liability. [n65] Therefore, because of foreign tax credits, U.S. taxpayers paying relatively high tax rates in foreign countries are less affected by the United States' global taxation scheme than taxpayers paying relatively low tax rates in foreign countries.

2. Section 911 Exclusions

Income exclusions present another solution to the problem of double taxation. I.R.C. ß 911(a) provides for two significant exclusions: one for foreign earned income, [n66] and one for housing costs. [n67] The exclusions are available for "qualified individuals," either (a) U.S. citizens that are "bona fide resident[s] of a foreign country or countries for an uninterrupted period which includes an entire taxable year," or (b) U.S. citizens or residents "who, during any period of [twelve] consecutive months, are present in a foreign country or countries during at least 330 full days in such period." [n68]

Under the foreign earned income exclusion, "earned income" is defined by the statute as "wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered . . . ." [n69] Put simply, the exclusion allows a non-resident citizen to exclude all earned income, capped at the delineated figure for that taxable year. The figure for any given year [*610] after 2007 is set according to the cost-of-living index. [n70] The figure for tax year 2014 is set at $ 99,200, which means that all income up to that limit may be excluded as taxable income. [n71] Phrased differently, only income earned in excess of the foreign earned income exclusion ($ 99,200 in 2014) is fully taxable in the United States (subject to other limitations).

The statute governing the housing cost exclusion is complex and significantly more fact-sensitive. Since this section is designed to merely introduce the foreign taxation regime used by the United States, the exact calculations of the housing cost exclusion will not be discussed here. [n72] However, what should be taken away, generally, is that certain housing costs may be deducted from gross income. The rationale behind the housing cost exclusion is that it "represents an estimate of housing costs that taxpayers would incur on housing regardless of whether they decided to live and work abroad." [n73]

3. Income Tax Treaties

Income tax treaties present one more solution to double taxation. [n74] These tax treaties advance a number of goals, including: (1) guaranteeing that "taxpayers of one country will not be subjected to more severe tax treatment" than the taxpayers of the other country; (2) creating avenues for dispute resolution; and, most germane here, (3) the general avoidance of double taxation. [n75] Tax treaties typically regulate tax policy in a number of areas, such as dividends, royalties, interest, and capital gains. [n76] For example, in the Income Tax Treaty between Germany and the United States, the resident country is given the sole power to tax royalties and interest, the source country has a limited right to withhold dividend taxation [*611] up to fifteen percent for individual receipts, and both countries may implement a foreign tax credit with respect to income sourced in the other country. [n77] Treaties help to avoid double taxation in part by regulating which country may tax certain income. [n78] The United States currently has income tax treaties with over sixty foreign countries. [n79]

C. The Necessity, Enactment, and Effects of FATCA

1. Why Was FATCA Enacted?

Though the tax compliance rate is rather high in the United States, [n80] the United States loses hundreds of billions of dollars each year due to unpaid taxes--U.S. companies and individuals in 2006, for example, failed to pay $ 385 billion in owed taxes. [n81] This tax gap [n82] is largely attributed to underpayment, underreporting, and the general failure to file. [n83] Individual income tax is the single largest source of the annual tax gap, responsible for over double that of employment tax, sextuple that of corporate tax, and twenty-two [*612] times that of estate and excise tax. [n84] It is further estimated that offshore tax evasion is responsible for approximately $ 100 billion in lost U.S. tax revenue each year. [n85]

The United States has made several attempts to solve this tax gap issue before. For example, the IRS launched a program under I.R.C. ß 911 known as the Qualified Intermediary ("QI") [n86] program, which required participating FFIs and foreign branches of U.S. financial institutions to maintain records, report income, and withhold taxes for U.S. account holders. [n87] However, the program was rather weak, as it was based only on voluntary participation by financial institutions and had too low of a participation rate to have any substantial effect. [n88] The program was also prone to abuse. [n89] Similarly, other programs launched by the IRS to uncover information and combat the tax gap, including amnesty for voluntary disclosures, [n90] rewards for whistleblowers, [n91] "John Doe" [*613] summons, [n92] and Title 31 subpoenas, [n93] failed to sufficiently solve the problem.

Recognizing the tax gap issue and the shortcomings of previous measures to fix it, Congress enacted FATCA in 2010. [n94] FATCA took a unique approach to taxation enforcement: although the United States cannot enforce its laws in foreign jurisdictions, it is able to forge binding agreements under international law with foreign governments and FFIs that would, in turn, enforce its laws--and subject FFIs to a thirty percent withholding tax should they fail to cooperate. [n95] To that effect, a Treasury Decision publishing the final FATCA provisions recognized the benefits of using these new avenues for tax enforcement:

> U.S. taxpayers' investments have become increasingly global in scope. FFIs now provide a significant proportion of the investment opportunities for, and act as intermediaries with respect to the investments of, U.S. taxpayers. Like U.S. financial institutions, FFIs are generally in the best position to identify and report with respect to their U.S. customers. Absent such reporting by FFIs, some U.S. taxpayers may attempt to evade U.S. tax by [*614] hiding money in offshore accounts . . . . To this end, [FATCA] extends the scope of the U.S. information reporting regime to include FFIs that maintain U.S. accounts. [n96]

FATCA is estimated to produce $ 8.7 billion in tax revenue over a ten-year period. [n97]

2. FATCA's Main Provisions

As outlined above, FATCA did not create the system of American taxation on international income. [n98] Instead, FATCA was principally designed to better enforce such a system (the United States loses as much as $ 100 billion in tax revenue each year due to offshore tax evasion, necessitating an enforcement mechanism like FATCA). [n99] To that end, FATCA's provisions generally address reporting requirements for both individuals and FFIs, in addition to implementing penalties for failure to comply.

One of FATCA's chief and, perhaps, most controversial and extraterritorial provisions, is located in I.R.C. ß 1471. [n100] In sum, ß 1471 requires FFIs to either disclose defined information related to U.S. account holders at the FFI, or, in the alternative, suffer a thirty percent withholding tax on U.S. source income. [n101] Specifically, in order to avoid the thirty percent withholding tax, FFIs must: (1) obtain information regarding accounts at the FFI held by U.S. [*615] persons; [n102] (2) comply with verification and due diligence procedures that the IRS requires to properly identify U.S. accounts; [n103] (3) report annually various information on U.S. accounts to the IRS [n104] (such as the name, address, and tax identification number of each account holder, the account number, account balance or value, gross receipts and gross withdrawals or payments from the account, etc.); [n105] (4) deduct and withhold a tax equal to thirty percent of certain passthru payments [n106] made by the FFI to a recalcitrant account holder [n107] or another FFI; [n108] (5) comply with the requests of the IRS for additional information with respect to any U.S. account held at the institution; [n109] and (6) attempt to obtain a valid and effective waiver of any foreign law that interferes with the requirements set forth in FATCA, if any so exists, and if such a waiver cannot be obtained, close the account. [n110] In some cases, ß 1471 is causing FFIs to shut down all American accounts and turn away American clients rather than incur the costs of locating and reporting on U.S. accounts. This trend, too, will be explored more below.

Another key FATCA provision, found in I.R.C. ß 6038D, creates new requirements as to what individual U.S. taxpayers must disclose on information returns. [n111] Specifically, ß 6038D requires individuals with any interest in "specified foreign financial assets" [n112] that exceed $ 50,000 to attach to an annual tax return the [*616] following information: (1) the names and addresses of the financial institutions that maintain any of the individual's accounts, as well as the number of such accounts, if any so exist; (2) the names and addresses of the issuers of any stocks or securities, as is necessary to identify the class or issue of which each stock or security is a part, if any stocks or securities so exist; (3) in the case of any other instrument, contract, or interest, information necessary to identify such instrument, contract, or interest, and the names and addresses of all issuers and counterparties with respect to such instrument, contract, or interest, if any exist; and (4) the maximum value of each of the assets during the taxable year. [n113] The initial penalty for failure to disclose any of the required information is $ 10,000. [n114] If the situation is not remedied within 90 days of the IRS mailing notice of such failure to the individual, the penalty increases an additional $ 10,000 each thirty-day period, capped at a maximum of $ 50,000. [n115] FATCA also elevated the penalty from twenty to forty percent on understatements of income for any "undisclosed foreign financial asset understatement," [n116] and extended the statute of limitations from three to six years for failure to disclose in certain situations. [n117] [*617] FATCA's new reporting requirements do not affect other filing requirements that were already in place, such as FBAR. [n118] Instead, FATCA simply creates additional disclosure requirements. [n119]

FATCA's third and final major provision closes a tax loophole that, in essence, permitted foreign shareholders receiving dividends from a U.S. company to avoid paying taxes on those dividends. [n120] The investors would use strategies that turned dividends into "dividend equivalents" [n121] by agreeing to swap shares of the company with a financial institution before the company issued dividends. [n122] After the dividend was paid, the swap would be cancelled and the investor would receive back the shares previously owned, plus the dividend equivalent payment. [n123] FATCA eliminates this loophole by treating swap payments as dividends. [n124]

3. FATCA's International Implementation and Enforcement Mechanisms

FATCA is U.S. law--it was passed by Congress with no international representation or consent. How, then, is it able to set [*618] rules that govern persons and entities situated globally, entirely outside of U.S. territory? How are its requirements and penalties enforceable within countries in which the United States lacks any jurisdiction?

As reviewed above, FATCA was designed to improve U.S. tax compliance on income earned abroad by ensuring greater disclosure from U.S. citizens and FFIs. The United States is able to enforce its disclosure requirements on FFIs in several ways. One way is by offering FFIs the opportunity to either reach an agreement with the IRS to disclose U.S. account holder information, or, in the alternative, suffer a thirty-percent withholding tax on all U.S.-source payments. [n125] While this may be presented as a choice that FFIs have (ß 1471 refers to the ability for FFIs to come to an agreement with the IRS), [n126] such a choice, in fact, barely exists. [n127] Exclusion from U.S. markets and a thirty percent tax on U.S. income could be catastrophic for FFIs, virtually compelling FFIs to comply--FATCA has even been referred to as "America's Big Stick." [n128] While many FFIs are dropping American clients entirely to avoid the headache of FATCA's reporting requirements, [n129] tens of thousands of FFIs are choosing to comply, [n130] proving that the thirty percent withholding penalty or the risk of losing all American customers is enough to render FATCA enforceable.

[*619] Another way the United States is able to enforce FATCA's disclosure requirements, and somewhat of an extension of the agreement method, is to require FFIs that reached the aforementioned agreement to withhold payments

to FFIs that have not reached such an agreement with the IRS. [n131] This way, instead of withholding only U.S. income, which may not affect some FFIs, the tax withholding extends to income derived from FFIs that are themselves FATCA compliant, reaching distinct, non-compliant FFIs. This provision may also discourage compliant FFIs from doing business with non-compliant FFIs, so as to not be required to withhold tax, a potential administrative burden.

Another way the United States is able to enforce its law on FFIs is by reaching agreements with foreign governments. The pioneer of such agreements came in February of 2012, when the Treasury Department, along with France, Germany, Italy, Spain, and the United Kingdom, issued a statement announcing that the six governments would work together to pursue implementing legislation in each of the FATCA partners' [n132] countries that would require FFIs located therein to collect and report information required by FATCA. [n133] After the information is collected, each FATCA partner would transfer the reported information to the United States. [n134] In exchange, the United States would agree to eliminate the obligation of every affected FFI to enter into a separate agreement with the IRS and allow FFIs to report information to the FATCA partner (rather than directly to the IRS), among other stipulations. [n135] As of this writing, over one-hundred countries have [*620] signed agreements with similar terms with the United States, [n136] including countries that might otherwise have been expected to resist compliance, such as Russia, China, and traditional tax havens. [n137]

While many, if not most, individual citizens' disclosures will be made by FFIs (due to the aforementioned systems in place), citizens also have an incentive to disclose information on their own. As stated, citizens face an initial penalty for failure to disclose any of the required information of $ 10,000, and the penalty increases in $ 10,000 increments up to a cap of $ 50,000. [n138] Understatements also face a forty percent penalty. [n139]

4. Effects of FATCA (Strengths and Weaknesses)

Although FATCA went into effect in July of 2014, the law was passed in 2010 and, as such, preparations were made in advance of the law's enactment. [n140] Consequently, despite the relative infancy of FATCA, we have had a fair opportunity to take notice of the law's global effects.

Given all that has been discussed above about FATCA, its benefits are rather obvious. FATCA renders the enforcement of U.S. international tax policy more viable. As noted, the United States loses hundreds of billions of dollars each year due to taxpayers' failure to pay taxes owed. [n141] At least $ 100 billion is lost [*621] each year due to offshore tax evasion alone. [n142] With so many countries and FFIs signed onto FATCA [n143] and agreeing to help enforce U.S. tax law, FATCA can only help raise compliance. [n144] As stated by the Treasury Department regarding FATCA's benefits, FFIs are generally in the best position to report on U.S. customers, and without such reporting, U.S. taxpayers can easily evade U.S. taxation by hiding money in offshore accounts. [n145] Thus, with the enactment of FATCA, the integrity of the U.S. voluntary tax compliance system is strengthened. FATCA is estimated to bring in about $ 8.7 billion in tax revenue over a ten-year period. [n146]

Still, despite its strengths, FATCA has a number of weaknesses. Domestically, one issue the United States will be forced to deal with is FATCA's problematic administrability. Many critics charge that Congress failed to provide the IRS with adequate capacity to handle the millions of new and complicated filings that will need to be processed each year as a result of FATCA. [n147] The United States also has to worry about capital flight, the risk that FFIs divest in U.S. assets to mitigate the risk of the U.S. enforcing a withholding levy on their U.S. assets. [n148] Similarly, there is a substantial risk that foreigners, a group that holds over one trillion dollars in bank deposits in the United States (often because these deposits are tax-free [*622] for non-resident aliens), may withdraw their funds from the United States to avoid a potential thirty-percent withholding tax assessed upon transfer of these deposits to an overseas account. [n149]

In addition to domestic concerns, FATCA brings about a slew of international law issues. First, there is apprehension that the law of many foreign nations would conflict with FATCA and not allow FFIs to transfer the personal information that FATCA requires. [n150] Such an occurrence may render FATCA ineffective or create confusion within the foreign nation. Another concern is reciprocity: would the United States want, or be compelled to, accept similar requests of information divulgence from tax authorities in other countries? [n151] If the United States so refuses, it might be jeopardizing the enforcement of its own law. A third and major international law complication with FATCA is that it borders on extraterritorial jurisdiction. [n152] FATCA gives the United States the ability to impose and enforce rules and regulations not only on its own citizens situated abroad, which is itself significant, but also on FFIs that may otherwise have few to no relations with the United States. [n153] Former Canadian Finance Minister, Jim Flaherty, expressed concern that FATCA has "far reaching and extraterritorial implications," requiring banks in Canada (and worldwide) to essentially act as arms of the IRS. [n154]

FATCA also adversely affects two groups in particular. The first group is FFIs, which have to bear significant costs to comply with FATCA. [n155] Hundreds of thousands of FFIs fall under [*623] FATCA's purview, and when accounting for the cost of compiling, analyzing, and reporting U.S. citizen customer data, the estimated costs of FATCA for FFIs range from hundreds of millions of dollars to well over ten billion dollars. [n156] The European Commission estimates that European banks alone will have to spend $ 100 million to comply. [n157] KPMG, one of the largest professional services companies in the world, predicts that FATCA's costs to FFIs will far outweigh any additional revenue that the IRS will collect. [n158]

The other group largely adversely affected by the implementation of FATCA is U.S. citizens living abroad. These citizens are affected for a few reasons. The first reason is related to the cost of FATCA compliance for FFIs. [n159] Since FATCA compliance would impose significant costs on FFIs, many FFIs are opting to turn away new U.S. customers or drop U.S. clients who already hold accounts in an effort to avoid having to satisfy FATCA's requirements. [n160] As such, many Americans abroad are being left without bank accounts, pension funds, insurance coverage, and other financial necessities. [n161] This is especially harmful to companies owned by Americans abroad, where financial services are absolutely essential. [n162] Citizens are also being adversely affected by facing a higher overall tax burden than their counterparts abroad. [n163] FATCA also subjects citizens to complex tax responsibilities and a possibly increased cost of filing taxes. [n164] FATCA has even given rise to identity fraud crimes--such crimes [*624] have increased five-fold from 2008 to 2010 alone, much of which is believed to be due to FATCA's requirement for FFIs worldwide to collect, gather, and report a large amount of private information on U.S. citizens. [n165] All of these downsides of FATCA have resulted in a record-setting number of Americans choosing to renounce their citizenship in the law's wake. [n166]

D. Proposals

As discussed above, the United States has been taxing the worldwide income of its citizens since as early as 1861. [n167] FATCA was enacted in 2010 (and went into effect in 2014), [n168] created merely as a vehicle to better carry out this greater policy goal of international taxation. As such, there are two general schools of thought related to fixing the weaknesses of the current system: one supports maintaining U.S. global taxation, but altering FATCA in some fashion, while the other advocates for dismantling the global taxation scheme in its entirety. Both proposals will be introduced below.

1. Keep Global Taxation, But Modify FATCA

Citizenship-based taxation has a fair number of justifications. A few of them include, but are not limited to: (a) it has been around for decades, and is thus traditional; [n169] (b) it generates greater tax revenue; [n170] (c) citizenship provides benefits, and those receiving benefits should share in its burdens; [n171] (d) those who have an ability to pay should pay; [n172] (e) citizens living abroad are still extensions of the United States, and so should be treated as any other U.S. [*625] citizens; [n173] and (f) it is more administrable than any other system. [n174]

Still, support of citizenship-based taxation does not necessarily translate to support of FATCA. A distaste for FATCA's extraterritorial concerns and harsh treatment of FFIs and U.S. citizens abroad may provide some rationales for opposing FATCA, among others. [n175] These issues are not mutually exclusive with global taxation; one can have both global taxation and less extraterritorial apprehensions, or both global taxation and less costs to FFIs and U.S. citizens, and so on. As follows, changing FATCA while keeping the general international taxation scheme is a popular proposal.

Repealing FATCA entirely is one option. However, that would leave in existence the issues that FATCA was created to help, such as the approximately $ 100 billion in revenue lost each year due to offshore tax evasion. [n176] To reconcile these issues, alternative approaches to FATCA's goal of combatting offshore tax evasion are plausible and commonly advanced. For example, one alternative is wage withholding for investment income, such as interest and dividends. [n177] Such an approach would immediately subject those receiving U.S.-based income to tax withholding, thereby ensuring that tax revenue is collected and making the process easier for citizens and FFIs. This approach would also arguably reach as far as FATCA does, since FATCA only reaches income derived from United States sources when it threatens to withhold on FFIs. [n178] [*626] Another approach is to work with foreign governments and increase enforcement efforts on known tax-evasion hotbeds, rather than casting a net on the entire world. Such an approach might also include the imposition of greater penalties and more whistleblower rewards for those who fail to pay their taxes. However, such proposals do not appear likely to come to fruition anytime soon, and many agree that FATCA is here to stay for the foreseeable future. [n179]

Beyond those proposals to replace FATCA with something entirely different are proposals to alter it on a section-by-section basis. Because FATCA has diverse provisions and weaknesses, depending on the weaknesses targeted, these proposals are also viable. For example, if the primary concern of FATCA is that it targets too many people, increasing the earned income exclusion above $ 99,200 may prove to be a good adjustment, as it would target fewer people. [n180] If the concern is that FATCA is overly complicated and burdensome on individuals, [n181] perhaps lessening the paperwork (including combining FATCA requirements with the additional FBAR requirements) or working with foreign nations to simplify the process would help. FATCA can call for citizens to only file in the foreign nation, as they would have to anyway, and for the foreign nation to relay that information. To lessen the cost to citizens, FATCA could provide more exemptions than it already does, such as exemptions on employment income. If the concern is the cost to FFIs, FATCA can require less information from FFIs, possibly even just the names of American citizens so that the IRS can follow up. In sum, if the issue with FATCA lies with its specific provisions, these can be modified as needed.

[*627] 2. Only Tax Based on Residency, Not Citizenship

The other alternative is to eliminate citizenship-based taxation entirely. In other words, the United States should no longer tax based on citizenship. Instead, the proposal advances, taxation should be based on residency. The residency approach is already tried-and-true worldwide; the United States is the only industrialized country in the world to tax income based on citizenship rather than residency. [n182]

The benefits of citizenship-based taxation were outlined above. [n183] What are the arguments against such a system? For one, as just stated, the United States is the only industrialized country employing this system. [n184] This may make it both unpopular and unfamiliar to many around the world, leading to greater difficulty in its administration. Another argument against it is that it adds an excessive burden on U.S. citizens, since they have to file and pay more in taxes on all income, regardless of where they live. [n185] Such a system may also put U.S. citizens at a disadvantage with their foreign counterparts, as they have a greater tax burden by virtue of being U.S. citizens. [n186] Perhaps most importantly, a citizenship-based taxation system is arguably fundamentally unfair. Merely being a citizen of the United States subjects you to its income tax requirements, regardless of whether you live there, utilize the benefits of your citizenship, or ever plan on returning.

Switching to a residence-based system would allow U.S. citizens abroad to maintain their citizenship while eliminating U.S. income tax obligations. Of course, it is not without its flaws. It is far less administrable than the current system of citizenship-based [*628] taxation. Citizenship is a factual, objective determination, whereas residency is not. The United States would have to parse out exactly what defines residency for purposes of taxation, a potential legislative nightmare. [n187] Another flaw is that such a system may lead wealthy Americans to decide to move abroad in order to avoid taxes. [n188] Additionally, and not to be overlooked, it would probably lead to a decrease in net tax revenue, since fewer people would be subject to U.S. taxation.

Regardless of which proposal is best, one thing is certain: the current individual taxation scheme, combined with FATCA, carries an abundance of problems. Something should change. This Comment's proposal of a system based on actual residency and international cooperation will be explored in Part IV, below. First, the trend of corporate inversion, a surprisingly related phenomenon, will be explored in Part III.

III. Corporate Inversion

A. Background of the Issue

Before jumping into the anatomy of an inversion, understanding what corporate inversion is and how it came to exist is imperative. Put simply, "corporate inversion is a process by which an existing U.S. corporation changes its country of residence [for tax purposes]." [n189] After an inversion takes place, the corporation restructures to become a subsidiary of a foreign parent corporation. [n190] Its headquarters and primary source of operations, however, typically remain in the United States. [n191] Inversion helps the company, now legally a foreign corporation, avoid taxation on [*629] foreign-source income by removing its subjection to U.S. jurisdiction and tax law. [n192] Corporate inversion is of growing significance. Since the first inversion in the 1980s, close to half of all inversions have occurred within the past five years. [n193] Inversions are estimated to cost the United States approximately $ 20 billion over the next decade. [n194]

1. How It Came to This Point--U.S. Worldwide Taxation

To fully comprehend why a corporation would want to invert, one must first understand the United States' current tax treatment of U.S.-based multinational corporations. Similar to its taxation of citizens, discussed above, the U.S. government taxes its corporations using a global taxation scheme. [n195] U.S. multinational corporations must pay U.S. income tax not only for income generated within the United States, but also for income generated abroad. [n196]

Internationally, countries generally adopt one of two approaches for taxing corporations. [n197] The first is referred to as the "worldwide approach." [n198] Under the worldwide approach, a country considers all income by its multinational corporations to be taxable, without regard to where the income is earned. [n199] In other words, as the name implies, the host country taxes all of the worldwide income of its corporations, not merely domestic income. [n200] The "territorial approach" is just the opposite--a country taxes only the income earned within its borders, not income earned abroad. [n201] Thus, under the territorial approach, a corporation's tax liability is solely determined by the tax rate of the country in which income is [*630] earned. [n202]

Most countries around the world have adopted more of a territorial approach. The United States, however, uses an approach that leans more toward the worldwide approach. [n203] The next section will explore the intricacies of the United States' version of the worldwide approach, explaining why it is not a pure worldwide approach and introducing the main motives for inversion.

B. Relevant Structure of the United States' Version of the Worldwide Approach

A pure worldwide approach is straightforward--all corporate income is taxable, without regard to where it is earned. [n204] While the United States undoubtedly uses more of a worldwide system than a territorial system, it does employ some variations that stray from the prototypical worldwide approach. Two provisions in particular, tax credits and deferrals, alter the dynamics of the taxation scheme, affecting how corporations choose to position themselves.

1. Double Taxation and Foreign Tax Credits

Similar to the issue explored above concerning taxation of American citizens' worldwide income, when it comes to taxing the worldwide income of multinational corporations, the problem of double taxation presents itself. [n205] Since corporations have to pay income tax in the foreign country where income is earned, double taxation arises because corporations also have to pay income tax in the United States on the same earnings. [n206] For example, ABC Co., a company incorporated in the United States, would have to pay income taxes twice on the money it earns in Argentina--once to the United States, and once to Argentina. Earnings of $ 100,000 in Argentina may be taxed first at Argentina's corporate tax rate of thirty-five percent ($ 35,000), and then again at the United States' [*631] corporate tax rate of 39.1% [n207] ($ 39,100), leaving ABC Co. with a total tax burden of $ 74,100 ($ 35,000 plus $ 39,100) and after-tax earnings of only $ 25,900.

To solve the issue of double taxation, and, again, similar to the treatment of individual citizen taxation of worldwide income, the United States provides a tax credit for foreign taxes paid on income earned abroad. [n208] While the law initially allowed only for a deduction, the United States now permits a full credit for the amount of foreign taxes paid abroad. [n209] The goal of this tax credit is to prevent the same income from being taxed twice. [n210] Essentially, this means that for every dollar a U.S. corporation pays in income taxes abroad, the corporation can pay that much less in what it would otherwise owe to the United States. Returning to the previous example, after ABC Co. pays the taxes that Argentina imposes ($ 35,000), it can subtract that from what it would otherwise owe the United States ($ 39,100), leaving ABC Co. owing only $ 4100 in taxes to the United States on that Argentinian income, and leaving it with after-tax earnings of $ 60,900, more than double the $ 25,900 it would have retained without the assistance of tax credits. Effectively, as is the case with foreign tax credits for U.S. citizens, if the U.S. taxes income at a higher rate than the foreign government, credits work to limit a corporation's total tax liability to what it would otherwise owe the United States. [n211] If the United States taxes at a lower rate than the foreign government, foreign tax credits effectively eliminate any U.S. tax liability. [n212]

[*632] Two other features of foreign tax credits should be noted. First, today's foreign tax credit system is based on categories (or "baskets") of income. [n213] Previously, the foreign tax credit was calculated on a country-by-country basis to hinder a company's ability to "cross credit" (use taxes paid to high-tax countries to reduce U.S. tax owed on income from low-tax countries). [n214] Later, when the system shifted to one based on categories of income, nine categories were used. [n215] Each category had a certain limit, and income from all countries could be combined within each category. [n216] Today, the categories have been condensed and there remain just two main categories--general income (namely, active income) and passive income. [n217] Income from these categories can be grouped together when calculating the amount of the foreign tax credit. [n218]

The other notable aspect of foreign tax credits is that they only apply to "compulsory" taxes--that is, those taxes that foreign laws require. [n219] "Voluntary" taxes will not be eligible for a tax credit and, thus, will be subject to double taxation. [n220] Though this occurrence does not arise very often, if, for example, the United States were to [*633] determine that a U.S. corporation should not have paid as much as it did, or should have challenged some tax requirement put forth by a foreign country, the corporation may not receive a foreign tax credit for that amount. [n221] The rationale is that in the absence of this rule, U.S. corporations may not be concerned with how much is paid in foreign taxes because a credit will offset that amount anyway, and the United States will ultimately collect less. [n222]

2. Foreign Income Deferral

The other major provision in the United States' international taxation regime is the allowance of tax deferrals on foreign income. [n223] Corporations are not required to pay any U.S. taxes on income earned abroad until that income is repatriated to the United States. [n224] A rationale behind the rule is that income should not be taxed before it is available for use. [n225] These transactions are often referred to as deferrals because corporations are able to control when income is repatriated to the United States and, thus, when the income is taxable. [n226] Rather predictably, this deferral exception largely influences the way corporations choose to allocate their funds--many strategically leave funds abroad instead of returning them to the United States to avoid U.S. tax liability. [n227]

Continuing from the example above, assume ABC Co. is the parent corporation, and that its foreign subsidiary, ABC Empresa, operates in Argentina. If ABC Empresa earns $ 100,000 in Argentina, all of that income will be taxable income in Argentina, but only the amount returned to ABC Co. will be taxable in the United States (and subject to the foreign tax credits). If Argentina has a thirty-five percent corporate income tax rate and the United States has a 39.1% tax rate, and if ABC Co. decides that ABC Empresa should return $ 50,000 of its earnings back to the United [*634] States while keeping the other $ 50,000 in Argentina, then, in total, $ 35,000 in taxes will be owed to Argentina (thirty-five percent of the entire $ 100,000 earned), while only $ 2,050 will be owed to the United States (the United States will not tax any of the deferred $ 50,000 left in Argentina, and its taxation on the repatriated $ 50,000 will follow normal tax credit analysis--4.1%, the difference in the tax rates of the two countries).

C. The Ideal Corporate Taxpayer Solution to the Worldwide Approach: Corporate Inversion

Given the United States' employment of a worldwide taxation scheme, the use of inversions may appear to follow logically. Corporate inversions essentially alter the residency of a corporation for tax purposes. [n228] They allow corporations to avoid U.S. taxes on income earned abroad. Phrased another way, the thought process might proceed as follows: "If we're incorporated in the United States, we'll pay thirty-five percent taxes on our income in the United States and Canada and Mexico and Ireland and Bermuda and the Cayman Islands, but if we're incorporated in Canada, we'll pay thirty-five percent on our income in the United States but fifteen percent in Canada and thirty percent in Mexico and 12.5% in Ireland and zero percent in Bermuda and zero percent in the Cayman Islands." [n229]

This section will begin with a brief history of inversions and the legislation and regulations that made them what they are today, followed by a discussion of the structure of modern inversions. The section will then shift to the international effects of corporate inversions, including the strengths and weaknesses of the strategy and of U.S. international tax policy as a whole.

1. Brief History of Corporate Inversions--The Road to the Current Trend of Inversions

The first known major corporate inversion came in 1983, when [*635] McDermott Inc., a construction company based in New Orleans, inverted to become a Panamanian corporation. [n230] McDermott flipped its corporate structure so that its subsidiary in Panama, McDermott International, became the parent company. [n231] This allowed McDermott to pass its substantial profits from Panama to its shareholders without paying any U.S. income tax on them. [n232] Congress responded by adopting I.R.C. ß 1248(i), preventing these types of inversions from occurring again by treating stock received by a corporation from its foreign subsidiary as stock issued to the corporation and transferred to its shareholders in the form of redemption or liquidation, thereby subjecting it to taxation. [n233]

The next major inversion took place in 1994. [n234] Instead of involving a then-existing foreign subsidiary becoming the parent corporation, Helen of Troy, a corporation based in Texas, created a new corporation in Bermuda called Helen of Troy-Bermuda. [n235] Shareholders of Helen of Troy exchanged their shares for stock in the new corporation, and the new corporation became the parent. [n236] Under I.R.C. ß 367(a) at the time, no recognition of shareholder gain was required for this type of transaction. [n237] After this inversion, the IRS altered ß 367(a) to tax gains realized from all transfers of stock or securities of a U.S. corporation to a foreign corporation if the transferors owned fifty-percent or more in vote or value of the foreign corporation after the transaction. [n238] The IRS believed that this tax imposed on shareholders would deter future inversions; [n239] this belief, however, ultimately proved to be incorrect. [n240]

After the Helen of Troy inversion, the late 1990s and early [*636] 2000s saw corporate inversions become commonplace. [n241] Major corporations like Tyco, Fruit of the Loom, and Ingersoll-Rand reincorporated abroad but kept most of their substantial economic activities within the United States. [n242] The country noticed. A 2002 Treasury Department report concluded that even though the statutory framework had not changed, there had been a "marked increase" in the frequency, size, and profile of corporate inversions. [n243] U.S. Senator Charles E. Grassley, a Republican from Iowa, remarked in 2002 that while "expatriations aren't illegal[,] they're sure immoral." [n244]

After great national awareness and debate, Congress enacted the American Jobs Creation Act of 2004 ("AJCA"). [n245] The AJCA declared that a foreign parent company would be treated as a domestic corporation (for tax purposes) if it was owned by at least eighty-percent of the former parent company's stockholders. [n246] It also provided that if there is less than eighty-percent but greater than or equal to sixty-percent continued ownership, the foreign parent company would not be taxed like a domestic corporation, but would have to pay any U.S. taxes on gains that apply to transfers of assets to the new entity. [n247] Foreign tax credits or net operating losses would not be able to offset these obligations. [n248] The law exempted corporations with "substantial business activity" in the foreign country, defined as at least ten-percent of worldwide activity. [n249]

Though inversions slowed down after the AJCA, they still [*637] persisted and became more mainstream. Since 2004, at least forty-seven companies have inverted. [n250] The substantial activity exemption was often utilized, so in 2012, the Treasury increased the safe harbor substantial business activity test from ten-percent to twenty-five percent. [n251]

Apparently, the 2012 regulations were not enough to stop the inversion trend. In 2014 alone, at least fourteen inversions have taken place or were in the works. [n252] In response, the Treasury released a notice of regulatory actions in September of 2014. [n253] The Notice set out to "significantly diminish the ability of inverted companies to escape U.S. taxation," removing techniques that inverted companies used to access funds earned overseas from foreign subsidiaries without paying U.S. taxes. [n254] The new regulations accomplished the following: (1) they eliminated "hopscotch" loans, with which U.S. multinationals would skirt the taxation-upon-repatriation requirement by having subsidiaries invest in foreign parents; [n255] (2) they prevented inverted companies from restructuring foreign subsidiaries in order to access earnings without paying taxes; [n256] (3) they eliminated a loophole whereby an [*638] inverted company would transfer cash or property from a subsidiary to the new parent company to avoid U.S. tax; [n257] and (4) they strengthened checks on the requirement that former owners of the previous U.S. parent own less than eighty percent of the new entity. [n258]

2. Today's Inversions

Today, there remain three primary avenues for corporate inversions: (1) meeting the substantial activity test; (2) merging with a smaller foreign company; and (3) merging with a larger foreign company. [n259]

The first method, meeting the substantial activity test, takes place when a U.S. corporation with substantial activity in a foreign country creates a foreign subsidiary. [n260] The U.S. corporation and the foreign subsidiary proceed to exchange stock so that each owns some amount of the other's stock. [n261] By the end of the transaction, the former subsidiary becomes the parent company, and the U.S. company becomes its subsidiary. [n262] Effective control of the corporation, however, usually remains the same. [n263] Recall from above that following the AJCA and the 2012 Treasury regulations, the substantial activity test requires at least twenty-five percent of the entity's worldwide activity to take place in the foreign [*639] country. [n264] As such, it is not as popular a method for inversion as merging is. [n265]

The two other methods, merging with a smaller foreign company and merging with a larger foreign company, share the same underlying approach (merging), but contain different results. The former is more akin to the U.S. corporation acquiring the smaller foreign corporation (since it is larger), while the latter is more similar to the U.S. corporation being acquired by the larger foreign corporation. [n266] Thus, when a U.S. corporation merges with a smaller foreign company, U.S. shareholders usually maintain a majority share of the new, merged company; control remains in the United States. [n267] Conversely, when the U.S. corporation merges with a larger foreign company, U.S. shareholders end up owning a minority share in the new company, and control is shifted outside the United States. [n268] Given the change in control after merging with a larger foreign company, this transaction often involves a greater deal of business considerations (rather than solely tax considerations). [n269] Recall that after the AJCA, for a merged corporation to be considered a foreign corporation for tax purposes, the current shareholders of the U.S. firm must own less than eighty percent of the merged corporation. [n270] As such, current shareholders of the U.S. firm typically own between seventy and seventy-nine percent of the newly merged firm. [n271] This helps keep control of the new corporation with the U.S. corporation. [n272]

In addition to the aforementioned quintessential inversions, U.S. corporations are frequently discovering creative new ways to avoid [*640] U.S. taxation on income earned abroad. A common approach, referenced earlier, takes advantage of the deferral of taxation requirements if funds are left abroad and not repatriated back into the United States. [n273] Many companies issue debt utilizing those funds, usually in the form of bonds, in order to access the funds in the United States and avoid repatriating the money. [n274] Major companies such as Apple, Microsoft, Cisco, and Oracle employ this strategy. [n275] An estimated two trillion dollars in cash is "trapped" abroad because companies are reluctant to bring it back to the United States and pay tax on it. [n276]

3. International Legal Implications

In terms of international law, corporate inversions are surprisingly unregulated. It is theorized that governments are averse to working together on the issue because they want to attract relocating companies and reap the ensuing economic benefits. [n277] Beyond a few exceptions, international law as a whole is largely removed from the issue.

The U.S. tax code generally focuses on place of incorporation to determine domestic or foreign tax status. [n278] One internationally-legally binding way to change this disposition is by shifting tax treaties away from the focus on place of incorporation, and more toward other factors. For example, in the U.S.-Netherlands tax treaty, instead of incorporation location, the test is the corporation's "primary place of management or control" in determining eligibility for treaty benefits. [n279] However, similar international agreements are rare, and place of incorporation remains the dominant determinant [*641] with regard to income earned in most countries.

A major international law issue concerning inversions relates to taxation on inbound foreign investment. [n280] The United States taxes payments of dividends, royalties, and other types of interests earned by non-residents [n281] with no U.S. trade or business. [n282] In order to avoid the discouragement of foreign investment in the United States, the United States has reached income treaties with dozens of countries that reduce withholding taxes imposed by each treaty partner. [n283] Sometimes, however, in order to take advantage of the lower tax implications of these treaties, foreign investors in countries that do not have such a treaty with the United States establish entities in countries that do have such a tax treaty with the United States. [n284] In this regard, otherwise taxable payments from the United States must first be routed through the newly formed entity, thereby avoiding U.S. taxation by benefitting from the treaty. [n285] Essentially, the third-country residents are able to exploit a tax treaty that their country of residence is not a party to. [n286] This strategy is related to corporate inversions because it could be used to avoid U.S. taxes; after an inversion, when the U.S. company that was previously the parent corporation becomes a subsidiary, it is owned by a corporation and residents abroad, and they have to deal with U.S. taxation on its income. [n287] This method, known as "treaty shopping," utilizes international law to improve the tax effects of inversions.

The United States has made several attempts to use international law to combat treaty shopping. [n288] Initially, the United States tried to make unregulated determinations of the taxpayer's motives for [*642] establishing entities in the treaty partner. [n289] These measures fell short of their goals, since some of these entities were made for legitimate business reasons, and since such an anti-abuse rule was overly subjective. [n290] The United States then developed a series of objective tests known as Limitation-on-Benefits ("LOB") provisions, which were supposed to determine whether a taxpayer was sufficiently connected to the treaty partner to warrant treaty benefits. [n291] LOB provisions developed and changed significantly over time. [n292] Today, LOB provisions vary from treaty to treaty. [n293] There are, however, two main tests that most LOB provisions use: the publicly traded corporation test, and the active trade or business test. [n294]

The publicly traded corporation test is the most common test used. [n295] It provides that a corporation on a recognized stock exchange may be granted tax benefits simply by virtue of being a [*643] publicly traded corporation. [n296] Sometimes, additional nexus between the publicly traded corporation and its country of residence is required in LOB provisions, depending on the circumstances. [n297] A common additional nexus in the publicly traded corporation test, to be focused on further in this Comment's proposal, is what is known as the "primary place of management and control" test, defined as "the country where the corporation's executive officers and senior management employees exercise the most day-to-day responsibility for the strategic, financial, and operational decision making of the corporation, and where the most day-to-day activities necessary for preparing and making those decisions take place." [n298] Additional requirements of the publicly traded test vary by treaty. [n299]

The active trade or business test comes up when the corporation is privately held (and thus the publicly traded test cannot apply). [n300] While the exact provisions of the active trade or business test also vary by treaty, there are common aspects used in most treaties, including: (1) the active trade or business does not include the making or management of investments; (2) for something to qualify as active trade or business, the activities in the company's country of residence must include all steps in the process that gives rise to the income, or must be complimentary to the trade or business; (3) the income must be either connected to the trade or business activities and substantial in relation to the company's activities in the other country, or must be incidental to the trade or business conducted in the other contracting country; and (4) income is incidental to trade or business activities if the production of income in one state facilitates the conduct of trade or business in the other state. [n301]

Beyond these aforementioned implications, international law provisions addressing corporate inversions are remarkably sparse, [*644] considering the intrinsic international nature of inversions and the severity of the problem. This Comment will, in part, advocate for greater bilateral and multilateral efforts to deal with the issue.

D. Proposals

Although several legislative and regulatory changes to deal with inversions have been enacted, the threat of inversions remains strong: as of August 2014, twenty-two major inversion deals within the last three years were completed or in the works, [n302] and in the next decade, inversions are estimated to cost the United States approximately twenty billion dollars in lost revenue. [n303] This section will introduce prominent policy proposals aimed at stopping the inversion problem.

1. Switch from a Worldwide Tax Approach to a Territorial Tax Approach

As discussed, the United States uses a (primarily) worldwide tax system, under which all global income of U.S. corporations is taxed. [n304] This approach contrasts starkly from the territorial system, in which a country only taxes income earned within its borders, not abroad. [n305] One very popular proposal is to simply switch systems.

Without much doubt, switching to a territorial approach would likely eliminate the corporate inversion problem entirely; companies invert for tax purposes, in an effort to avoid taxation on foreign income. [n306] Switching to the territorial system would essentially remove this tax from existence, thereby removing the desire to avoid it. [n307] It also may lead to an influx of cash into the United States, since many companies try to leave their foreign income abroad (deferral) to avoid paying U.S. taxes upon repatriation. [n308] Further, it may raise revenue by restricting the [*645] ability of companies to deduct expenses related to foreign operations and by taxing income from royalties more effectively. [n309] Lastly, it would put the United States on the same footing as most other developed countries in the world, which also use a territorial approach. [n310]

Despite its benefits, switching to a territorial system would also have disadvantages. First, such a switch would significantly reduce tax revenue. [n311] Virtually all corporate tax revenue currently collected on income earned abroad would vanish. In that regard, it would be somewhat similar to maintaining the current system but allowing all companies to invert. [n312] A territorial system may also lead to more profit shifting or base erosion, wherein domestic income is made to appear like foreign income to avoid taxes, a serious issue in territorial tax systems. [n313] Such a system is also feared to discourage domestic investment, since taxes will be lower on investment abroad than domestically, and thus companies may have financial incentives to shift accordingly. [n314]

2. Lower or Eliminate the Corporate Income Tax

Another popular proposal, not very dissimilar from the proposed territorial income tax, is to lower or eliminate the corporate income tax. [n315] The rationale is simple: the United States has the third highest top marginal corporate tax rate in the world, behind only the United Arab Emirates and Chad. [n316] This high tax rate naturally leads corporations to take steps to lower their tax liability. The proposal's reasoning also becomes somewhat theoretical, using the claim by many economists that corporations do not even pay their [*646] taxes and, instead, individuals (workers, shareholders, consumers, and so on) pay the cost in the form of higher prices. [n317] Proponents of this approach therefore claim that reducing or eliminating the corporate income tax would dramatically increase domestic investment, output, and wages. [n318]

Lowering or eliminating the corporate income tax would also have its drawbacks. First, the corporate income tax is the system that is in use and that has been in use for a long time, [n319] and thus changing it would be both expensive and unfamiliar. Second, it may very well cost the United States more in revenue (by not collecting these taxes) than the United States would save by way of the aforementioned economists' theories. [n320] And third, while it may help solve the issue of corporate inversion by effectively eliminating a large reason that companies invert (to lower tax liability), like a switch to a territorial tax approach, it may be too extreme and counter to policy goals. [n321] In other words, while it may help decrease or eliminate corporate inversions, it may do so in an undesirable way, destroying a core feature of U.S. tax policy.

3. Other Proposals

The two most popular proposals (switching to a territorial system and lowering or eliminating the corporate income tax) were listed above. Many other proposals to fix the corporate inversion issue exist, but they are rather varied. This section will identify and introduce some of these other proposals. Most of them primarily target legislative and administrative action.

One proposal, advocated for by President Obama, is to modify the eighty percent former shareholder ownership test in the AJCA and shift it to a fifty percent test. [n322] This would mean that if at least fifty percent of shareholders after a merger are still the former U.S. [*647] shareholders, the corporation is still a U.S. corporation for tax purposes. [n323] Obama also suggests eliminating the sixty percent test for transfer of assets entirely. [n324] Finally, Obama's proposal calls for the new foreign corporation, in order to be recognized as a foreign company, to be managed and controlled outside of the United States. [n325] This proposal was put forth in the President's FY2015 budget. [n326] Similar bills that adjust the ownership percentages have since been introduced in the House and Senate. [n327]

Another proposal is to impose an "exit tax" on corporations. [n328] The proposed legislation would tax any earnings that have not yet been repatriated for corporations deciding to invert. [n329] Proponents believe that such a tax would discourage inversions or, at the very minimum, provide a more fair taxation scheme than the one currently in place. [n330] "Everyone knows that before you leave a restaurant you have to settle your tab," U.S. Senator Sherrod Brown, of Ohio, said in a statement. [n331] "Corporations shouldn't get to play by different rules." [n332] While there is little data to suggest how many corporate inversions this would stop, it is certainly conceivable how such an added cost may prevent a process aimed at reducing taxes.

[*648] A third proposal, somewhat related to the last, is to completely eliminate the foreign income tax deferral (until repatriation) exception. [n333] Such a law would return roughly two trillion dollars held abroad to the United States. [n334] Proponents argue that this would not only be a more equitable system, but it would also improve the economy and increase the number of American jobs. [n335] It would raise approximately $ 220 billion over a ten-year period that could be invested in American services, such as schools, infrastructure, and medicine. [n336] Still, while such a proposal would certainly generate an influx of capital into the United States, its impact on the corporate inversion phenomenon is questionable. [n337] The proposal does not discourage inversions or make them more difficult. [n338] In fact, some wonder whether such legislation would actually encourage inversions, as it would increase the cost of remaining a U.S. corporation by closing such a popular tax-saving strategy. [n339]

Yet another proposal is to withhold government contracts from companies choosing to invert. [n340] Such legislation would presumably discourage companies from inverting by threatening to withhold federal dollars from inverting companies. [n341] Federal agencies would also be able to stop doing business with companies that subcontract with inverted corporations, widening the scope of those affected. [n342] "With every successful inversion, the tax burden increases on the rest of us to pay what the corporate inverter [*649] doesn't," Senator Richard Durbin, of Illinois, said in a statement. [n343] "The burden is made worse by allowing companies to profit off of federal contracts paid for by U.S. taxpayers, while those very companies run from their U.S. tax responsibility." [n344] This type of legislation may be successful to an extent, as corporations (at least those with federal contracts) would have to re-evaluate whether the tax savings from inverting would outweigh the lost income that federal contracts offer.

In all, there are many legislative and administrative proposals aimed at curbing corporate inversion. [n345] Due to the sheer quantity of such bills and proposals, listing all of them would prove nearly impossible. Those listed above cover some of the most popular and viable proposals. Most other proposals are simply alterations of those listed above, employing different figures and details but advocating for the same general approaches.

This Comment's proposal to help fix the problem of corporate inversion, as well as the problems surrounding FATCA, calls for a taxation system based on actual residency and international cooperation. That proposal will be discussed below, in Part IV.

IV. Proposal: Continue Taxing Worldwide Income, But Use Actual Residency and International Cooperation

A. FATCA and Corporate Inversion: Two Sides of the Same Coin

As explored in this Comment, the issues surrounding FATCA and corporate inversion are plentiful. [n346] FATCA is placing an extremely heavy burden on expatriates, FFIs, and the IRS to deal with the new reporting requirements, [n347] making it impossible for thousands of expatriates to own bank accounts or consume any sort of financial services abroad at all, [n348] and resulting in far more U.S. [*650] citizenship renunciations than ever before. [n349] The corporate inversion trend is resulting in a significant number of U.S. corporations exiting the United States to move abroad, [n350] as well as billions in lost tax revenue each year. [n351] Still, the two issues are distinct--how can one proposal adequately address both issues?

To recap the two issues, FATCA is a law that attempts to both respond to deficiencies in tax revenue collected, [n352] and to address offshore tax evasion. [n353] FATCA deals with individual income taxation, attempting to ensure that American citizens pay the taxes required of them on their worldwide income. [n354] It accomplishes its goals, generally, by demanding greater disclosure compliance from FFIs and American citizens. [n355] FATCA is largely able to enforce its requirements by levying a withholding tax on FFIs that fail to comply, and by forging related agreements with foreign countries. [n356] On the other hand, corporate inversions are a reaction to the United States' system of worldwide taxation on all corporate income. [n357] Inversions seek to lower a corporation's tax bill, and in large part, they accomplish that goal by shifting incorporation overseas, thereby removing corporations from U.S. jurisdiction and U.S. international taxation subjection. [n358]

The reason this Comment advocates for one sweeping proposal to fix the problems of both FATCA and corporate inversion, two [*651] otherwise separate matters, is because both stem from the same issue: U.S. worldwide taxation. The United States taxes not just income earned domestically, but also the income earned abroad. [n359] American citizens and corporations alike must pay U.S. taxes for income generated outside of the United States. [n360] Both FATCA and corporate inversion are essentially products of this taxation regime--FATCA was enacted to better enforce U.S. worldwide taxation, [n361] while corporate inversion is a strategy designed to avoid it. [n362]

Since FATCA and corporate inversion stem from the same source (worldwide taxation), it should be conceivable why one proposal could fix both of them. Actual residency, the key proposal of this Comment, advocates for amending how the United States chooses which persons and entities it will tax by using a system that is more fair, workable, and consistent with the general policy goals of the United States' current taxation regime. Instead of taxing based on citizenship and place of incorporation, factors which do not accurately represent who should be subject to taxation and factors which are clearly flawed and susceptible to workarounds, [n363] the United States should tax based on actual residency, a term with slightly different meanings for persons and corporations, but with the same general goal. Actual residency for each entity will be explained below. International cooperation, also advocated for by this Comment and also explored below, is essential for ensuring that the proposed system of taxation works.

B. The Solution: Keep the Worldwide Taxation System, but Change Its Taxation Determination Standards to Actual Residency

Although this Comment argues that the source of the problems [*652] surrounding FATCA and corporate inversion is worldwide taxation, it does not advocate for dismantling the worldwide taxation system. The worldwide system, having been around since at least 1861, [n364] is an integral part of U.S. tax policy. Its elimination would be an overly-extensive change and a complete overhaul of the tax system. The goal of this Comment is to improve the current tax system and how it carries out its objectives, not to dispute the merits of its objectives entirely. The United States' choice to tax those who are American (citizens and corporations) around the world is a policy decision beyond the scope of this Comment. This Comment merely seeks to propose a sound and just way to effectuate said policy. [n365]

A system based on actual residency, instead of citizenship or place of incorporation, would largely fix the contemporary issues surrounding FATCA and corporate inversion, and improvements would be experienced in other areas as well, including administrative simplicity and international integrity. It would also maintain the United States' long-held policy of taxing Americans--it simply redefines what and who Americans are, for taxation purposes.

1. Actual Residency and Individual Citizens

The rationale behind taxing citizens was explored above: American citizens derive benefits from their citizenship, and therefore, they should have to incur the costs of those benefits by paying U.S. taxes. [n366] Presumably, citizenship bestows enough of a benefit to justify taxation. It also makes sense why, in terms of practicability, the United States uses citizenship to make the taxation determination--citizenship is objective and straightforward. A person either is a U.S. citizen or is not a U.S. citizen. If a person is a U.S. citizen, he or she is subject to global taxation; if a person is not a U.S. citizen, he or she is not subject to the tax.

[*653] However, basing taxation solely upon citizenship has a serious flaw. It uses an antiquated notion that those who are citizens derive such great benefits from their citizenship that they should be subjected to the same taxation as all other citizens, regardless of whether they even live in the United States and reap most of the benefits that citizenship or taxpayer-funded programs provide. [n367] While citizens living abroad do enjoy certain benefits by virtue of their citizenship (including, but not limited to, access to U.S. embassies and consulates, the possibility to have children of

U.S. citizenship while abroad, and the ability to vote via absentee ballots, among others), [n368] they miss out on the vast majority of citizenship and tax-funded benefits because they are overseas that their stateside counterparts are able to enjoy (the list of benefits available to domestic citizens is far too extensive to enumerate, but broadly speaking, infrastructure, police, firefighters, social services, and defense make up a few).

In addition to plainly receiving far fewer benefits while paying the same tax rates, citizens situated overseas actually experience a number of negative consequences by virtue of their U.S. citizenship. [n369] Beyond paying taxes in more than one country on the same income, as well as the aforementioned repercussions of FATCA implementation (including a lack of access to financial services), citizens may have trouble obtaining medical assistance overseas (Medicare benefits, for example, are unavailable outside of the United States), receiving a recognized marriage license, and acquiring valid work and travel visas. [n370] Just as citizenship bestows certain benefits, so too does it come with some undesirable ramifications exclusive to those abroad.

The inequity of citizens abroad paying the same tax rate as citizens living in the United States is clear--such individuals simply do not enjoy an even comparable extent of benefits, calling into [*654] question whether citizenship is a fair basis for taxation. In this increasingly globalized world, people travel--and permanently relocate--more than ever before. [n371] Just as in the hypothetical situation presented in the Introduction of this Comment, in which a person who lives in London and never plans on returning to the United States is subject to U.S. taxation, the system as it stands is often unbalanced. At the minimum, the benefits derived from citizenship do not sufficiently balance the cost of being an American citizen. [n372] Such a system places an undue burden on U.S. citizens. Accordingly, it has led to a record number of citizenship renunciations. [n373] Citizenship simply fails as a tax standard.

Still, even recognizing the current system's flaws and inequities, a change from the system could have greater consequences than simply increasing fairness. First, it might be harder to identify who to tax, since citizenship provides an impartial and objective indicator. Second, if the United States no longer taxed citizens abroad, tax revenue may drop, as fewer individuals would be taxed. And third, a change in systems may rob the United States of an important policy goal in effect since as early as 1861, to tax Americans without regard to where they may be located in the world. [n374]

The proposal presented in this Comment, actual residency, seeks to replace the current standard of taxing individuals based on citizenship and replace it with a standard based on where an individual is domiciled. With a shift to domicile, the United States would be able to successfully administer its taxes, continue to collect a significant amount in tax revenue, and maintain its goal of worldwide taxation of Americans, all while resolving the inequities of citizenship-based taxation and curbing the unprecedented number of citizenship renunciations in recent years. [n375]

Concerning the administrability of actual residency for individuals, the approach utilizes the same standard used across the [*655] United States for determining which state or country an individual resides in for most other purposes: domicile. [n376] "Domicile is established by physical presence in a place in connection with a certain state of mind concerning one's intent to remain there." [n377] That is, domicile is a combination of where one lives and where one intends to remain indefinitely. Domicile is not synonymous with residence; one can reside in one place but be domiciled in another. [n378] Additionally, an individual may have multiple residences, but can generally only have one domicile. [n379] Though not quite as objective as citizenship, it is certainly objective enough to make an accurate determination as to who should be subject to taxation, since there is an abundance of case law on it and since its use is already widespread (it's widely used for diversity of citizenship lawsuits, state income tax, education, determining which state a person may vote in, applicable death, estate, and divorce law, and many other purposes). [n380] In this regard, domicile has already proven to be administrable, so concerns that it may render taxpayer identification more difficult than using citizenship alone could largely be put to rest.

One of the most challenging aspects of the actual residency proposal is the effect it would have on tax revenue. Taxing all citizens casts a fairly wide net, leading one to believe it brings in a great deal in revenue. First, though, it should be noted that as it stands, the United States loses hundreds of billions of dollars each year in unpaid taxes, [n381] with individual income tax being the single largest source of the annual tax gap, responsible for over double that of employment tax, sextuple that of corporate tax, and twenty-two times that of estate and excise tax. [n382] Many citizens abroad simply do not pay their U.S. taxes (which partially prompted FATCA and other legislation in the first place). Further, the relative ease of [*656] renouncing citizenship and freeing oneself from U.S. tax liability, combined with the many aforementioned exceptions, exemptions, and credits provided to citizen-taxpayers, makes for a significantly lower tax base than might otherwise be expected from a tax levied upon all U.S. citizens worldwide.

Taxing based on actual residency, domicile for individuals, would still tax income earned abroad for those who are domiciled within the United States. That is, if an American spends a week, a month, or even a few years abroad, her income would still be taxable so long as she doesn't plan to reside abroad indefinitely and permanently. Thus, the tax base is still far larger than the most popular alternative proposal of a switch to a territorial tax system (where income would only be taxed where it is earned). It would, however, stop short of taxing those domiciled overseas, such as the London friend in the Introduction hypothetical. The inequities discussed above for such an individual (namely, failing to reap a majority of the benefits of citizenship while still having to pay equal tax rates), combined with the simple ability for an individual to renounce American citizenship (which is now being done in record numbers), makes such an approach fair and evenhanded while still capturing a significant deal of revenue.

Finally, the actual residency approach preserves the same policy objective sought with the citizenship-based worldwide approach of taxing: making Americans pay their fair share to account for the advantages they receive by virtue of being American. It simply satisfies that objective more accurately. Taxing based on where individuals actually reside effectively addresses the benefits that they receive. A U.S. citizen permanently residing within the United States surely makes much greater use of her citizenship and of U.S. tax expenditures than a U.S. citizen permanently residing in China, and should therefore pay her fair share of taxes. Using actual residency for individuals will more justly carry out the goal of taxing those who are actually, for all intents and purposes, Americans.

2. Actual Residency and Corporations

In a similar vein as individual taxation, this Comment takes issue with how corporations are determined to be subject to worldwide income taxation. While the more precise details of the determination are discussed above, place of incorporation is generally the key factor in indicating which corporations will be [*657] taxed and which will not. Again, this standard attempts to enforce the policy goal of taxing American entities based on the presumed benefits they enjoy by virtue of being American. Likewise, again, the current standard is fairly objective--a corporation either is incorporated in the United States or is not.

Still, like the tax on citizens, the current method for identifying corporations subject to taxation falls short of its goals. Place of incorporation simply does not, or at least in the age of corporate inversions, no longer sufficiently indicates benefit derivation.

To be fair, corporations do, indeed, enjoy some non-tax advantages by becoming incorporated in the United States. Incorporation within the United States is often fast, easy, and cheap. [n383] Venture capitalists and other investors typically prefer the security and predictability of U.S. state incorporation law, particularly Delaware law. [n384] Companies can also rely on U.S. courts to enforce intellectual property, contractual, and shareholder rights that may be less reliable in other countries. [n385] Still, many companies would (and have) come to the conclusion that the benefits of incorporation in the United States are outweighed by the tax liability. A 39.1% tax [n386] on all worldwide income is simply not worth it for companies doing a lot of business overseas. Like citizenship taxation, the benefits are often outweighed by the (tax) liabilities.

Aware of the tremendous tax burdens of remaining incorporated in the United States, corporations are inverting at record rates. [n387] Despite the history of increasing regulations, corporations can invert fairly easily, including by creating a foreign subsidiary and swapping stock, merging with a smaller company, and merging with a larger company. [n388] Thus, a corporation could maneuver itself so [*658] as to no longer have to abide by American tax law while changing little about its operations. Still, the corporation could proceed to derive many of the benefits of being a U.S. corporation, avoiding only a higher tax burden. [n389]

Given the ease of avoiding U.S. tax liability, a different taxation system that preserves the U.S. policy goal of taxing those corporations that derive benefits from their U.S. status should be put into place. Of course, a change so sweeping would not be without its challenges. Switching from place of incorporation to some other mechanism may prove difficult in determining which companies are subject to taxation, as place of incorporation is objective. There may also be concerns about tax revenue dropping and the failure to accurately target those companies that should be taxed (corporations that are American).

Actual residency, the proposal advanced by this Comment, calls for a replacement of the place of incorporation test with a test based on "primary place of management and control," a test already common in bilateral treaties. [n390] "Primary place of management and control" is defined as:

> [a test that looks to] where day-to-day responsibility for the management of the company (and its subsidiaries) is exercised. [n391] The company's primary place of management and control will be located in the State in which the company is a resident only if the executive officers and senior management

> employees exercise day-to-day responsibility for more of the strategic, financial and operational policy decision making for the company (including direct and indirect subsidiaries) in that State than in the other State or any third state, and the staff that support the management in making those decisions are also based in that State. [n392] Thus, the [*659] test looks to the overall activities of the relevant persons to see where those activities are conducted. [n393] In most cases, it will be a necessary, but not a sufficient, condition that the headquarters of the company (that is, the place at which the CEO and other top executives normally are based) be located in the Contracting State of which the company is a resident. [n394]

In short, the test attempts to determine where the company is actually located and operated, rather than merely identifying where it is incorporated.

Because the test is common in bilateral treaties, it would be simple to implement on an international scale for purposes of taxation; countries are largely already familiar with the test. [n395] Thus, even though place of incorporation may boast a degree of objectivity, the "primary place of management and control" test is sufficiently reliable. It can be trusted to provide an accurate indication of where a company conducts its core business in a way that is administrable worldwide.

Utilizing actual residency instead of place of incorporation would also likely not pose an issue of a fall in tax revenue collected. In fact, it would probably maintain or increase tax revenue. Presumably, at least a majority of companies incorporated in the United States have their primary place of management and control in the United States, too. [n396] Inverting and changing place of [*660] incorporation, though, is much easier and less expensive than shifting primary place of management and control overseas. The former could be completed as a virtually purely paper transaction, while the latter involves major business considerations that implicate much more than taxation. Since the actual residency test would require such an overhaul in operations, it would discourage and deter an immense number of inversions, keeping companies from being able to avoid their tax obligations. It would also recapture a vast majority of companies that have already inverted--companies that have shifted their place of incorporation overseas, but kept their primary place of management and control within the United States. This would increase tax revenue from its current base. Likewise, as the actual residency test would transform the future of inversions into decisions with significant business consequences, likely done more in good faith, it may just eliminate the "problem" of inversions entirely (i.e., inverting simply to avoid tax obligations).

Finally, the actual residency test preserves the policy goal of taxing U.S. corporations on their worldwide income. The test better identifies companies that truly benefit from their status as U.S. companies by determining whether they conduct their key operations and hold their primary place of management and control within the United States. Such companies could surely be said to derive significant benefits from their U.S.-based status. These companies would also find it much more difficult to abandon their tax obligations while maintaining the advantages they enjoy by being based in the United States.

3. International Cooperation

In order to carry out a shift to actual residency, and to ensure that such a shift hinders the ability of U.S. persons and corporations to easily avoid taxation (while also taxing in a more just manner), international cooperation is necessary. The very nature of these [*661] issues are international--the United States wants to tax its individuals and companies on income earned outside of the United States. It is therefore only reasonable that the United States work with other countries, where individuals and companies may be residing and operating, to help it carry out its goals.

FATCA proves that the United States has the ability to require information on its citizens from FFIs and foreign countries. [n397] The United States can continue to use this influence, but to an even lesser degree, to carry out its new actual residency test for individuals. It can request in treaties that foreign governments provide the residency information of those within their country--information that one would expect foreign governments to have--for individuals the United States suspects may be subject to U.S. taxation. [n398] Then, the United States can make the determination as to whether to consider that foreign country to be the individual's actual residency (domicile). FFIs need not be involved in this process unless the U.S. specifically requests financial information after it determines somebody to be an actual U.S. resident and subject to U.S. international taxation. This could save FFIs a lot of time and money by only requiring information about people specifically requested by the United States government, as opposed to requiring information about all U.S. persons. In turn, FFIs would incur less burdensome demands and lower costs when associating with U.S. persons, likely leaving expatriates with the ability to consume financial services abroad. [n399] Overall, the shift would lighten administrative costs for all governments and FFIs involved, as well as lessen the sentiment of U.S. extraterritoriality. To that end, it would probably be more welcomed than FATCA and the current taxation regime.

[*662] As for corporations, the existence of bilateral tax treaties and the common use of the "primary place of management and control" test renders international cooperation on the issue fairly simple. Countries are already familiar with the test that actual residency calls for, and they already make that determination in LOB provisions. [n400] Countries already often determine which corporations are American for purposes of avoiding treaty shopping. [n401] It would be simple to apply this same analysis to taxation--the same test is used, but its conclusion indicates which companies are American and which are foreign for worldwide taxation purposes. Virtually no added costs or burdens are necessary. Foreign governments may also be willing to comply with such a change because it may inspire some corporations to move all operations abroad (in order to benefit from tax and other benefits that come with relocation), which means more money and jobs for those countries, instead of merely moving on paper. However, it would still benefit the United States because it is unlikely that many corporations would want to incur the cost of moving all operations abroad for tax benefits alone. The actual residency test would be easy for both parties to a treaty to carry out, and each respective party may be incentivized to do so.

V. Conclusion

The system of worldwide taxation used by the United States is flawed in its determination of who is American. It unfairly subjects to taxes those who should not be subjected to U.S. taxes. Citizenship and place of incorporation, the criteria used for individuals and corporations, respectively, fall short of policy goals. Each fails to accurately identify which persons and entities receive sufficient benefits by virtue of being American. The standards have also led to disastrous results--for citizens, the enactment of FATCA, aimed at better enforcing worldwide taxation, has resulted in thousands of expatriates being left without any ability to own bank accounts or consume financial services abroad, placed heavy burdens on expatriates, FFIs, and the IRS to process the new reporting requirements, and led to a record of citizenship [*663] renunciations. [n402] For corporations, it has led to more companies than ever before exiting the United States, and the United States losing billions in tax revenue each year.

Using an actual residency test for both entities, instead of the place of citizenship and incorporation standards in use today, would help the United States better identify which individuals and corporations should be taxed on their international income. It would allow the United States to target for tax liability only those that actually benefit from their significant relations and ties with the United States (those individuals who are domiciled in the United States, or those companies that maintain their primary place of management and control within the United States). It is consistent with U.S. policy goals in that it still places a worldwide taxation on American individuals and companies. However, at the same time, it provides for a much more effective and fair way of carrying out those policy goals. The proposed standards also not only just abide by international law, but would likely be welcomed by the international community and would be fairly easy for the United States and other countries to implement, since both standards have been utilized in other capacities for decades. Overall, the actual residency test would provide for an equitable administration of U.S. worldwide taxation--only those that should be taxed, would be taxed.

Legal Topics:

For related research and practice materials, see the following legal topics:
International Trade LawTrade AgreementsIntellectual Property ProvisionsTax LawInternational TaxesForeign Persons' Activities in the United StatesNonresident & Resident Aliens (IRC secs. 864, 871-880)General OverviewTax LawState & Local TaxesIncome TaxGeneral Overview

FOOTNOTES:

n1 Other tax-related consequences, such as sales tax, may also prove to be relevant considerations. These matters should not be confused. This Comment focuses exclusively on income tax.

n2 The underlying assumption here is that the money is repatriated to the United States. A U.S. corporation earning income abroad could avoid owing income taxes in the United States by setting up a subsidiary in the foreign country and leaving the money abroad; only when the money is returned to the United States, either to the parent corporation or to stockholders in the form of dividends, is it taxable. CONG. BUDGET OFFICE, OPTIONS FOR TAXING U.S. MULTINATIONAL CORPORATIONS 2 (2013), http://www.cbo.gov/sites/default/files/cbofiles/attachments/02-28-2013-MultinationalTaxes_One-Col.pdf [http://perma.cc/NW3A-797V] ("[C]ompanies can defer U.S. taxes on income earned abroad by their subsidiaries until that income is remitted (or 'repatriated') to the U.S. parent company, thus allowing some foreign income to escape U.S. taxation--at least temporarily."). This, as well as other factors that help determine the amount of income tax owed, will be discussed below.

n3 Complications may arise if Samsung repatriates its funds to a U.S. subsidiary. For purposes of this scenario, it is assumed that Samsung's earnings in London either remain in the United Kingdom or are ultimately remitted to its parent corporation, located in South Korea.

n4 Owing income taxes in the United States may not be an issue if your friend has explicitly renounced his U.S. citizenship. For purposes of this scenario, it is assumed that your friend is still a U.S. citizen. It is also assumed that your friend is not subject to exemptions on this general rule, highlighted below. One example of a common type of exemption is the foreign income exclusion, wherein all income up to $ 99,200 for tax year 2014 may be excluded. See I.R.C. ß 911 (2014) (providing exemption); Rev. Proc. 13-35, 2013-47 I.R.B. 537, 543 (providing exclusion amount for 2014). The exclusion amount changes each year.

n5 "[D]omicile is established by physical presence in a place in connection with a certain state of mind concerning one's intent to remain there." Mississippi Band of Choctaw Indians v. Holyfield, 490 U.S. 30, 48 (1989) (citing Texas v. Florida, 306 U.S. 398, 424 (1939)).

n6 See CHRIS EDWARDS &DANIEL J. MITCHELL, GLOBAL TAX REVOLUTION: THE RISE OF TAX COMPETITION AND THE BATTLE TO DEFEND IT 107-08 (2008) (noting that most countries utilize a territorial approach, where the home country taxes only the income earned within its borders); Michael E. Zeller & Eric D. Gazin, The Long Arm of the IRS: U.S. Tax Treatment of Foreign-Source Income, GP SOLO &SMALL FIRM, Oct.-Nov. 1999, at 34, 35, http://www.americanbar.org/content/newsletter/publications/gp_solo_magazine_home/gp_solo_magazine_index/oct99zg.html [http://perma.cc/35H3-YQX4] ("Most other countries restrict taxation to income derived only from within its territorial borders. Not so in the United States; if you are a U.S. taxpayer, no matter where you are located in the world, the IRS is interested in your income.").

n7 See CONG. BUDGET OFFICE, PUB. NO. 4664, OPTIONS FOR REDUCING THE DEFICIT: 2014 TO 2023, at 130 (2013), https://www.cbo.gov/sites/default/files/cbofiles/attachments/44715-OptionsForReducingDeficit-3.pdf [https://perma.cc/K2P4-NJN4] (stating that U.S. citizens who live in other countries must file individual U.S. tax returns and still have U.S. tax liability); CONG. BUDGET OFFICE, supra note 2 ("The U.S. government taxes both the domestic and the foreign income of business that are incorporated in the United States and that operate abroad."). Resident aliens within the United States have the same worldwide tax liabilities as U.S. citizens, but to maintain simplicity, this Comment will refer to all U.S.-individuals affected by the U.S. worldwide taxation scheme as citizens. See U.S. Citizens and Resident Aliens Abroad, INTERNAL REVENUE SERV. (Dec. 5, 2014), http://www.irs.gov/Individuals/International-Taxpayers/U.S.-Citizens-and-Resident-Aliens-Abroad [http://perma.cc/3B7D-DDUA] ("If you are a U.S. citizen or resident alien, the rules for filing income, estate, and gift tax returns and paying estimated tax are generally the same whether you are in the United States or abroad. Your worldwide income is subject to U.S. income tax, regardless of where you reside.").

n8 See Act of Aug. 5, 1861, ch. 45, ß 49, 12 Stat. 292, 309, repealed by Act of July 1, 1862, ch. 119, ß 89, 12 Stat. 432, 473 (introducing U.S. worldwide taxation as early as 1861). This statement is made solely in reference to the general, fundamental system of taxing U.S. citizens and corporations on income earned abroad. There have, of course, been several minor and less sweeping adjustments to this taxation scheme. See, e.g., Act of Oct. 3, 1913, ch. 16, ß II(A)(1), 38 Stat. 114, 166 (continuing this general taxation approach, but altering how citizenship is lost for purposes of international taxation).

n9 FATCA is a portion of the 2010 Hiring Incentives to Restore Employment (HIRE) Act. Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, ß 451 tit. V(A), 124 Stat. 71, 97-108 (2010).

n10 T.D. 9610, 2013-15 I.R.B. 652 ("An FFI is defined as any financial institution that is a foreign entity, other than a financial institution organized under the laws of a possession of the United States (generally referred to as a U.S. territory in this preamble). For this purpose, section 1471(d)(5) defines a financial institution as, except to the extent provided by the Secretary, any entity that: (i) accepts deposits in the ordinary course of a banking or similar business; (ii) as a substantial portion of its business, holds financial assets for the account of others; or (iii) is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest in such securities, partnership interests, or commodities.").

n11 I.R.C. ß 1471(c)(1)(A) (2014).

n12 Id. ß 1471(a). "Withholdable payment" is defined as

> (i) [A]ny payment of interest (including any original issue discount), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, if such payment is from sources within the United States, and (ii) any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States.

Id. ß 1473(1)(A).

n13 See, e.g., Agreement between the Government of the United States of America and the Government of [FATCA Partner] to Improve International Tax Compliance and to Implement FATCA art. 2, June 6, 2014, http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Reciprocal-Model-1A-Agreement-Preexisting-TIEA-or-DTC-6-6-14.pdf [http://perma.cc/8WUF-4797] (official model treaty that, in part, regulates governmental obligations to obtain and exchange information with respect to reportable accounts).

n14 FATCA was enacted to improve the tax compliance rate of U.S. taxpayers with foreign accounts. Foreign Account Tax Compliance Act, Pub. L. No. 111-147, 124 Stat. 71 (2010).

n15 Ali Weinberg, Record Number of Americans Renouncing Citizenship Because of Overseas Tax Burdens, ABC NEWS (Oct. 28, 2014), http://abcnews.go.com/International/record-number-americans-renouncing-citizenship-overseas-tax-burdens/story?id=26496154 [http://perma.cc/C9V2-LXE4]. The primary rationale for this phenomenon is that, since the inception of FATCA, many FFIs have opted to deny accounts to all American citizens in order to avoid the expenses of having to comply with FATCA's burdensome reporting requirements.

n16 Dropping the Bomb, ECONOMIST (June 28, 2014), http://www.economist.com/news/finance-and-economics/21605911-americas-fierce-campaign-against-tax-cheats-doing-more-harm-good-dropping [http://perma.cc/FAF6-VYSJ].

n17 Experts report that FATCA is largely responsible for record numbers of Americans renouncing their citizenship in both 2013 and 2014. Weinberg, supra note 15.

n18 The term "corporate inversion" is interchangeable and commonly used in place of other terms, such as "corporate expatriation." This Comment will use "corporate inversion" or "inversion" throughout.

n19 Quite obviously, the United States neither has the power nor the jurisdictional reach to tax those companies not subject to U.S. law.

n20 See, e.g., Protocol Amending 1980 Tax Convention with Canada, Can.-U.S., Sept. 21, 2007, S. TREATY DOC. NO. 110-15 (2008) ("The United States and Canada are part of the same regional free trade area and, as a result, the Convention reflects the fact that publicly traded companies resident in one country may be traded on a stock exchange of the other country. Nevertheless, the Contracting States agree that in making future amendments to the Convention, they shall consult on possible modifications to subparagraph 2(c) of Article XXIX A (Limitation on Benefits) of the Convention (including, modifications necessary to discourage corporate inversion transactions).").

n21 Similar to how U.S. states often act to attract incorporation, so too may other countries act for the added benefits that a greater corporate presence may bring (such as economic stimulus and job growth). See Alexandra Thornton, The Skinny on Corporate Inversions, CTR. FOR AM. PROGRESS 1, 8 (Sept. 25, 2014), https://cdn.americanprogress.org/wp-content/uploads/2014/09/CorporateInversions-brief.pdf [http://perma.cc/TW2M-AVZT] ("Developed countries truly are in a race to the bottom as national governments lower corporate tax rates in order to attract relocating companies and the economic benefits they bring.").

n22 Kyle Pomerleau, Everything You Need to Know About Corporate Inversions, TAX FOUND. (Aug. 4, 2014), http://taxfoundation.org/blog/everything-you-need-know-about-corporate-inversions [http://perma.cc/JA9P-WNMG].

n23 Kimberly Clausing, Corporate Inversions, URB.-BROOKINGS TAX POL'Y CTR. 2 (Aug. 20, 2014), http://www.taxpolicycenter.org/UploadedPDF/413207-corporate-inversions.pdf [http://perma.cc/GJD2-HB5M].

n24 Id.

n25 Tanya Somanader, The Cost of Doing This Kind of Business: What Corporate Inversions Mean for America's Future, WHITE HOUSE (Sept. 26, 2014), http://www.whitehouse.gov/blog/2014/09/26/cost-doing-kind-business-what-corporate-inversions-mean-america-s-future [http://perma.cc/F8UB-ZNRP].

n26 See CONG. BUDGET OFFICE, supra note 2, at 3-4.

n27 See Mississippi Band of Choctaw Indians v. Holyfield, 490 U.S. 30, 48 (1989).

n28 See DEP'T OF THE TREASURY, REPORT TO THE CONGRESS ON EARNINGS STRIPPING, TRANSFER PRICING AND U.S. INCOME TAX TREATIES 81-82 (2007) [hereinafter TREATIES REPORT] ("[T]he country where the corporation's executive officers and senior management employees exercise the most day-to-day responsibility for the strategic, financial, and operational decision making of the corporation, and where the most day-today activities necessary for preparing and making those decisions take place.").

n29 See id. at 81 (referencing the use of the primary place of management and control test in agreements that the United States has reached with other countries).

n30 In this regard, the test is somewhat similar to the "principal place of business" test used in 28 U.S.C. ß 1332(c)(1), "the place where the corporation's high level officers direct, control, and coordinate the corporation's activities," also referred to as the "nerve center." Hertz Corp. v. Friend, 559 U.S. 77, 80-81 (2010). Since the "primary place of management and control" test is commonly used in bilateral treaties, nations are familiar with it and can more easily understand and implement it.

n31 Such a test would render international law compliance easier for FFIs, since treaties created with each FFI's home country and the United States have forced a reporting on all American accounts to the United States, which has proven to be both encumbering and expensive. See Dropping the Bomb, supra note 16.

n32 Obligations may include military enlistment, labor, jury duty, taxation, etc.

n33 See U.S. Citizens and Resident Aliens Abroad, supra note 7.

n34 The State Department estimated in March 2015 that about 8 million non-military Americans live and work outside of the United States. 8 Million Americans (Excluding Military) Live in 160-Plus Countries, ASS'N AM. RESIDENT OVERSEAS (Mar. 19, 2015), https://aaro.org/about-aaro/6m-americans-abroad [http://perma.cc/JG66-VYP9]. In comparison, the population of the United States as of July 2015 exceeded 320 million. The World Factbook, CENT. INTELLIGENCE AGENCY, https://www.cia.gov/library/publications/the-world-factbook/geos/us.html [http://perma.cc/RX7E-EF43] (last updated Sept. 24, 2015).

n35 See Weinberg, supra note 15 (describing these impediments).

n36 See Mihir A. Desai et al., Sharing the Spoils: Taxing International Human Capital Flows, 11 INT'L TAX & PUB. FIN. 663, 678 (2004) ("[Only t]hree countries--the United States, the Philippines, and Eritrea--use citizenship as the basis of ongoing taxation.").

n37 See Act of Aug. 5, 1861, ch. 45, ß 49, 12 Stat. 292, 309, repealed by Act of July 1, 1862, ch. 119, ß 89, 12 Stat. 432, 473. The concept of such a tax was seriously contemplated even earlier and proposed by the Secretary of the Treasury during the War of 1812 (but never became law). EDWIN R.A. SELIGMAN, THE INCOME TAX: A STUDY OF THE HISTORY, THEORY AND PRACTICE OF INCOME TAXATION AT HOME AND ABROAD 430 (2d ed. 2004).

n38 CONG. GLOBE, 38th Cong., 1st Sess. 2661 (1864) (statement of Sen. Collamer) ("[A] distinction is made as to the income tax between resident citizens and non-resident citizens of the United States. We do not desire that our citizens who have incomes in this country . . . should go out of the country, reside in Paris or elsewhere, avoiding the risk of being drafted or contributing anything personally to the requirements of the country at this time, and get off with as low a tax as anybody else. The law . . . makes a difference to those persons of two perc[ent] in the income tax on account of the obligations which are avoided by those who reside abroad, and endured by those who stay at home. If a man draws his income from our public debt, or from property here, and resides in Paris, skulking away from contributing his personal support to the Government in this day of its extremity, he ought to pay a higher income tax.").

n39 Id.

n40 Act of June 30, 1864, ch. 173, ß 116, 13 Stat. 223, 281.

n41 Act of Oct. 3, 1913, ch. 16, ß II(A)(1), 38 Stat. 114, 166.

n42 ROGER FOSTER, A TREATISE ON THE FEDERAL INCOME TAX UNDER THE ACT OF 1913, at 153 n.5 (2d ed. 1915) (quoting Act of Mar. 2, 1907, ch. 2534, 34 Stat. 1228).

n43 Id.

n44 265 U.S. 47 (1924).

n45 Id. at 56 ("[T]he government, by its very nature, benefits the citizen and his property wherever found and, therefore, has the power to make the benefit complete. Or to express it another way, the basis of the power to tax was not and cannot be made dependent upon the situs of the property in all cases, it being in or out of the United States, and was not and cannot be made dependent upon the domicile of the citizen, that being in or out of the United States, but upon his relation as citizen to the United States and the relation of the latter to him as citizen. The consequence of the relations is that the native citizen who is taxed may have domicile, and the property from which his income is derived may have situs, in a foreign country and the tax be legal--the government having power to impose the tax.").

n46 387 U.S. 253 (1967).

n47 See FOSTER, supra note 42.

n48 See Afroyim, 387 U.S. at 268 ("We hold that the Fourteenth Amendment was designed to, and does, protect every citizen of this Nation against a congressional forcible destruction of his citizenship, whatever his creed, color, or race. Our holding does no more than to give to this citizen that which is his own, a constitutional right to remain a citizen in a free country unless he voluntarily relinquishes that citizenship.").

n49 See id. This Comment will not expand into how U.S. citizenship can be renounced. That process is beyond this Comment's scope. Nonetheless, today's law, consistent with the ruling in Afroyim, requires a formal and explicit renunciation. See Immigration and Nationality Act, 8 U.S.C. ß 1481(a) (2014) ("A person who is a national of the United States whether by birth or naturalization, shall lose his nationality by voluntarily performing any of the following acts with the intention of relinquishing United States nationality." (emphasis added)). Renunciation thus cannot be accidental.

n50 Double taxation in the international context should be distinguished from double taxation in the U.S. corporate context. The former refers to multiple governments taxing the same income. The latter refers to corporate earnings being taxed, followed by shareholders being taxed after receiving dividends or payouts from the corporation. Only the former is relevant in this Comment.

n51 1 NAT'L TAXPAYER ADVOCATE, 2011 ANNUAL REPORT TO CONGRESS 194 n.16 (2011).

n52 Revenue Act of 1918, ch. 18, ß 222(a), 40 Stat. 1057, 1073 (1919) (repealed 1921).

n53 Hart v. United States, 218 Ct. Cl. 212, 215 (1978).

n54 See I.R.C. ßß 90-98 (2014).

n55 Zeller & Gazin, supra note 6.

n56 Id.

n57 Id.

n58 Id. Practically speaking, the math rarely favors deductions. Foreign tax credits are typically more significant. Id.

n59 Id.

n60 Id. For example, "if foreign taxable income is [30%] of worldwide taxable income, and U.S. tax imposed on a taxpayer equals $ 25,000, then the maximum amount excludable as [foreign tax credit] is $ 7,500 [30% of $ 25,000]." Id.

n61 Id.

n62 See I.R.C. ß 61 (2014) (defining gross income).

n63 This example does not adequately reflect the intricacies of Italy's system of income taxation. The assumption in this example is that Italy taxes all income earned within its borders.

n64 Similar to footnote 63, the provided tax rate is unfounded and is set forth for example purposes only.

n65 This is because the entirety of the taxes paid to the foreign government may be credited to (or subtracted from) taxes owed to the United States. For example, using the same illustration as above, had Italy's income tax rate been 50%, Bob would owe $ 50,000 (50% of his $ 100,000 gross income) in taxes to Italy, and would thus owe nothing to the United States, since the foreign tax credit would reduce $ 50,000 from what he would otherwise owe to the United States, $ 35,000. As for the remaining $ 15,000 in unused credit, Bob can carry over or carry back the excess to another tax year. See I.R.S. Publication 514 (Apr. 7, 2015), https://www.irs.gov/pub/irs-pdf/p514.pdf [https://perma.cc/Q4M6-FF4N] ("[T]axes paid or accrued exceed[ing] the credit limit for the tax year . . . may be . . . carr[ied] over or carr[ied] back the excess to another tax year.").

n66 I.R.C. ß 911(a)(1).

n67 Id. ß 911(a)(2).

n68 Id. ß 911(d)(1).

n69 Id. ß 911(d)(2)(A).

n70 Id. Prior to 2007, the figure was predetermined by statute. Zeller & Gazin, supra note 6.

n71 Rev. Proc. 13-35, 2013-47 I.R.B. 537, 543 (providing the exclusion amount for 2014).

n72 I.R.C. ß 911(c) lays out the formula.

n73 Press Release, U.S. Senate Comm. on Fin., Background Fact Sheet on Tax Changes Affecting Americans Working Abroad (May 25, 2006), http:// www.finance.senate.gov/newsroom/chairman/release/?id=caab3c6c-81c1-4edb-b6f9-7af28c32b25c [http://perma.cc/6627-RE9K].

n74 Zeller & Gazin, supra note 6.

n75 Id.

n76 Id.

n77 See id.; Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes, Ger.-U.S., arts. 10, 11, 12, & 23, Aug. 29, 1989, S. TREATY DOC. NO. 101-10 [hereinafter U.S.-Germany Tax Convention] (listing the points of agreement on tax between the United States and Germany).

n78 See, e.g., U.S.-Germany Tax Convention, supra note 77, art. 6.

n79 See United States Income Tax Treaties -- A to Z, INTERNAL REVENUE SERV. (Feb. 25, 2015), http://www.irs.gov/Businesses/International-Businesses/United-States-Income-Tax-Treaties--A-to-Z [http://perma.cc/7J6E-K4LA] (listing each country with which the United States has an income tax treaty, and providing access to each respective treaty).

n80 See IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study, INTERNAL REVENUE SERV. (Jan. 6, 2012), http://www.irs.gov/uac/IRS-Releases-New-Tax-Gap-Estimates;-Compliance-Rates-Remain-Statistically-

Unchanged-From-Previous-Study [http://perma.cc/4TFB-9MF3] [hereinafter Tax Gap Estimates] (estimating that tax compliance was 85.5% in 2006 and 86.3% in 2001).

n81 Id.

n82 Tax Gap Facts and Figures, INTERNAL REVENUE SERV. 1 (Mar. 14, 2005), http://www.irs.gov/pub/irs-utl/tax_gap_facts-figures.pdf [http://perma.cc/T5T4-YMFZ] [hereinafter Tax Gap] (defining "tax gap" as the "difference between the tax that taxpayers should pay and what they actually pay on a timely basis.").

n83 Id.

n84 Id. at 6.

n85 Senator Carl Levin, U.S. Senator, Floor Speech Addressing the Commerce, Justice, Science, and Related Agencies Appropriations Act of 2010 (Mar. 17, 2010) ("Right now, thousands of U.S. tax dodgers conceal billions of dollars in assets within secrecy-shrouded foreign banks, dodging taxes and penalizing those of us who pay the taxes we owe. The Permanent Subcommittee on Investigations, which I chair, has estimated that these tax-dodging schemes cost the Federal Treasury $ 100 billion a year.") [hereinafter Levin Speech].

n86 Miscellaneous Qualified Intermediary Information, INTERNAL REVENUE SERV. (Nov. 5, 2014), http://www.irs.gov/Businesses/International-Businesses/Miscellaneous-Qualified-Intermediary-Information [http://perma.cc/KC2M-FXKK] ("A qualified intermediary (QI) is any foreign intermediary (or foreign branch of a U.S. intermediary) that has entered into a qualified intermediary withholding agreement with the IRS.").

n87 Id.

n88 Offshore Financial Activity Creates Enforcement Issues for IRS: Hearing Before the S. Comm. on Fin., 111th Cong. 10-11 (2009) (statement of Michael Brostek, Dir., Strategic Issues Team, U.S. Gov't Accountability Office), http://www.gao.gov/assets/130/121902.pdf [https://perma.cc/Q2YV-ZRRY].

n89 For example, UBS, a Swiss Bank that had registered with the IRS as a QI in 2001, was found to have fraudulently concealed information related to its U.S. account holders, leading to a settlement with the U.S. government for $ 780 million. Id.

n90 I.R.S. News Release IR-2011-94 (Sept. 15, 2011) ("The programs gave U.S. taxpayers with undisclosed assets or income offshore a second chance to get compliant with the U.S. tax system, pay their fair share and avoid criminal charges.").

n91 I.R.C. ß 7623(b)(2)(A) (2014) ("In the event the action . . . is one which the Whistleblower Office determines to be based principally on disclosures of specific allegations . . . resulting from a judicial or administrative hearing, from a governmental report, hearing, audit, or investigation, or from the news media, the Whistleblower Office may award such sums as it considers appropriate, but in no case more than [10%] of the collected proceeds (including penalties, interest, additions to tax, and additional amounts) resulting from the action (including any related actions) or from any settlement in response to such action, taking into account the significance of the individual's information and the role of such individual and any legal representative of such individual in contributing to such action.").

n92 Under "John Doe" summons, when the IRS suspects a tax violation but is not certain who the violator is, it may summon information when it can establish that

> (1) the summons relates to the investigation of a particular person or ascertainable group or class of persons, (2) there is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law, and (3) the information sought to be obtained from the examination of the records or testimony (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources.

Id. ß 7609(f).

n93 Under Title 31 subpoenas, the U.S. government may "require by subpoena the production of all information, documents, reports, answers, records, accounts, papers, and data not otherwise reasonably available to the authority" for U.S. taxpayers of whom it is suspicious. 31 U.S.C. ß 3804(a) (2014).

n94 FATCA is a portion of the 2010 HIRE (Hiring Incentives to Restore Employment) Act. Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, tit. V(A), 124 Stat. 71, 97-117 (2010).

n95 I.R.C. ß 1471(a).

n96 Regulations Relating to Information Reporting by Foreign Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities, 78 Fed. Reg. 5874 (Jan. 28, 2013) (to be codified at 26 C.F.R. pts. 1, 301) [hereinafter Regulations Relating to Information].

n97 JANE G. GRAVELLE, CONG. RESEARCH SERV., R40623, TAX HAVENS: INTERNATIONAL TAX AVOIDANCE AND EVASION 38 (2015).

n98 That system has been around since as early as 1861. See Act of Aug. 5, 1861, ch. 45, ß 49, 12 Stat. 292, 309, repealed by Act of July 1, 1862, ch. 119, ß 89, 12 Stat. 432, 473 ("Upon the income, rents, or dividends accruing upon any property, securities, or stocks owned in the United States by any citizen of the United States residing abroad, there shall be levied, collected, and paid a tax . . . .").

n99 See Levin Speech, supra note 85.

n100 See generally I.R.C. ß 1471.

n101 Id. ß 1471(a) (U.S. source income, referred to in the Code as "withholdable payment[s]," broadly includes "(i) any payment of interest (including any original issue discount), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, if such payment is from sources within the United States, and (ii) any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States"); id. ß 1473(1)(A).

n102 Id. ß 1471(b)(1)(A).

n103 Id. ß 1471(b)(1)(B).

n104 Id. ß 1471(b)(1)(C).

n105 Id. ß 1471(c)(1).

n106 Id. ß 1471(b)(1)(D). "Passthru payments" are defined as "any withholdable payment or other payment to the extent attributable to a withholdable payment." Id. ß 1471(d)(7).

n107 "Recalcitrant account holder" is defined as any account holder that fails to provide the information required to determine whether the account is a U.S. account, or the information required to be reported by the FFI, or a waiver of a foreign law that would preclude reporting. Id. ß 1471(d)(6).

n108 Id. ß 1471(b)(1)(D).

n109 Id. ß 1471(b)(1)(E).

n110 Id. ß 1471(b)(1)(F). How the IRS is able to enforce its disclosure requirements will be addressed in greater detail below.

n111 See id. ß 6038D(c) (setting forth the required information).

n112 Id. ß 6038D(b) ("[T]he term 'specified foreign financial asset' means--(1) any financial account (as defined in section 1471 (d)(2)) maintained by a foreign financial institution (as defined in section 1471 (d)(4)), and (2) any of the following assets which are not held in an account maintained by a financial institution (as defined in section 1471(d)(5))--(A) any stock or security issued by a person other than a United States person, (B) any financial instrument or contract held for investment that has an issuer or counterparty which is other than a United States person, and (C) any interest in a foreign entity (as defined in section 1473).").

n113 Id. ß 6038D(c).

n114 Id. ß 6038D(d)(1).

n115 Id. ß 6038D(d)(2).

n116 Id. ß 6662(j)(3). "Undisclosed foreign financial asset understatement" is defined as "the portion of the understatement for such taxable year which is attributable to any transaction involving an undisclosed foreign financial asset" for any taxable year. Id. ß 6662(j)(1). An "undisclosed foreign financial asset" for these purposes is "any asset with respect to which information was required to be provided under section 6038, 6038B, 6038D, 6046A, or 6048 for such taxable year but was not provided by the taxpayer as required under the provisions of those sections" with respect to any taxable year. Id. ß 6662(j)(2).

n117 See id. ß 6501(e) (stipulating that if a taxpayer omits from gross income any amount that should have been included, and the omitted amount is in excess of 25% of the gross income stated in the return, or such amount is in excess of $ 5,000 and is attributed to one or more assets that would be required under ß 6038D, the tax may be assessed, or a proceeding for collection may begin without assessment, at any time within six years after the return was filed); Foreign Bank Account Reporting and Tax Compliance: Hearing Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means, 111th Cong. 7 (2009) (statement of William J. Wilkins, Chief Counsel of the Internal Revenue Serv.) ("Individuals also would face an extended 6-year statute of limitations in the event of significant omissions of income attributable to foreign financial assets.").

n118 FBAR (Report of Foreign Bank and Financial Accounts) is a portion of the Bank Secrecy Act of 1970, Pub. L. No. 91-508, 84 Stat. 1114 (1970).

n119 See I.R.S. News Release IR-2011-117 (Dec. 14, 2011) ("The FATCA Form 8938 requirement does not replace or otherwise affect a taxpayer's obligation to file an FBAR Form 114."); Robert W. Wood, 10 Facts About FATCA, America's Manifest Destiny Law Changing Banking Worldwide, FORBES (Aug. 19, 2014), http://www.forbes.com/ sites/robertwood/2014/08/19/ten-facts-about-fatca-americas-manifest-destiny-law-changing-banking-worldwide/ [http://perma.cc/LDX3-RJV9] ("FBARs Are Still Required. FBARs predate FATCA, but get ready for duplicate reporting. FATCA just adds to the burden, including Form 8938, but it doesn't replace FBARs. The latter have been in the law since 1970 but have taken on huge importance since 2009. U.S. persons with foreign bank accounts exceeding $ 10,000 must file an FBAR by each June 30.").

n120 See Gretchen Morgenson, Death of a Loophole, and Swiss Banks Will Mourn, N.Y. TIMES (Mar. 27, 2010), http://www.nytimes.com/2010/03/28/business/28gret.html?_r=0 [http://perma.cc/8VC5-G97Y] (explaining the loophole). The dividend equivalent loophole will not be explored beyond this short paragraph, as although it is a key aspect of FATCA that is worth mentioning when discussing FATCA provisions, it is not pertinent to the topic of this Comment.

n121 Id. ("Although these payments look like dividends, because they are embedded in a derivative they do not generate a tax.").

n122 Id.

n123 Id. Financial institutions typically receive a fee tied to the amount of the investor's tax savings. Id.

n124 See id.

n125 I.R.C. ß 1471(a) (2014) ("In the case of any withholdable payment to a foreign financial institution which does not meet the requirements of subsection (b), the withholding agent with respect to such payment shall deduct and withhold from such payment a tax equal to [30%] of the amount of such payment.").

n126 See id. ß 1471(b)(1) (setting forth the disclosure requirements that an FFI may choose to subject itself to, and referring to these requirements as a product of an agreement reached between the FFI and the IRS).

n127 As a matter of fact, Congress stated that in enacting FATCA, the legislative intent was to "force foreign financial institutions to disclose their U.S. account holders" or pay for their failure to do so. Hiring Incentives to Restore Employment Act of 2010, Pub. L. No. 111-147, 124 Stat. 71 (2010) (statement of Sen. Levin) (emphasis added).

n128 Wood, supra note 119.

n129 See, e.g., Hong Kong Banks Shut Down U.S. Accounts Rather Than Deal with FATCA, CHINA BRIEFING (Dec. 18, 2014), http://www.china-briefing.com/news/2014/12/18/hong-kong-banks-shut-us-accounts-rather-deal-fatca.html [http://perma.cc/SH9L-G9SS] [hereinafter CHINA BRIEFING] (reporting that many banks based in Hong Kong have been refusing to open new accounts and shutting down existing accounts for American individuals and corporations in order to avoid having to comply with FATCA). This phenomenon will be explored later, when FATCA's effects are addressed.

n130 See Wood, supra note 119 (noting that as of August 2014, more than 77,000 FFIs have reached an agreement).

n131 I.R.C. ß 1471(b)(1)(D)(i).

n132 "FATCA partner" refers to the country partnering with the United States to make an agreement to address FATCA. In this instance, it would refer to France, Germany, Italy, Spain, and the United Kingdom.

n133 See DEP'T OF THE TREASURY, JOINT STATEMENT FROM THE UNITED STATES, FRANCE, GERMANY, ITALY, SPAIN, AND THE UNITED KINGDOM REGARDING AN INTERGOVERNMENTAL APPROACH TO IMPROVING INTERNATIONAL TAX COMPLIANCE AND IMPLEMENTING FATCA sec. B, para. 1 (Feb. 7, 2012), http://www.treasury.gov/resour-cecenter/tax-policy/treaties/Documents/FATCA-Joint-Statement-US-Fr-Ger-It-Sp-UK-02-07-2012.pdf [http://perma.cc/YK5V-E75E] (stating that the United States and the FATCA partner would agree that the FATCA partner would "[p]ursue the necessary implementing legislation to require FFIs in its jurisdiction to collect and report to the authorities of the FATCA partner the required information" and "[t]ransfer to the United States, on an automatic basis, the information reported by the FFIs").

n134 Id.

n135 Id. sec. B, para. 2. (noting that other stipulations the United States would agree to include eliminating U.S. withholding under FATCA on payments to FFIs established in the FATCA partner, better identifying specific categories of FFIs within the FATCA partner that would be treated as deemed compliant or presenting a low risk of tax evasion, and reporting to the FATCA partner information on U.S. accounts of residents of the FATCA partner).

n136 See DEP'T OF THE TREASURY, FATCA--ARCHIVE, http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA-Archive.aspx [http://perma.cc/D74Y-GXY6] (last updated Oct. 16, 2015) [hereinafter COUNTRIES] (providing a full list of FATCA partner countries, as well as access to the text of many of the agreements).

n137 See Wood, supra note 119.

n138 I.R.C. ß 6038D(d) (2014).

n139 Id. ß 6662(j)(3).

n140 See, e.g., Katie Holliday, HSBC Cuts Ties with US Clients Ahead of FATCA, INV. WK. (July 21, 2011), http://www.investmentweek.co.uk/investment-week/news/2095508/hsbc-cuts-ties-clients-ahead-fatca [http://perma.cc/JVX4-E599] (discussing HSBC's decision to sever ties with U.S. clients in 2011 to prepare for FATCA's implementation).

n141 See Tax Gap Estimates, supra note 80 (estimating that approximately $ 385 billion was lost in 2006 due to unpaid taxes).

n142 Levin Speech, supra note 85.

n143 See COUNTRIES, supra note 136 (providing a full list of FATCA partners, numbering greater than 100); Wood, supra note 119 (noting that as of August 2014, more than 77,000 FFIs have signed on to FATCA).

n144 Since FATCA was just implemented in July 2014, data reflecting improved compliance rates is not yet available.

n145 Regulations Relating to Information, supra note 96.

n146 GRAVELLE, supra note 97.

n147 David Jolly & Brian Knowlton, Law to Find Tax Evaders Denounced, N.Y. TIMES (Dec. 26, 2011), http://www.nytimes.com/2011/12/27/business/law-to-find-tax-evaders-denounced.html [http://perma.cc/5RT6-CJCR]. However, an IRS spokesman, Dean Patterson, stated that the IRS was "allocating the requisite resources and personnel to implement [FATCA]." Id.

n148 See Gabrielle Cintorino, Tax Laws Pushing Americans Living Abroad to Renounce Their U.S. Citizenship, CNS NEWS (June 16, 2015), http://www.cnsnews.com/news/article/gabrielle-cintorino/tax-laws-pushing-americans-living-a broad-renounce-their-us [http://perma.cc/6JWV-H3EC] (discussing the risk of foreign divestment of U.S. investments). Some FFIs have already indicated their intention to divest and have advised their institutional and private clients accordingly, such as the Japanese Bankers Association. Id.

n149 ALAN R. EBER, ASSET PROTECTION STRATEGIES AND FORMS 6-11 (2008). Congress established this policy to attract foreign funds to the U.S. economy. Id.

n150 See Jolly & Knowlton, supra note 147 (elaborating on the concern, including the fact that twenty-seven members of the European Union forbid such information divulgence). Nevertheless, this issue may be dealt with by intergovernmental agreements, which, as discussed above, have proliferated. Still, even if agreements do deal with the issue, there may be concern in foreign nations over conflict between legislation and treaties.

n151 Id.

n152 See I.R.C. ß 1471(b)(1) (2014) ("any foreign institution").

n153 See id. ß 1471(a) (imposing a 30% withholding tax for FFIs that fail to meet the Code's requirements).

n154 Vaughn E. James, FATCA and You, SUN (Dominica) (July 20, 2014), http://sundominica.com/articles/fatca-and-you-1462 [http://perma.cc/9FK6-W97H].

n155 Brian Kindle, FATCA May Identify Tax Cheats, But Its Dragnet for Financial Criminals May Produce an Even Bigger Yield, ASS'N CERTIFIED FIN. CRIME SPECIALISTS (Mar. 1, 2012), http://www.acfcs.org/fatca-may-identify-tax-cheats-but-its-dragnet-for-financial-criminals-may-produce-an-even-bigger-yield [http://perma.cc/ PGC3-ZYUK].

n156 Id.

n157 Id.

n158 Id.

n159 Cintorino, supra note 148.

n160 Id.; see also CHINA BRIEFING, supra note 129 (reporting that many banks in Hong Kong have been refusing to open new accounts and shutting down existing accounts for American individuals and corporations in order to avoid having to comply with FATCA).

n161 Cintorino, supra note 148.

n162 Id.

n163 Though FATCA did not create the U.S. global tax scheme, it does enforce the scheme rather well, causing citizens abroad who otherwise may have been able to skirt its requirements to comply. See Act of Aug. 5, 1861, ch. 45, ß 49, 12 Stat. 292, 309.

n164 Such responsibilities include (1) United States income tax returns, including calculations for foreign exchange, foreign tax credits, and exemptions; (2) one or more foreign income tax returns (in country of residence and/or country or countries where income is earned); and (3) U.S. reporting obligations for foreign assets, such as Form 8938 and FBAR.

n165 Cintorino, supra note 148.

n166 See Weinberg, supra note 15 (reporting that 2013 saw a new historical record in renunciations, and as of that writing (Oct. 28, 2014), 2014 was on pace to break 2013's record).

n167 See Act of Aug. 5, 1861, ch. 45, ß 49, 12 Stat. 292, 309.

n168 Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, ß 451 tit. V(A), 124 Stat. 71, 97-108 (2010).

n169 The system has been in place since as early as 1861. See Act of Aug. 5, 1861, ch. 45, ß 49, 12 Stat. 292, 309.

n170 Naturally, taxing more individuals results in greater tax revenue.

n171 Benefits may include the ability to vote, seek help from a U.S. consulate while abroad, return to the United States, and so on.

n172 This is a fairness argument, commonplace in tax law and policy.

n173 Michael S. Kirsch, Article, Revisiting the Tax Treatment of Citizens Abroad: Reconciling Principle and Practice, 16 FLA. TAX REV. 117, 126 (2014) ("[C]itizens living within the United States often view U.S. citizens living overseas as part of the United States. Particularly in times of crisis overseas, media in the United States often focus on the plight of U.S. citizens, thereby strengthening the view that overseas citizens remain a part of United States society.").

n174 Whether an individual is a U.S. citizen or not is a straightforward, objective question. Therefore, taxing U.S. citizens may be easier and more administrable than, say, taxing based on residency (which may be more open to debate and interpretation) or taxing based on where income is earned.

n175 See supra Part II.C.4 (expanding on these and other weaknesses of FATCA).

n176 Levin Speech, supra note 85.

n177 Lily Kahng, Investment Income Withholding in the United States and Germany, 10 FLA. TAX REV. 315, 322-23 (2010) (explaining the effectiveness of investment income withholding).

n178 FATCA subjects FFIs to a 30% tax withholding on "withholdable payments." I.R.C. ß 1471(a) (2014). "Withholdable payment" is defined as

> (i) any payment of interest (including any original issue discount), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, if such payment is from sources within the United States, and (ii) any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States.

Id. ß 1473(1)(A).

n179 Wood, supra note 119.

n180 Rev. Proc. 13-35, 2013-47 I.R.B. 537, 543 (providing exclusion amount for 2014).

n181 Burdens include: (1) United States income tax returns, including calculations for foreign exchange, foreign tax credits, and exemptions; (2) one or more foreign income tax returns (in country of residence and/or country or countries where income is earned); and (3) United States reporting obligations for foreign assets, such as Form 8938 and FBAR.

n182 Barbara Stcherbatcheff, Why Americans Abroad Are Giving Up Their Citizenship, NEWSWEEK (June 28, 2014), http://www.newsweek.com/why-americans-abroad-aregiving-their-citizenship-256447 [http://perma.cc/3GTK-2E4B].

n183 See supra Part II.D.1 (describing ways to keep the global taxation system while only maintaining or altering FATCA and explaining several of the system's benefits).

n184 Stcherbatcheff, supra note 182.

n185 This is in addition to any taxes assessed by the country they reside in, further increasing the overall burden.

n186 And, with FATCA in particular, they may not have access to FFIs. See Cintorino, supra note 148 (explaining that many FFIs are dropping American customers to avoid having to comply with FATCA requirements); CHINA BRIEFING, supra note 129 (reporting that many banks in Hong Kong have been refusing to open new accounts and shutting down existing accounts for American individuals and companies in order to avoid having to comply with FATCA).

n187 Simple solutions have been proposed. For example, one proposal is to use the same "substantial presence" test currently used to determine the tax residence status of an alien. See I.R.C. ß 7701(b)(3) (2014) (presenting the substantial presence test).

n188 A similar occurrence, however, could take place if one just renounces citizenship in the current system.

n189 DONALD J. MARPLES & JANE G. GRAVELLE, CONG. RESEARCH SERV., R43568, CORPORATE EXPATRIATION, INVERSIONS, AND MERGERS: TAX ISSUES 3 (2014).

n190 Id.

n191 Orsolya Kun, Corporate Inversions: The Interplay of Tax, Corporate, and Economic Implications, 29 DEL. J. CORP. L. 313, 367 (2004) ("The inversion dramatically changes the tax liability of the inverted multinational without substantially altering its operation. The location of the corporate headquarters and economic operations, along with the corporation's business practices, remain unchanged.").

n192 MARPLES & GRAVELLE, supra note 189.

n193 Somanader, supra note 25.

n194 Id.

n195 CONG. BUDGET OFFICE, supra note 2.

n196 Id. This is why, in the Introduction to this Comment, the Marriott and the California-based wine corporation had to pay income taxes in the United States for their sales made in the United Kingdom.

n197 See id. at 1 (introducing the approaches).

n198 Id.

n199 Id.

n200 Id.

n201 Id. at 2.

n202 Id. at 5.

n203 See id. at 2 (explaining that the U.S. system is generally more worldwide than territorial).

n204 Id. at 1.

n205 See Lowell Yoder, Beware of Double Taxation of Foreign Profits, FORBES (Mar. 6, 2012), http://www.forbes.com/sites/lowellyoder/2012/03/06/beware-of-doubletaxation-of-foreign-profits [http://perma.cc/T3S5-LHPV] (covering the issue of double taxation for U.S. corporations).

n206 Id.

n207 See Kyle Pomerleau, Corporate Income Tax Rates Around the World, 2014, TAX FOUND. (Aug. 20, 2014), http://taxfoundation.org/article/corporate-income-tax-ratesaround-world-2014 [http://perma.cc/QVE9-S64B] (providing the top marginal corporate income tax rates for Argentina and the United States).

n208 CONG. BUDGET OFFICE, supra note 2, at 7.

n209 Id. A deduction reduces a taxpayer's taxable income, while a credit reduces the total amount that the taxpayer owes on a dollar-for-dollar basis. Id. A tax credit thus reduces tax liability more than a tax deduction.

n210 Id.

n211 Note that in the ABC Co. example, where Argentina's corporate tax rate was lower than that of the United States, ABC Co. had a total tax liability of $ 39,100, or 39.1% of its Argentinian income, the same as the U.S. corporate tax rate.

n212 Using the ABC Co. example, had Argentina's tax rate been higher than that of the United States, any rate greater than 39.1%, ABC Co.'s total tax liability on its Argentinian income would only be the amount that Argentina imposes, since the amount paid to Argentina would eliminate U.S. tax liability entirely via tax credit. In the past, corporations were able to use the excess of the amount paid to foreign governments and the amount owed to the United States as tax credits to offset other U.S. income taxes. CONG. BUDGET OFFICE, supra note 2, at 7. Now, however, the rules have changed, since this would mean the United States was effectively subsidizing the taxes a corporation owes to a foreign country. Id. Under the current taxation scheme, the foreign tax credit is limited to the amount owed to the United States. Id. Regardless, this is a rare situation, as the United States has the third-highest top marginal corporate income tax rate in the world, behind only Chad and the United Arab Emirates. Pomerleau, supra note 207 (providing the twenty highest top marginal corporate tax rates in the world, and listing the United Arab Emirates' top rate at 55%, Chad's top rate at 40%, and the United States' top rate at 39.1%). Thus, unless either of those two countries are at issue, this situation would not arise.

n213 CONG. BUDGET OFFICE, supra note 2, at 8.

n214 Id.

n215 Id.

n216 Id.

n217 Id. Though these are the two most widely used categories, there are actually two other categories that receive special treatment. The first is income from investments in countries in which the United States does not have diplomatic relations and from countries that support terrorism--income from this category is not eligible for a tax credit. Id. at 8 n.6. The other is income that is attributed to foreign countries by treaty--foreign tax credit is computed separately for that income. Id.

n218 See id. at 8.

n219 Yoder, supra note 205.

n220 Id.

n221 Id.

n222 Id.

n223 See CONG. BUDGET OFFICE, supra note 2, at 8-9, 12-13.

n224 Id. at 8.

n225 Id. For purposes of income taxation, funds are not considered available for use until returned to the parent corporation. See id.

n226 Id. at 8-9.

n227 See Dan Freed, How U.S. Corporations Use Overseas Cash in U.S. Without Paying Taxes, STREET (Feb. 23, 2015), http://www.thestreet.com/story/13053211/1/howus-corporations-use-overseas-cash-in-us-without-paying-taxes.html [http://perma.cc/YP6S-2LV2] (covering the deferral strategy).

n228 See MARPLES & GRAVELLE, supra note 189 ("A corporate inversion is a process by which an existing U.S. corporation changes its country of residence . . . . [T]he typical result is that the new foreign parent company faces a lower home country tax rate and no tax on the company's foreign-source income.").

n229 Matt Levine, Burger King May Move to Canada for the Donuts, BLOOMBERG VIEW (Aug. 25, 2014), http://www.bloombergview.com/articles/2014-08-25/burger-king-maymove-to-canada-for-the-donuts [http://perma.cc/S5YZ-3TV3].

n230 Kun, supra note 191, at 315-16.

n231 Id. at 316-17.

n232 Id.

n233 Id. at 317. This is because the McDermott shareholders simply took ownership in the foreign corporation by virtue of being owners of the domestic corporation, rather than selling their shares and then buying new shares. Id. at 316-17. No disposition of stock even took place. Id. at 317.

n234 Id. at 317.

n235 Id.

n236 Id.

n237 Id.

n238 Id. at 318.

n239 Id.

n240 See id. (noting that this became accepted practice and inversions became more common).

n241 MARPLES & GRAVELLE, supra note 189, at 5.

n242 David Gelles, New Corporate Tax Shelter: A Merger Abroad, N.Y. TIMES: DEALB%K (Oct. 8, 2013), http://dealbook.nytimes.com/2013/10/08/to-cut-corporatetaxes-a-merger-abroad-and-a-new-home/?_r=0 [http://perma.cc/PZR4-344P].

n243 OFFICE OF TAX POLICY, DEP'T OF THE TREASURY, CORPORATE INVERSION TRANSACTIONS: TAX POLICY IMPLICATIONS 1 (2002), http://faculty.law.wayne.edu/tad/Documents/Country/Treasury%20inversion%20report%205%2017%2002.pdf [http://perma.cc/BL5E-DKB5].

n244 Press Release, U.S. Senate Comm. on Fin., Grassley Announces Bill to Rein in Corporate Expatriation (Apr. 11, 2002), http://www.finance.senate.gov/newsroom/ranking/release/?id=c084249c-2113-476b-a2bd-ad2efbdce01d [http://perma.cc/VSG3-J5KA].

n245 MARPLES & GRAVELLE, supra note 189, at 6.

n246 Id.

n247 Id.

n248 Id.

n249 Id. at 6 n.28.

n250 Pomerleau, supra note 22.

n251 T.D. 9652, 2014-12 C.B. 655.

n252 Pomerleau, supra note 22.

n253 I.R.S. Notice 2014-52, 2014-42 C.B. 712.

n254 Press Release, Dep't of the Treasury, Fact Sheet: Treasury Actions to Rein in Corporate Tax Inversions (Sept. 22, 2014), http://www.treasury.gov/press-center/pressreleases/ Pages/jl2645.aspx [http://perma.cc/UT8Z-KK7S].

n255 Id. As stated above, U.S. multinationals owe U.S. taxes on profits of their controlled foreign corporations when the profits are repatriated. See supra text accompanying notes 217-21. The law also provides that if a controlled foreign corporation attempted to avoid the repatriation tax by investing in certain U.S. property, such as by making a loan to, or investing in stock of its U.S. parent or its domestic affiliates, the U.S. parent is treated as if it received taxable, repatriated income from the controlled foreign corporation. Id. Before this Notice, some companies worked around this rule by having the controlled foreign corporation make the loan to a new foreign parent, instead of the U.S. parent, essentially allowing the loan to avoid taxation because the loan was not considered U.S. property. Id. Such a loan is known as a "hopscotch" loan. Id. Under this Notice, "hopscotch" loans were made to be considered U.S. property for purposes of applying the anti-avoidance rule. Id.

n256 Id. Former U.S. parents previously avoided taxes on deferred earnings by having the new foreign parent buy enough stock to take control of the controlled foreign corporation away from the former U.S. parent. Id. This way, somewhat similar to "hopscotch" loans, the new foreign parent could access the earnings of the controlled foreign corporation without paying U.S. taxes on them. Id. The Notice did away with this strategy, recognizing this transaction as the foreign parent owning stock in the former U.S. parent. Id.

n257 Id.

n258 Id. Since tax benefits of an inversion can only be realized if the original U.S. company shareholders own less than 80% of the new company, this Notice sought to combat strategies that were often used to work around the 80% requirement. Id. To accomplish this goal, the Notice did the following: it (1) prevented firms from inflating the size of the foreign merger partner by use of passive assets in order to reach the less than 80% goal (it stated that passive assets would not be recognized if more than 50% of the foreign company's assets were passive); (2) banned U.S. companies from intentionally shrinking in size by paying large dividends prior to a merger to meet the less than 80% requirement; and (3) prevented "spinversions," a process in which a portion of a U.S. company would spin off into a new foreign corporation to avoid tax liability. Id.

n259 See MARPLES &GRAVELLE, supra note 189 (presenting the three methods).

n260 Id. at 4.

n261 Id.

n262 Id. This is because the exchange is usually proportionate to the respective company valuations. Id.

n263 Id. It is thus often referred to as a "naked inversion." Id.

n264 T.D. 9652, 2014-12 C.B. 655. Worldwide activity may refer to employees, assets, income, etc. Thomas L. Hungerford, Policy Responses to Corporate Inversions: Close the Barn Door Before the Horse Bolts, ECON. POL'Y INST. 4-5 (Sept. 8, 2014), http://s4.epi.org/files/2014/corporate-inversions.pdf [http://perma.cc/UG5S-E5XD].

n265 Id.

n266 See MARPLES & GRAVELLE, supra note 189, at 4-5 (explaining the respective mergers).

n267 Id.

n268 Id. at 4.

n269 See id. (mentioning that business considerations may be a factor). This type of inversion is therefore less often targeted by inversion critics and policymakers, since it does often involve good faith business decisions. See id. at 4-6.

n270 Id. at 6.

n271 Hungerford, supra note 264, at 4.

n272 Id.

n273 See supra text accompanying notes 217-21 (discussing this strategy).

n274 See Freed, supra note 227.

n275 Id.

n276 Id.

n277 See Thornton, supra note 21, at 8 ("Developed countries truly are in a race to the bottom as national governments lower corporate tax rates in order to attract relocating companies and the economic benefits they bring.").

n278 Of course, there are now more restrictive regulations in place, such as treating a foreign parent company as a domestic corporation if it is owned by at least 80% of the former parent company's stockholders. MARPLES &GRAVELLE, supra note 189, at 6. Still, place of incorporation is the general rule. See id. at 1.

n279 See Protocol Amending Tax Convention With the Netherlands, Neth.-U.S., art. 7, Mar. 8, 2004, S. TREATY DOC. NO. 108-25 (adding art. 26, para. 2(c)(i) to the treaty, limiting benefits to qualified residents of either country, as defined by this test).

n280 See TREATIES REPORT, supra note 28, at 73 (discussing treaties the United States reaches with other countries aimed at minimizing tax impediments to inbound foreign investment).

n281 Note that "non-resident" includes foreign corporations, not just individuals. This makes it more relevant to inversions.

n282 TREATIES REPORT, supra note 28, at 73. The tax is generally a 30% gross-basis withholding tax. Id.

n283 Id. at 73-74.

n284 See id. at 78 (discussing this phenomenon, referred to as "treaty shopping").

n285 Id.

n286 Id.

n287 See id. at 80 (explaining how treaty shopping is used in inversion transactions).

n288 See id. at 78-81 (covering anti-abuse rules and the Limitations-on-Benefits concept).

n289 Id. at 77-78.

n290 See id. at 79 (noting that the United States replaced these rules with objective tests because they were too subjective).

n291 Id.

n292 In the 1970s, these provisions denied benefits to a corporation 25% or more owned by individuals not resident in the treaty partner state which face lower effective tax rates than it otherwise would; later, they included a determination of a person's economic nexus to the corporation's country of residence; they were supplemented in following years with an ownership test, requiring that a corporation's gross income not be used "in substantial part" to satisfy liabilities to non-residents; that later became the ownership/base-erosion test, denying treaty benefits to corporations that are majority owned by third-country residents or that disburse more than half of gross income to third-country residents; they also came to include the "publicly traded" test, where corporations publicly traded on a recognized stock exchange were granted benefits, on the theory that publicly held corporations would probably not be used as vehicles for treaty shopping; they were also given an "active-conduct" test, where a corporation that did not satisfy the publicly traded or ownership/base-erosion test would be eligible for treaty benefits if it (1) is engaged in the active conduct of a trade or business in its country of residence; and (2) sought benefits on a payment related to the trade or business (and sometimes the corporation would have to also be substantial in size relative to the activity in the source country generating the income). See id. at 79-80 (walking through the progression of the LOB provisions).

n293 See generally David Zaiken, Limitation on Benefits Clauses: The Balancing Act Between Business Needs and Tax, ALVAREZ & MARSAL (May 30, 2013), http:// www.alvarezandmarsal.com/limitation-benefits-clauses-balancing-act-between-business-needs-and-tax [http://perma.cc/CN95-8X33] (describing the numerous bilateral income tax treaties the United States has with foreign governments).

n294 Id.

n295 Id.

n296 See TREATIES REPORT, supra note 28, at 80-81 (explaining today's publicly traded test). The theory is that such a corporation would probably not be created only to take part in treaty shopping. Id.

n297 Id. This was the case, for example, in the U.S.-Barbados protocol (2004), where an additional nexus of the corporation's stock listed and primarily traded on the Barbados stock exchange was needed. Id.

n298 Id. at 81-82.

n299 See, e.g., id. at 80-81 (comparing the differing requirements of the publicly traded test in the U.S.-Barbados protocol and the U.S.-Netherlands protocol).

n300 Zaiken, supra note 293, at 2.

n301 Id.

n302 Clausing, supra note 23.

n303 Somanader, supra note 25.

n304 See CONG. BUDGET OFFICE, supra note 2 (explaining that the U.S. system is generally more worldwide than territorial). Note that the U.S. system does have some nonpurely worldwide elements, such as allowing for foreign tax credits and deferrals, but it is still overwhelmingly closer to the worldwide system. Id.

n305 Id.

n306 Id. at 3-4.

n307 See id. at 24.

n308 See generally Freed, supra note 227 (discussing the issuance of debt to avoid repatriation taxation).

n309 CONG. BUDGET OFFICE, supra note 2, at 25.

n310 Id. at 2.

n311 Since the territorial approach would not collect taxes on income earned abroad, tax revenue would be reduced. See id. at 24.

n312 In that the companies would no longer have to pay tax on foreign earnings.

n313 See GRAVELLE, supra note 97, at 16-22 (discussing corporate profit shifting).

n314 MARPLES & GRAVELLE, supra note 189, at 12.

n315 See generally John C. Goodman, Let's Abolish the Corporate Income Tax, FORBES (Aug. 26, 2014), http://www.forbes.com/sites/johngoodman/2014/08/26/lets-abolish-the-corporate-income-tax/ [http://perma.cc/WTP4-6U6P] (advocating for such an elimination).

n316 See Pomerleau, supra note 207 (providing the twenty highest top marginal corporate tax rates in the world).

n317 See Goodman, supra note 315 (discussing this theory).

n318 See id. (making this claim and providing simulations to reinforce it).

n319 See generally Steven A. Bank, Entity Theory as Myth in the Origins of Corporate Income Tax, 43 WM. & MARY L. REV 447, 472-90 (2001) (explaining the history of corporate income tax in the United States).

n320 See id. (discussing the theory). Perhaps corporations would not lower their prices so that individuals save more; perhaps they would maintain their pricing structure and keep more of the profits, instead. There is little empirical proof as to the effectiveness of this theory.

n321 See supra Part II.A.

n322 MARPLES & GRAVELLE, supra note 189, at 13.

n323 Id.

n324 Id. Recall, this test states that if there is 60% continued ownership, the foreign parent company will not be taxed like a domestic corporation, but will have to pay any U.S. taxes on gains that apply to transfers of assets to the new entity, and foreign tax credits or net operating losses cannot offset those obligations. Id. at 6.

n325 Id. at 13.

n326 Id.

n327 See id. at 13-14 (discussing H.R. 4679, which would call for the same 50% test that Obama proposed, as well as a 25% business activity minimum in the United States, and S. 2360, a companion bill in the Senate).

n328 See Emily Stephenson, U.S. Senate Democrats Propose Exit Tax for Inverting Companies, REUTERS (Sept. 19, 2014), http://www.reuters.com/article/2014/09/19/us-usa-inversion-congress-idUSKBN0HE1SS20140919 [https://perma.cc/GYY2-F4K8] (covering the exit tax proposal). Legislation advocating this proposal is entitled "Pay What You Owe Before You Go Act (S. 2895, H.R. 5549)." Proposals to Curb Inversions and Corporate Tax Loopholes, AMERICANS FOR TAX FAIRNESS, http://www.americansfor taxfairness.org/files/FACT-Bill-specific-fact-sheet-Inversions-2.pdf [http://perma.cc/F2U5-ZHND] (last visited Oct. 25, 2015) [hereinafter Proposals].

n329 Stephenson, supra note 328. Recall that income is only taxable when repatriated back to the United States.

n330 Id.

n331 Id.

n332 Id.

n333 Offshore Tax Loopholes, AMERICANS FOR TAX FAIRNESS, http://www.americansfortaxfairness.org/stop-tax-haven-abuse/ [http://perma.cc/DF2TY22B] (last visited Oct. 25, 2015). Legislation advocating this proposal is entitled "Stop Tax Haven Abuse Act (S. 1533, H.R. 1554)." Proposals, supra note 328.

n334 Offshore Tax Loopholes, supra note 333.

n335 Id.

n336 Id.

n337 See supra notes 131-32.

n338 See Offshore Tax Loopholes, supra note 333.

n339 Id.

n340 David Gelles, New Legislation Targets Inversions from Different Angle, N.Y. TIMES: DEALB%K (July 29, 2014), http://dealbook.nytimes.com/2014/07/29/new-legislation-targets-inversions-from-different-angle/?_r=0 [https://perma.cc/AG4FRD7H]. Legislation advocating this proposal is entitled "No Federal Contracts for Corporate Deserters Act (S. 2704, H.R. 5278)." Proposals, supra note 328.

n341 Gelles, supra note 340.

n342 Id.

n343 Id.

n344 Id.

n345 See MARPLES & GRAVELLE, supra note 189, at 13-16 (listing several legislative and administrative proposals); Proposals, supra note 328 (listing proposals and their sponsors).

n346 See supra Parts II-III.

n347 Dropping the Bomb, supra note 16.

n348 Weinberg, supra note 15.

n349 Id.

n350 See Pomerleau, supra note 22 (pointing out that prior to 2004, there had only been less than thirty total inversions, but since 2004, more than forty-seven U.S. companies have inverted).

n351 See Somanader, supra note 25 (stating that corporate inversions will cost the United States more than $ 20 billion in the next ten years).

n352 See Tax Gap, supra note 82 (noting that the U.S. tax gap is due to underpayment, underreporting, and failure to file).

n353 See Levin Speech, supra note 85, at S1635-36 (estimating offshore tax evasion to cost the Treasury $ 100 billion a year).

n354 See supra Part II.A.

n355 See I.R.C. ß 1471 (2014) (requiring disclosure from FFIs); id. ß 6038(d) (setting requirements as to what individual U.S. taxpayers must disclose).

n356 See id. ß 1471(b)(1) (imposing a 30% withholding tax on all U.S.-source payments if FFIs fail to comply); COUNTRIES, supra note 136 (providing a list of countries, numbering over 100, that have reached agreements with the United States to carry out FATCA).

n357 See CONG. BUDGET OFFICE, supra note 2 (explaining that the U.S. system is generally more worldwide than territorial).

n358 MARPLES & GRAVELLE, supra note 189.

n359 See U.S. Citizens and Resident Aliens Abroad, supra note 7 (explaining that U.S. citizens and resident aliens are taxed on worldwide income, regardless of residence); CONG. BUDGET OFFICE, supra note 2 (explaining that the United States taxes the foreign income of companies incorporated in the United States).

n360 See U.S. Citizens and Resident Aliens Abroad, supra note 7. Of course, there are several exceptions to this general rule for both citizens and corporations, including foreign tax credits, deferrals, and others reviewed above.

n361 See supra Part II.C.

n362 See supra Part III.A.

n363 Workarounds present themselves in the form of citizenship renunciations and corporate inversions.

n364 Act of Aug. 5, 1861, ch. 45, ß 49, 12 Stat. 292, 309, repealed by Act of July 1, 1862, ch. 119, ß 89, 12 Stat. 432, 473.

n365 Beyond deferring to the overall tax policy decision of the United States, dismantling the worldwide taxation system has been presented and advocated for countless times. Posing such an argument here would provide nothing new to the taxation discourse. Using the same test (actual residency) to improve how both individual citizen taxation and corporate taxation, two concepts traditionally kept distinct, however, does present a new approach.

n366 See supra text accompanying note 171.

n367 See supra text accompanying note 171.

n368 Ryan C. Fuhrmann, What Americans Need to Know About Living Abroad, INVESTOPEDIA (May 15, 2012), http://www.investopedia.com/financial-edge/0512/what-americans-need-to-know-about-living-abroad.aspx [https://perma.cc/HWH7-XFYU]. The benefits to U.S. resident aliens abroad are naturally slimmer, yet their tax obligations remain the same. Each of these benefits contain a number of conditions and restrictions outside the scope of this Comment.

n369 See id. (discussing some of the negative considerations in deciding to move abroad as a U.S. citizen).

n370 Id.

n371 Frequent Fliers: Increased International Travel, NAT'L SCI. FOUND., https://www.nsf.gov/news/speeches/colwell/rc04_indian/sld007.htm [http://perma.cc/UV49-8G4E] (last visited Oct. 25, 2015).

n372 The cost, of course, being taxes.

n373 Weinberg, supra note 15.

n374 See Act of Aug. 5, 1861, ch. 45, ß 49, 12 Stat. 292, 309, repealed by Act of July 1, 1862, ch. 119, ß 89, 12 Stat. 432, 473.

n375 See Weinberg, supra note 15.

n376 Residence and Domicile, AM. FOREIGN SERV. ASS'N, http://www.afsa.org/residence-and-domicile [https://perma.cc/7PN8-ELSV] (last visited Mar. 24, 2016).

n377 Mississippi Band of Choctaw Indians v. Holyfield, 490 U.S. 30, 48 (1989) (citing Texas v. Florida, 306 U.S. 398, 424 (1939)).

n378 Id.

n379 Martinez v. Bynum, 461 U.S. 321, 339-40 (1983).

n380 Residence and Domicile, supra note 376.

n381 Tax Gap Estimates, supra note 80.

n382 Tax Gap, supra note 82, at 6.

n383 Victor Fleischer, Despite Tax Rules, Companies Stick with U.S., N.Y. TIMES: DEALB%K (June 6, 2013), http://dealbook.nytimes.com/2013/06/06/despite-tax-rules-companies-stick-with-u-s/?_r=0 [https://perma.cc/Q2A4-8BWM].

n384 Id.

n385 Id.

n386 See Pomerleau, supra note 207 (providing the top marginal corporate income tax rate in the United States).

n387 In all the years prior to 2004, the United States saw fewer than thirty total inversions. Pomerleau, supra note 22. Since then, at least forty-seven companies have inverted. Id. Since 2011, at least twelve large U.S. companies have inverted. Clausing, supra note 23.

n388 See MARPLES & GRAVELLE, supra note 189 (presenting the three methods).

n389 Inverting has no effect on a corporation's ability to operate within the United States or sue in U.S. courts, for example.

n390 See TREATIES REPORT, supra note 28, at 80-82 (describing the "primary place of management and control" test).

n391 See DEP'T OF THE TREASURY, TECHNICAL EXPLANATION OF THE PROTOCOL SIGNED AT BERLIN ON JUNE 1, 2006 AMENDING THE CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND THE FEDERAL REPUBLIC OF GERMANY FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL AND TO CERTAIN OTHER TAXES SIGNED ON 29TH AUGUST 1989 art. XIV, para. 2 (2007), http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/tegermany07.pdf [http://perma.cc/6C3K-4DXZ].

n392 Id.

n393 Id.

n394 Id.

> To apply the test, it will be necessary to determine which persons are to be considered 'executive officers and senior management employees.' In most cases, it will not be necessary to look beyond the executives who are members of the Board of Directors (the 'inside directors') in the case of a U.S. company. That will not always be the case, however; in fact, the relevant persons may be employees of subsidiaries if those persons make the strategic, financial and operational policy decisions. Moreover, it would be necessary to take into account any special voting arrangements that result in certain board members making certain decisions without the participation of other board members.

Id.

n395 See TREATIES REPORT, supra note 28, at 81 (listing several countries with such treaties).

n396 While there isn't much data on this correlation, the question arises of why a company would incorporate in the United States if its major management and control operations took place outside the United States. It would open itself up to taxation by the United States on income earned outside the country, which, as a company with major operations outside the country, there would likely be a lot of. There are some non-tax advantages of incorporating in the United States, as listed above, but these may be less advantageous for companies based outside the country. A foreign company could just as easily incorporate in its home country and simply conduct business in the United States. Or, if it would like to incorporate in the United States but avoid the U.S. tax bill on all international income, it could open a foreign subsidiary in the United States that incorporates in the country, but that would have no effect on tax revenue regardless of which test is used, since the U.S. subsidiary would (theoretically) limit its operations to the United States.

n397 FFIs comply with U.S. disclosure requirements to avoid the 30% withholding tax under FATCA. See I.R.C. ß 1471(a) (2014) (setting forth the 30% withholding requirement). Countries also choose to comply. See COUNTRIES, supra note 136 (providing a list of countries, numbering over 100, that have reached agreements with the United States to carry out FATCA). This includes even countries that may otherwise be expected to not comply, like Russia, China, and countries that are traditionally tax havens. See Wood, supra note 119.

n398 The United States can probably limit this analysis to U.S. citizens or those who were formerly U.S. residents.

n399 See Weinberg, supra note 15 (noting that the demands placed on FFIs by FATCA have resulted in many FFIs choosing to deny accounts to all American citizens rather than comply and incur the burdens and expenses).

n400 See TREATIES REPORT, supra note 28, at 80-81 (covering some of the common tests in LOB provisions, including primary place of management and control).

n401 Id.

n402 See Weinberg, supra note 15 (discussing the impact of FATCA on expatriates and the resulting record-breaking number of citizenship renunciations); Dropping the Bomb, supra note 16 (commenting on burdens placed upon expatriates, FFIs, and the IRS due to FATCA's implementation).