WHY DO TAX HOLIDAYS NOT WORK? AN ANALYSIS OF THE 2004 TAX HOLIDAY AND SOLUTIONS TO ADDRESS THE CURRENT PROBLEMS INHERENT WITH CORPORATE TAXATION

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ABSTRACT

The purpose of this research is to identify solutions for two problems inherent in current corporate tax policy, which are (1) the recent increase in corporate inversions, and (2) the stockpiling of cash overseas by U.S. domiciled multinational corporations. While lawmakers passed the 2004 tax repatriation holiday as an intended solution, it did not remedy the aforementioned problems. Thus, my research analyzes the 2004 holiday and its ultimate consequences. Further, I evaluate four alternatives that could provide solutions for these ongoing problems with corporate taxation. These alternatives included (1) maintaining the status quo, (2) enacting an additional tax holiday with strict guidelines and provisions, (3) converting to a territorial tax system, and (4) converting to a foreign minimum tax system. I conclude that a foreign minimum tax system would be the most effective solution to address the current problems and stimulate the U.S. economy. Overall, this research highlights the need to reform corporate tax policy to provide economic benefits for the United States.

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INTRODUCTION

Recently, corporate taxation has been a hot point for debate, as publicized research has shown an increase in the use of foreign tax havens by American multinational firms over the past few decades (Alexander, 2015). These tax havens allow firms to avoid paying United States (U.S.) taxes on profits earned overseas, which would normally be taxed at the U.S. corporate tax rate of 35 percent. With over $2.1 trillion currently sitting in untaxable overseas tax shelters for American multinational firms (Alexander, 2015), this suggests that the U.S. government is missing out on over $500 billion in tax revenues. Similarly, corporate inversions, which are essentially strategies for U.S. corporations to lower their tax bills by relocating operations overseas, have increased dramatically in recent years. In fact, there have been more than 50 inversions in the past decade -- more than any other decade on record since the inception of corporate inversions in the early 1980's. These growing problems have led to research and debates concerning the most efficient way to bring this cash back into the U.S. economy. However, this current predicament is not unique, as similar problems were heavily debated in Congress in the early 2000's.

In 2004, the U.S. government passed the tax repatriation act to allow multinational firms domiciled within the U.S. to bring back foreign earnings at a low tax rate of 5.25 percent, compared with the normal corporate tax rate of 35 percent (Dharmapala, Foley, & Forbes, 2011). Under this act, U.S. corporations brought over $365 billion into the U.S. economy (Dharmapala, Foley, & Forbes, 2011). The tax cuts for corporate profits were passed with two primary goals in mind. The first goal of the 2004 tax repatriation act was to deter American multinational corporations from stockpiling cash overseas. In 2004, the amount of money held

overseas by multinational companies was estimated to be over $650 billion. Rather than decreasing this amount, multinational corporations have consistently increased the amount of money kept overseas year after year. As described above, in January of 2015, it was estimated that American companies had cash stockpiles overseas amounting to over $2.1 trillion (Alexander, 2015).

The second goal was to stimulate the domestic economy by increasing investment and jobs in the U.S. Along these lines, the legislation specified that the repatriated earnings should be used for specific activities, such as hiring workers, or making investments in research and development (Brennan, 2010). However, many critics have since pointed out that this tax holiday failed in its goal to stimulate economic growth in the U.S. For example, research conducted on the effects of the 2004 tax holiday found that, "The 15 companies that benefited the most from a 2004 tax break for the return of their overseas profits cut more than 20,000 net jobs and decreased the pace of their research spending" (Levin & Coburn, 2011).

Furthermore, the act prohibited the repatriated money from being used to increase stock buybacks or to pad executives' bonuses (Shapiro & Mathur, 2009). Unfortunately, analysis of the tax holiday has shown that the opposite occurred (Shapiro & Mathur, 2009). That is, research has shown that repatriating firms increased share repurchases after the act by $60 billion more than other similar non-repatriating firms (Blouin & Krull, 2009). This happened because the "act did not require a direct tracing of the spending of the repatriated funds" (Shapiro & Mathur, 2009). In fact, the "repatriating firms could ignore the investment prescriptions, since tax regulators were provided no legally viable basis to pursue violations of the spending requirements" (Cao, Chen, Clemons, & Kinney, 2014).

To summarize, the 2004 tax repatriation holiday was designed to stimulate the domestic economy by increasing domestic investment and creating jobs in the U.S., and deterring American multinational corporations from holding earnings overseas. Clearly, the tax holiday failed to produce the intended economic benefits, with evidence indicating that firms generally used the repatriated funds to repurchase stock and pay bigger dividends to shareholders, as opposed to investing in U.S. jobs and domestic growth prospects (Marr & Huang, 2014).

The negative effects of the 2004 tax repatriation holiday have been researched extensively, but there is still little consensus on how to address the similar problem that exists today. This paper will address the inherent problems within U.S. corporate taxation policy by briefly overviewing the U.S. corporate tax system, synthesizing the effects of the 2004 tax holiday, and offering recommendations moving forward to remedy these problems inherent in corporate taxation. These recommendations will be derived from an explanation and analysis of three solutions, which have been proposed to help remedy the corporate taxation problem. Specifically, these three possible solutions include (1) maintaining the status quo, (2) enacting a future tax holiday with more stringent provisions and guidelines, and (3) revamping the current tax system.

Literature Review

U.S. Tax Policy

"The U.S. follows a worldwide system of corporate taxation, under which U.S. persons and firms are liable for tax on all income, regardless of where it is earned" (Shapiro & Mathur, 2009). Thus, U.S. corporations pay taxes on profits earned domestically and abroad. Foreign earned income is taxable to the U.S. as well as at the corporate tax rate set forth by the host

country, which may differ substantially from the U.S. domestic tax rate (Bloink, 2012). To avoid double taxation, "taxpayers can claim a foreign tax credit for corporate income taxes paid to foreign governments, offsetting U.S. tax liability" (Shapiro & Mathur, 2009).

For example, if a U.S. corporation earns $1,000 overseas and the local tax rate in the foreign jurisdiction is 25 percent, then the corporation would pay $250 dollars to the foreign jurisdiction in taxes. This would decrease the corporation's U.S. tax liability to equate the tax rates between the U.S. and the foreign jurisdiction. In this example, the corporation would record a U.S. tax liability of 10 percent of $1,000, because the U.S. tax rate would be reduced by 25 percent from the 35 percent rate to yield a remaining tax liability of 10 percent. Similarly, if U.S. corporations' tax payments in the foreign jurisdiction exceed the U.S. income tax liability, then the taxpayer may "apply their excess foreign tax credits to reduce their U.S. income tax liability on foreign source income from the two previous years of the following five years" (Shapiro & Mathur, 2009). To avoid paying taxes in the U.S., corporations can also "defer their U.S. tax liability of their foreign-earned profits until those profits are transferred to the U.S. parent company in the form of dividends" (Shapiro & Mathur, 2009).

Furthermore, the U.S. Treasury's collection of taxes on foreign-earned profits is dependent on how the foreign income is earned. If the firm is organized as a branch of a U.S. corporation, then the U.S. Treasury taxes the income as it is earned. In contrast, if the firm is organized as a subsidiary and is therefore incorporated within the foreign country, then the foreign earnings are not taxed by the U.S. Treasury until the subsidiary's profits are remitted to the U.S. (Altshuler, R., Newlon, T., & Slemrod, J., 1993). For example, in 2014, the corporate income tax rate for U.S. corporations was 35 percent (Levin & Coburn, 2011). However,

Microsoft Corporation -- an American multinational firm based in Redmond, Washington -- paid an effective tax rate of 21 percent (Microsoft 2014 annual report, 2014). This tax rate is lower than the federally-enforced 35 percent tax rate because some of Microsoft's earnings are taxed at lower rates in foreign jurisdictions.

While firms that earn foreign profits through subsidiaries are not required to pay taxes until they are repatriated back to the U.S., the firms are required to record a deferred tax liability on their balance sheet to account for the eventual remittance of earnings to the U.S. (Marr & Huang, 2014). Furthermore, "economists have studied the current "deferral" provisions for three decades and have concluded that they create strong incentives to retain earnings in foreign countries with lower corporate tax rates than the U.S. until those earnings can be used to offset U.S. domestic losses" (Shapiro & Mathur, 2009). However, firms can classify foreign earnings as 'permanently reinvested' to avoid paying U.S. taxes and "recording deferred tax liabilities altogether" (Tomy, 2014).

Recent Trends

Economists and analysts alike have pointed out that inherent problems within U.S. corporate tax policy have led to an increase in "corporate inversions" in the recent past. In fact, there have been over fifty corporate inversions in the past decade (Douglas-Gabriel, D., 2014). A corporate inversion generally originates with a domestic corporation that has operations in the U.S. and abroad. The domestic corporation creates an additional corporation abroad in a low-tax country with the "sole purpose of facilitating the inversion" (Sheppard, 2002). The foreign corporation will then merge with the domestic corporation to create one large corporation with the headquarters in the low-tax country and subsidiaries located domestically

(Sheppard, 2002). Essentially the new foreign corporation becomes the parent of the U.S. subsidiary. This type of corporate inversion does not necessarily mean there is a significant or noticeable change in the economic activity or governance of the corporation, but instead signals a move by management to have lower effective tax rates. In summary, corporate inversions are simply "mail-box inversions accomplished entirely on paper" that do not "affect domestic employment, management structure, or the location of production facilities" (Sheppard, 2002).

The corporate inversion lowers the U.S. tax bill for corporations by taking advantage of two benefits that result from such inversions. First, dividend distributions from foreign subsidiaries are exempt from U.S. taxes after inversions because the foreign subsidiaries would be paying dividends to the parent corporation that is not headquartered in the U.S. In essence, the dividends would be distributed by two foreign corporations, which would allow the distributions to be untouched by the U.S. (Sheppard, 2002). Second, the corporate inversion allows the firm to take advantage of "earnings stripping." That is, the American subsidiary borrows from the parent corporation abroad in the form of debt. The American subsidiary then pays interest on the debt back to the parent company located abroad in a low-tax area. These interest payments from the domestic subsidiary to the foreign parent are tax deductible in the U.S., which will therefore decrease the tax bill of the American corporation (Sheppard, 2002). In fact, a corporate inversion typically leads to an effective tax rate decrease of 11.6 percent or a one-third reduction of inverting firms' pre-inversion income tax expense (Seida & Wempe, 2004).

Overview of 2004 Tax Repatriation Holiday

On October 22, 2004, President George W. Bush signed the American Jobs Creation Act into law. One of the main provisions of the act created a temporary tax holiday that "effectively reduced the U.S. tax rate on repatriations from foreign subsidiaries from 35 percent to 5.25 percent" (Blouin & Krull, 2009). To be eligible for this repatriation holiday, U.S. firms had to meet the following requirements: "First, repatriations had to be paid in cash. Second, qualifying repatriations could not exceed the greater of (a) $500 million, (b) the earnings reported as permanently reinvested on the last audited financial statements filed on or before June 30, 2003, or (c) the amount the firm had historically repatriated from its foreign subsidiaries" (Dharmapala, Foley, & Forbes, 2011).

Congress also added that the reduction in taxes was a means to "increase jobs in the U.S." (Blouin & Krull, 2009). The act also included restrictions on the amount of funds eligible for the low tax rate and on the use of the funds in the U.S. Namely, "approved uses of the funds include funding for hiring and training, infrastructure, research and development, capital investments, and financial stabilization for purposes of job retention and creation" (Blouin & Krull, 2009). The act specifically prohibited the repatriated funds from being used for dividends, share repurchases, tax payments, and purchases of debt instruments or a less than 10 percent interest in a business entity (Blouin & Krull, 2009). The IRS notice also noted that the uses of the repatriated funds would be too difficult to monitor, and therefore there would be no tracing of the use of the repatriated funds by the federal government.

According to the Bureau of Economic Analysis, U.S. multinationals repatriated $300 billion after the 2004 tax holiday was implemented, compared to $60 billion in repatriations

over the previous half-decade before 2004. Although the legislation for the act prescribed and prohibited specific uses of the funds, research has shown that repatriated funds were associated with "significantly higher levels of shareholder payouts, mainly through share repurchases" (Dharmapala, Foley, & Forbes, 2011). This implies that "government regulations on how firms used the repatriated funds appear to have been ineffective" (Dharmapala, Foley, & Forbes, 2011). The tax holiday act also failed to increase jobs in the U.S. As pointed out by the Center on Budget and Policy Priorities, many firms actually decreased their workforce in the U.S. as they reaped "multi-billion-dollar benefits from the tax holiday and passed them on to shareholders" (Marr & Highsmith, 2011). In addition, "a comprehensive study published by the National Bureau of Economic Research (NBER) found that the repatriation holiday did not increase domestic investment, employment, or [research and development]" (Marr & Highsmith, 2011). Other studies found that "firms enjoying disproportionately larger gains under the act were no more likely to spend repatriated funds on growth-generating activities than other firms" (Clemons & Kinney, 2008). In terms of domestic investment by repatriating firms, analysis has shown that "multinationals that repatriated higher levels of earnings under the holiday did not increase their domestic investments (or any other approved uses of the funds) to a larger degree than multinationals that repatriated lower levels of earnings" (Marr & Highsmith, 2011). These findings are consistent with those of the U.S. Senate, as described below.

Independent Subcommittee Findings

On October 11, 2011, the Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs of the U.S. Senate released an investigative

report covering the effects of the American Jobs Creation Act passed in 2004. With respect to The Act's goal of increasing investments in research and development and domestic job creation, the study found that "after repatriating over $150 billion, the top 15 repatriating corporations showed slight decreases in the pace of their U.S. research and development expenditures, while broad-based studies of all 840 repatriating corporations found no evidence that repatriation funds increased overall U.S. research and development outlays" (Levin & Coburn, 2011). Furthermore, "the top 15 repatriating corporations reduced their overall U.S. workforce by 20,931 jobs, while broad-based studies of all 840 repatriating corporations found no evidence that repatriation funds increased overall U.S. employment" (Levin & Coburn, 2011).

The report also stated that the American Jobs Creation Act of 2004 "essentially provided guidelines on four specific uses of repatriated funds: two -- using funds for jobs and research and development -- were encouraged, while two others -- using funds for executive compensation and stock buybacks -- were prohibited" (Levin & Coburn, 2011). This sharply contrasts the findings of the same report that states, "the evidence shows that, rather than producing new jobs or increasing research and development expenditures, the 2004 repatriation tax provision was followed by an increase in dollars spent on stock repurchases and executive compensation" (Levin & Coburn, 2011). More specifically, the study found that "the top 15 repatriating corporations accelerated their spending on stock buybacks after repatriation, increasing them 16 percent from 2004 to 2005, and 38 percent from 2005 to 2006, while a broad-based study of all 840 repatriating corporations estimated that each extra dollar of repatriated cash was associated with an increase of between 60 and 92 cents in payouts to

shareholders" (Levin & Coburn, 2011). In addition, the report also found that "despite prohibition on using repatriated funds for executive compensation, annual compensation for the top five executives at the top 15 repatriating corporations jumped 27 percent from 2004 to 2005, and another 30 percent from 2005 to 2006, with ten of the corporations issuing restricted stock awards of $1 million or more to senior executives" (Levin & Coburn, 2011).

This evidence clearly indicates that the prohibition of using funds for share repurchases and executive compensation was neither achieved nor enforced. This evidence further supports the assumption that not only did the American Jobs Creation Act of 2004 fail to meet its stated goals of stimulating job growth and investment in research and development domestically, but the act also did nothing to prevent the two prohibited outcomes -- increases in executive compensation and corporate share repurchases (Marr & Huang, 2014). As a result of the evidence gathered during the subcommittee's investigation, the report concluded that "the 2004 repatriation cost the U.S. Treasury an estimated net revenue loss of $3.3 billion over ten years, produced no appreciable increase in U.S. jobs or research investments, and led to U.S. corporations directing more funds offshore" (Levin & Coburn, 2011). The report also recommended against "enacting a second corporate repatriation tax break due to the harms associated with a substantial revenue loss, failed stimulus, and added incentive for U.S. corporations to move job and investments offshore" (Levin & Coburn, 2011).

Simply put, the growth in American jobs and investment that was supposed to follow the tax holiday did not occur (Levin & Coburn, 2011). In addition, the report also acknowledged that "the U.S. tax code now encourages corporations to move jobs and money overseas" and "over the past ten years, some U.S. corporations with multinational operations have been

reporting staggering increases in profits offshore, while reducing the taxes they pay to the U.S." (Levin & Coburn, 2011). The findings from the independent subcommittee therefore illustrate how the primary goals were not met by the tax holiday, as it did not stimulate the economy by creating domestic investment and jobs, nor did it deter American multinational corporations from holding money overseas.

Purpose of Research

When the 2004 tax holiday was passed in the American Jobs Creation Act, Congress specifically indicated that the tax holiday would be a one-time-only event, and that a similar act should not be repeated in the future. However, today, U.S. multinational corporations hold $2.1 trillion overseas to avoid paying repatriation taxes in the U.S., and corporate inversions continue to increase. This type of erosion of the corporate tax base has brought on pressure for U.S. lawmakers to come up with a solution to bring money back to the U.S. and stimulate the economy. Perhaps not surprisingly, a large coalition of companies, led by Apple, Google, and Cisco Systems, has lobbied for the federal government to pass another tax holiday. The coalition and other proponents for another tax holiday have said that an additional tax holiday would "play a meaningful role in helping to stabilize and restore employment, capital spending and wages, and provide additional liquidity to the U.S. financial system" (Shapiro & Mathur, 2009). In contrast, opponents of another act similar to the 2004 tax relief program say that "repeating the tax holiday would increase incentives to shift income overseas," and would make corporations more inclined to "shift income into tax havens and less likely to make investments in the U.S." (Marr & Highsmith, 2011).

Both proponents and opponents of the tax holiday agree that there are inherent problems within the U.S. corporate tax system that have led to the problems I've discussed. The rest of this paper will discuss three possible solutions that can address these problems – (1) maintain the status quo, (2) treat the problem in the short-term by enacting future tax holidays and requiring more stringent repatriation guidelines and rules for participating firms, and (3) treat the problem from a long-term perspective by revamping current tax legislation to encourage domestic investment by American multinational companies.

Possible Solutions

Maintain the Status Quo

A "status quo" position describes the scenario in which the U.S. tax laws do not change, and no future tax holidays are planned to alleviate the large capital stockpiles overseas. Proponents of a "status quo" position may suggest that this strategy is best for two reasons. First, proponents for a status quo strategy would argue that the cost of tax holidays outweigh their benefits. That is, not only was there opportunity cost associated with the 2004 tax holiday, but it also cost the U.S. Treasury $3.3 billion dollars in the ten years after its passing (Marr & Huang, 2014). Second, status quo proponents would argue that the problems with U.S. corporate tax policies are overblown and out of touch with the economic principles that govern corporate decision-making (Bogenschneider, 2015). For example, they would dispute the assertion that corporate inversions have been too common recently, arguing instead that the limited number of inversions are driven by valid corporate choices, rather than tax avoidance.

To illustrate this second point, consider Burger King, which recently relocated to Canada in a deal with Tim Horton's to avoid the high corporate tax rate in the U.S. One could argue that

the inverted U.S. corporations, such as Burger King, “have no plans to invest incremental foreign capital into U.S. businesses anyway” (Bogenschneider, 2015). Substantial increases in domestic investment by such corporate inverters are unlikely because of the inherent characteristics of the U.S. tax system, which allows business capital investments to be written off against profits for tax purposes. The Burger King corporate inversion and others like it are more likely to reveal more about the inverters’ investment prospects within the U.S. rather than any pitfalls existent within U.S. corporate tax policy. Furthermore, the notion that domestic investment is inhibited by U.S. tax policy as opposed to a corporation’s inability or unwillingness to invest its capital in the U.S. is often “overblown and more likely based in an attitude of xenophobia” (Bogenschneider, 2015). Alternatively stated, corporations are much more likely to have other reasons for not investing domestically, such as a corporate strategy to focus on growth in markets outside of the U.S (Davidoff, 2011). This explanation could provide a reason why the 2004 tax repatriation act did not bring in the new jobs and domestic investment that policymakers anticipated it would.

To summarize, if a multinational corporation decides it would be advantageous to invest capital in the U.S., the current tax policy should not influence its decisions when considering the tax deferral of capital investment. The decision by corporate decision makers to relocate to regions outside of the U.S. therefore cannot be solely attributed to U.S. tax policy. Therefore, a “status quo” approach could be the best policy to implement in the short-term to avoid spending legislative time and money on creating and implementing tax policies that may or may not be effective.

Short-term Solution

Another viable option to alleviate the problems inherent with U.S. corporate tax policy is to treat the problem in the short-term by enacting an additional tax holiday. This new tax repatriation holiday would have goals similar to the 2004 act, which would be to stimulate the American economy by spurring domestic investment and creating jobs in the U.S. However, the future tax holiday would differ from the 2004 holiday in that the future act would require direct tracing of the repatriated funds from participating firms. The participating firms would be required to use the repatriated funds for approved uses similar to those set forth in the original 2004 tax repatriation act such as hiring and training of employees, infrastructure, research and development, capital investments, and financial stabilization for purposes of job retention and creation (Blouin & Krull, 2009). Positive effects that could result from a future tax holiday are economic stimulation in the form of increased jobs and domestic investment, as well as significant tax revenues that could be used for needed domestic projects like significant infrastructure development programs.

Under such an act, the U.S. would not receive upwards of $700 billion from the estimated $2.1 trillion dollars held overseas at the 35 percent tax rate that the participating corporations would pay under normal circumstances. Instead, the tax holiday would likely lower this 35 percent tax rate to around 5 percent, similar to the 2004 tax holiday repatriating rate, yielding an incoming cash flow to the U.S. government of around $100 billion dollars. While the $100 billion-dollar cash inflow is trumped by the $700 billion the U.S. should receive under a normal 35 percent rate, there is little evidence to suggest a large repatriation of profits in the near future by multinationals under the current tax rate.

While there are clearly benefits to a second tax holiday, there is also tremendous opposition. Opponents point out that a second holiday would fail to meet economic goals, would incentivize corporations to further shift production and profits into tax havens, and would ultimately cost the U.S. economy more money in the long term (Marr & Huang, 2014). In 2014, Thomas Barthold of the U.S. Congress Joint Committee on Taxation analyzed a proposal for a second tax repatriation holiday. He argues that a second tax holiday would increase U.S. tax revenues over the first two years after its implementation, as eligible corporations would repatriate foreign earnings under the substantially lower tax rate. After ten years, however, the same tax holiday would actually cost the U.S. close to $100 billion dollars in lost revenues. These losses result from "reduced tax liabilities for dividends" that corporations are expected to repatriate in the future in the absence of a lower tax rate, a loss in tax revenues from accelerated dividend repatriations that would normally be taxed under a higher rate, and a decline in tax revenues, as corporations will likely decrease future repatriations in anticipation of future holidays (Barthold, 2014).

Opponents to a second tax holiday also argue that a future tax holiday would fail to meet economic goals similar to how the first holiday failed to produce the economic benefits it promised when it was created. If a second tax holiday was enacted, corporations could simply use the increase in cash to pay for already budgeted expenses, which would further free up cash for corporate payouts and dividends. This is to say that strict restrictions and prohibitions on uses for repatriated earnings could possibly be sidestepped by corporations with effective forward planning. Therefore, achieving the desired outcome of an economic stimulus from a second act would be highly unlikely. Instead, the act would likely fail to meet its economic

goals, similar to how the first act did not increase domestic investment, employment, or R&D (Dharmapala, Foley, & Forbes, 2011).

In addition to costing the U.S. economy more than it would gain and falling short of producing any type of economic stimulus, opponents of a second tax holiday argue that it would also further incentivize corporations to shift profits and operations overseas (Marr & Huang, 2014). The belief that American multinational corporations would further increase investment overseas as opposed to domestically under a second corporate tax holiday stems from the notion that, with a second tax holiday, companies could conclude that future tax holidays would occur as well. In essence, corporations would rationally react to another tax holiday as an indication that the tax code would allow and schedule additional tax holidays in the future. Corporate executives would react to this policy by deferring more cash from repatriation in the future as they wait for future tax holidays. Further, it can be assumed that corporations would continue to move operations and jobs out of the U.S. to take advantage of the lower repatriation tax rates. This result directly conflicts with the intentions of the tax holiday and would further damage the U.S. economy by shifting jobs, production, and tax revenues out of the U.S.

In summary, while there are possible positive economic repercussions stemming from another tax holiday, the negative implications and future effects of a second tax holiday likely outnumber such positive results.

Long-term Solutions

The U.S. corporate tax code is now over a century old (Coven, G., 1993). It is therefore time to update the corporate tax code substantially to achieve the following goals that the

original 2004 tax holiday set out to do. Namely, raise sufficient tax revenues from corporations, bring jobs back to the U.S., deter American multinational corporations from shifting income to lower-tax jurisdictions, and deter American multinational corporations from stockpiling cash overseas.

The inherent nature of the U.S. tax code has created an environment in which multinationals are somewhat encouraged to invest overseas. While the U.S. does have a global tax system in the sense that the U.S. government taxes American corporations' profits regardless of where they are earned, the profits are actually not taxed until they are repatriated into the U.S. This "loophole" incentivizes corporations to defer repatriating profits into the U.S. for as long as possible. While repatriation tax holidays solve this problem by allowing firms to repatriate funds at a lower tax rate, it ignores the incentive that keeps multinationals' profits outside of the U.S. in the first place. To address these problems from a long-term perspective, the U.S. needs a comprehensive reform of business tax policies. Two strategies that have been proposed to transform the problems that I have outlined are (1) a new territorial tax policy for the U.S., and (2) an elimination of the deferral on foreign-earned profits and, relatedly, a move towards a foreign minimum tax. Below, I discuss each of these proposed strategies.

As stated earlier, the U.S. tax system is worldwide. That is to say that the U.S. domiciled corporations are taxed regardless of where their profits are earned (Bloink, 2012). This type of taxation is unique to most of the industrialized world, as the U.S. is currently the only member of the G-7 (formerly G-8) that hasn't adopted some form of a territorial tax system. A territorial tax system entails corporations paying taxes on profits earned in their specific jurisdictions. For example, if a corporation is headquartered in the U.S. and has subsidiaries and offices in

different countries around the world, that corporation would only pay taxes to the U.S. on the profits earned within the U.S. under a territorial tax system. All other profits would be taxed at the rate set in their corresponding jurisdictions (Marples & Gravelle, 2011).

There has been a strong push for the U.S. to adopt a territorial tax system. However, such a tax system would be inefficient in reaching the goals I've outlined and that were proposed in the 2004 tax holiday of (1) raising sufficient tax revenues from corporations, (2) bringing jobs back to the U.S., (3) deterring American multinational corporations from shifting income to lower-tax jurisdictions, and (4) deterring American multinational corporations from stockpiling cash overseas.

A territorial tax system would exacerbate the problem of corporations moving operations and profits overseas as a territorial tax system would further incentivize corporations to shift income to foreign jurisdictions with lower tax rates (McIntyre & Wamhoff, 2011). Under this assumption, the territorial tax system would not provide a long-term solution to remedy the current problem of American multinational corporations stockpiling cash overseas and moving operations out of the U.S. Similarly, a territorial tax system would also decrease tax revenues by nature of the new tax system not having as wide of a tax base from which to generate revenues. A territorial tax system would also encourage firms to shift revenues and profits from the U.S. to foreign subsidiaries in order to take advantage of the tax exemptions for foreign-earned profits (McIntyre & Wamhoff, 2011). It can, therefore, be concluded that a territorial tax system would provide no benefits under the context of raising sufficient tax revenues and deterring corporations from keeping cash overseas and shifting income abroad.

The second proposed strategy listed previously involves an elimination of the deferral on foreign-earned profits and a move towards a foreign minimum tax. A deferral of taxes refers to the practice of not repatriating foreign-earned profits by American multinational corporations. Many corporations choose to "reinvest, rather than repatriate, a significant portion of their income overseas and as a result may never face U.S. taxes on much of that income" (The President's Framework for Business Tax Reform: A Joint Report by The White House and the Department of the Treasury, 2012). Deferrals of taxes therefore allow U.S. corporations to ultimately pay lower effective tax rates by shifting income and profits away from the U.S. and into low-tax jurisdictions. To get rid of this deferral policy, the U.S. government should implement a foreign minimum tax policy that taxes foreign earned profits at a specified minimum rate and allows this tax to count as a credit toward any existing taxes owed to the foreign jurisdiction (Marr & Huang, 2014).

Not only does a foreign minimum tax (FMT) address the problem that deferrals create by immediately taxing foreign-earned American multinationals' profits regardless of where they are earned, it can also address the larger problem of stockpiled cash overseas. That is, a FMT would eliminate any need for tax holidays, and would instead tax foreign earnings at a constant rate that would fall below the U.S. corporate rate. Therefore, the U.S. would receive an increase in tax revenues from such a policy on an annual basis and American multinationals would have no incentive to stockpile cash overseas. This incentive to keep profits overseas would disappear because the profits earned by American multinationals would already be taxed immediately after they were earned, which would then make the current strategy of avoiding U.S. taxes unavoidable by such corporations that defer repatriating taxes.

Further, a FMT would also decrease the incentive for American multinationals to move operations overseas as long as the FMT is set high enough to deter movement. With a low FMT, say 10 percent, the benefits of shifting income to a tax haven are still realized as the 10 percent rate will still save corporations' a large portion of profits as opposed to if the income was taxed at the U.S. corporate rate of 35 percent. The FMT should therefore be set high enough to deter corporations from investing in complicated tax planning strategies to avoid paying U.S. tax rates, or moving operations and profits overseas altogether. To summarize, the FMT would raise U.S. tax revenues, eliminate corporations' incentives for stockpiling cash overseas, and would stimulate the U.S. economy by erasing the incentive for corporations to move jobs and profits overseas.

Conclusion and Implications

It is clear that some inherent problems of the U.S. tax system have created incentives for corporations to move profits and jobs overseas, all while delaying repatriations of profits back to the U.S. and ultimately shielding hundreds of billions of dollars in tax revenues from the U.S. government. In this time of an eroding corporate tax base due to corporate inversions and deferrals of tax repatriations, politicians and researchers alike have debated the merits of possible solutions. One such solution to combat inefficiencies of the U.S. tax system was the 2004 American Jobs Creation Act, which included a one-time tax holiday allowing participating firms to repatriate foreign profits at a 5.25 percent tax rate back to the U.S. The act intended to curtail the problem of American multinationals stockpiling cash overseas, and hoped to increase jobs and investment within the U.S. While many large firms participated in the repatriation holiday, the intended effects were not realized.

Today there are over $2.1 trillion dollars held overseas by American multinational corporations, and there is currently no evidence available that would suggest that this number will not continue to increase in the future. Similar to the discussions that preceded the 2004 tax holiday, researchers and lawmakers are examining ways to eliminate overseas cash holdings, thereby generating greater tax revenues. In addition, corporate inversions have continued to increase recently which have led to jobs, profits, and tax revenues ultimately leaving the country.

I recommend that to address these problems, the U.S. should implement tax policies that would decrease corporations' incentives to move jobs and profits overseas, and increase tax revenues by eliminating the incentive to not repatriate foreign-earned profits back to the U.S. Under the context of achieving these results, the most efficient method of mending the current problems inherent with corporate taxation is to eliminate the deferral of foreign-earned profits and implement a foreign minimum tax policy. This type of tax policy will eliminate corporations' incentives for not repatriating earnings and moving jobs and profits overseas to low-tax regions. The foreign-minimum tax will also increase U.S. tax revenues by immediately recognizing tax revenues when multinational corporations earn profits outside of the U.S.

While the 2004 tax holiday was initially praised as a solution to solve a multitude of economic problems, its passing provided little evidence of any economic relief for the U.S. This paper provided an explanation of what went wrong with the 2004 tax holiday and discussed alternatives that aim to combat similar economic problems that have persisted since its passing.

This research is important for academics and the general public because it highlights how current tax policy negatively affects the domestic economy by incentivizing firms to keep money overseas and rewarding companies for moving jobs and profits overseas altogether. It is therefore essential that U.S. tax policy should be reformed to stimulate the domestic economy by increasing tax revenues and moving jobs and profits back into the United States.

There are also many opportunities for further research on this topic, as the U.S. tax system is very flexible and can change from year to year. Therefore, additional research could be conducted examining how to reform the corporate tax system under changing variables and assumptions. For example, my findings were derived under the assumption that the top U.S. corporate tax rate is 39.6 percent. However, there could be legislation in the future that could lower this rate significantly. A substantial drop in this rate would affect my recommendations and their consequences, and therefore there is room for further research under the likelihood of changing variables like the U.S. corporate tax rate.

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