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CORPORATE INCOME TAX: WE TRIED THE STICK, HOW ABOUT THE CARROT?

Doron Narotzki[*] *& Tamir Shanan*[*]

ABSTRACT

Due to their ongoing focus on tax planning and continuous efforts to find new tax minimization strategies, multinational corporations have not been paying their fair share of taxes for a long time. As a result, the federal government is unable to generate much revenue through taxes levied on corporations. The government's response to this problem has always been the same: introduce new tax laws and regulations, revise old tax laws to close "loopholes," and hope that this will solve corporate tax evasion. For decades, this approach has failed.

This Article examines the history of the corporate income tax in the United States and the parallel evolution of an industry dedicated to helping corporations avoid those taxes. This Article finds that the development of this industry has had significant influence on the federal government's decisions with respect to how it taxes corporations, usually opting to adopt anti-abuse, -avoidance rules in an effort to crack down on perceived bad actors. These policy choices, though, have had little success over the years. Instead, tax revenue generated from large-scale corporate groups has been modest, and there appears to be a consensus that these entities don't pay their fair share.

We propose a different course. Instead of anti-abuse and -avoidance rules, the tax code should use tax and other economic incentives to encourage entrepreneurs and corporations to invest in the domestic economy. Economic activity creates positive externalities in the domestic economy specifically and United States generally.[1] *Congress should amend the tax code to better allocate the proceeds of these positive externalities between the Internal Revenue Service, corporations, and stakeholders.*

Since the Internal Revenue Code for corporations was enacted in 1909, Congress has attempted to block abusive tax planning. However, its chosen method–deterrence–has had little positive impact on the U.S. economy. In many instances, deterrence has even had a negative impact, encouraging corporations to shutter their U.S. plants and dismiss hundreds of thousands of American employees in favor of foreign operations. Such legislative measures have "trapped" billions of dollars overseas by making the distribution of these profits to U.S. shareholders too costly. Instead, Congress should adopt tax incentives that balance the positive externalities of economic activity on local communities with the need to protect small- and medium-sized businesses' ability to

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1. *See* Thomas J. Chemmanur et al., Can Mergers and Acquisitions Internalize Positive Externalities in Funding Innovation? 22-23 (Feb. 4, 2020) (unpublished manuscript) (available at https://ssrn.com/abstract=3532157).

compete with the entities that will be most advantaged by these favorable incentives. This approach would reduce the advantages built-in to existing complex corporate structures that enable the largest corporations to easily shift revenue and profits to lower-tax jurisdictions. This approach, however, does not jeopardize recent attempts to set a global minimum tax aimed at reducing the tax incentive driving corporations to move operations overseas in search of a lower tax rate. Instead, this Article's recommendation focuses on rewarding the positive externalities such operations create for domestic communities.

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INTRODUCTION

On December 3, 1901, President Theodore Roosevelt, in his State of the Union address to Congress, stated that "[g]reat corporations exist only because they are created and safeguarded by our institutions, and it is therefore our right and our duty to see that they work in harmony with these institutions."[2] More than a century later, on October 25, 2021, President Joe Biden opined on Twitter that "[a]t least 55 corporations in America didn't pay a single penny in federal income tax last year. That's got to change – and my Build Back Better Agenda will get it done."[3]

It's certainly no secret that "corporate America" is at an all-time high, with record-setting profits, valuations, and accumulated political power.[4] However, since World War II, revenue from taxes levied on corporations as a share of the federal government's total receipts has declined from almost 40% in 1943 to less than 15% in 2000.[5] Likewise, the corporate income tax rate also declined over this period, from 53% in 1943 to 21%. in 2018.[6] Despite this sharp decline, the difference between pre-tax book income reported by corporations to their shareholders and the taxable income reported by the same corporations to the Internal

2. THEODORE ROOSEVELT, ADDRESSES AND PRESIDENTIAL MESSAGES OF THEODORE ROOSEVELT 1902–1904 292–98 (G. P. Putnam's Sons, ed., 1st ed. 1904). While the first part of Roosevelt's statement regarding who created corporations is not necessarily accurate, the second part is undisputable.

3. Joe Biden (@JoeBiden), TWITTER (Oct. 25, 2021, 11:59 AM), https://twitter.com/JoeBiden/status/1452666011350614020.

4. *See* Tom Orlik et al., *World-Dominating Superstar Firms Get Bigger, Techier, and More Chinese*, BLOOMBERG (May 21, 2021, 12:01 AM EDT), https://www.bloomberg.com/graphics/2021-biggest-global-companies-growth-trends/?leadSource=uverify%20wall.

5. *Federal Tax Revenue by Source, 1934 – 2018*, TAX FOUND. (Nov. 21, 2013), https://taxfoundation.org/data/all/federal/federal-tax-revenue-source-1934-2018/.

6. *Historical Federal Corporate Income Tax Rates and Brackets, 1909–2020*, TAX FOUND. (Aug. 24, 2021), https://taxfoundation.org/data/all/federal/historical-corporate-tax-rates-brackets/.

Revenue Service (IRS) remains significant, leaving billions of dollars untaxed by some estimates.[7] These losses cast doubt on Roosevelt's hundred-year-old remarks regarding the corporate tax regime.[8] Was Roosevelt right that the corporate tax could push corporations to "work in harmony with [our] institutions"? This Article seeks to answer these questions, ultimately proposing a new approach to the relationship between large-scale multinational corporations and the federal and state governments who seek to tax them.

Take a moment. Think about the computer you are using to read this Article, your WIFI password, the car you drive, or even the coffee you drink. Now more than ever before, large corporations are everywhere, and their success often comes at the expense of local businesses that are unable to compete.[9] Yet, paradoxically, the more profitable, powerful, and well-known these corporations become, the less corporate income tax they've likely paid over the years—despite the taxes levied upon them by the jurisdictions in which they operate.[10] In fact, according to the Institute on Taxation and Economic Policy, at least fifty-five of the largest corporations in the United States paid no federal corporate income tax in 2020 despite having reported a high pre-tax book income to their shareholders.[11] Not being a coincidence, it must neither be a mistake. At the very least, it has not been a one-off.[12]

So, first—why does this keep happening?

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7. *Federal Tax Revenue by Source, 1934–2018*, TAX FOUND. (Nov. 21, 2013), https://taxfoundation.org/federal-tax-revenue-source-1934-2018/.

8. ROOSEVELT, *supra* note 2.

9. *See* Kate Taylor, *In 2020, Big Business Got Bigger and Small Business Died. The Vicious Cycle Won't Stop Until We Take Action*, BUS. INSIDER (Jan. 3, 2021, 8:31 AM), https://www.businessinsider.com/in-2020-big-businesses-got-bigger-small-businesses-died-2020-12.

10. *See* Ryan Koronowski et al., *These 19 Fortune 100 Companies Paid Next to Nothing—or Nothing at All—in Taxes in 2021*, CTR. FOR AM. PROGRESS (Apr. 26, 2022), https://www.americanprogress.org/article/these-19-fortune-100-companies-paid-next-to-nothing-or-nothing-at-all-in-taxes-in-2021/; *Fact Sheet: Corporate Tax Rates,* AMS. FOR TAX FAIRNESS, https://americansfortaxfairness.org/files/11-ATF-Corporate-Tax-Rates-fact-sheet.pdf 17 (last visited Apr. 28, 2023) ("General Electric, Boeing, Verizon and 23 other profitable Fortune 500 firms paid no federal income taxes from 2008 to 2012," while "288 big and profitable Fortune 500 corporations paid an average effective federal tax rate of just 19.4% from 2008 to 2012.").

11. Matthew Gardner & Steve Wamhoff, *50 Corporations Paid $0 in Federal Taxes on 2020 Profits*, INST. ON TAX'N & ECON. POL'Y. (Apr. 2, 2021), https://itep.org/55-profitable-corporations-zero-corporate-tax/. Among those corporations are HP, Dish Network, Nike, Penske Automotive Group, Michaels, and Lincoln National. Koronowski et al., *supra* note 10.

12. For example, in 2018 there were ninety-one domestic and large corporations who were profitable pre-tax and did not pay any corporate income tax in the United States. *See* Jesse Pound, *These 91 Companies Paid No Federal Taxes in 2018*, CNBC (Dec. 17, 2019, 4:36 PM), https://www.cnbc.com/2019/12/16/these-91-fortune-500-companies-didnt-pay-federal-taxes-in-2018.html.

I. CORPORATE INCOME TAX AVOIDANCE

Until the early 1990s, tax specialists' work largely centered around tax compliance.[13] However, tax planning had been around long before that.[14] In fact, it appears that, in one form or another, tax planning has always arisen where significant income was involved. Why is that?

Economists generally sort taxes into one of two categories. First, a tax can take the form of a direct levy on individuals. In the other category, a tax could be structured as an indirect levy on consumption.[15] Historically, the tax code has viewed the corporation as little more than a "device" or proxy to tax shareholders. Accordingly, the corporate income tax itself was seen as a method to tax shareholders before the corporation distributed its earnings.[16] "Tax planning" has long been an academic debate,[17] its success largely dependent on the view that the corporate tax was focused on the corporation's shareholders.[18] Up until the Economic Recovery Tax Act of 1981 (ERTA), the prevailing view among members of the media and government was that, for the most part, corporations were paying their "fair share."[19] Their focus instead was on high net worth individuals who, they seem to have believed, were exploiting "gaps" in the tax code and creating "tax shelters" in order to avoid paying very much federal income tax at all.[20]

By the 1980s, however, "trickle-down economics" had made its way into the tax code. It appeared first in the ERTA under the guise of generous corporate income tax breaks[21] believed to stimulate the U.S. economy.[22] Unfortunately,

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13. Enterprise Risk Mgmt. Initiative Staff, *Tax Risk Management: The Evolving Role of Tax Directors*, NC ST. POOLE COLL. OF MGMT. (Dec. 31, 2004), https://erm.ncsu.edu/library/article/tax-directors-role; *see also* Michael P. Donohoe et al., *Risky Business: The Prosopography of Corporate Income Tax Planning, 67(4)* NAT'L TAX J. 851, 852 (2014).

14. *See generally* George Cooper, *The Avoidance Dynamic: A Tale of Tax Planning, Tax Ethics, and Tax Reform*, 80 COLUM. L. REV. 1553 (1980).

15. *See generally* Gerhard Colm, *The Corporation and the Corporate Income Tax in the American Economy*, 44 AM. ECON. REV. 486 (1954).

16. *Id.* at 488; *see also* Reuven S. Avi-Yonah, *Corporations, Society, and the State: A Defense of the Corporate Income Tax*, 90 VA. L. REV. 1193 (2004).

17. *See Tax Planning According to Judge Learned Hand,* IFC (Jan. 5, 2015), https://www.ifcreview.com/articles/2015/may/the-big-debate-tax-planning/; *see also Can and Should Morality Be Applied To Corporate Tax Planning?*, IFC (Mar. 6, 2013) https://www.ifcreview.com/articles/2013/june/the-big-debate-can-and-should-morality-be-applied-to-corporate-tax-planning/; Jane McCormick, *Tax Avoidance and Evasion – Six Questions for Debate*, KPMG (Jan. 5, 2018) https://responsibletax.kpmg.com/article/tax-avoidance-and-evasion-six-questions-for-debate.

18. *See* Avi-Yonah, *supra* note 16, at 1197.

19. Donohoe et al., *supra* note 13, at 853.

20. *Id.*; *see also* STAFF OF THE JOINT COMM. ON TAX'N, 98TH CONG., BACKGROUND ON FEDERAL INCOME TAX COMPLIANCE (Joint Comm. Print 1983).

21. The bill also introduced an across-the-board 25% cut in marginal individual tax rates. *See Reagan Signs Economic Recovery Tax Act (ERTA)*, HIST.: THIS DAY HIST. (Oct. 14, 2010), https://www.history.com/this-day-in-history/reagan-signs-economic-recovery-tax-act-erta.

22. President Reagan, during his presidential campaign in 1980, argued for what he referred to as "supply chain economics," the idea that tax cuts can incentivize productions of goods (supply) rather than incentivize consumers (demand). Later, in 1981, Representative Jack Kemp, a Republican

things did not seem to go to plan. An analysis by the Joint Committee on Taxation in 1983[23] that reviewed the effective tax rates of different U.S. corporations across various sectors and industries concluded that a decline in the effective corporate tax rate was a main factor leading to the decline in revenue from taxes levied on corporations as a percentage of total revenue raised through taxes.[24]

Still, the ERTA did more than just slash income tax rates. It also introduced the Accelerated Cost Recovery System (i.e., accelerated depreciation deductions) and safe harbor leasing,[25] essentially permitting corporations to sell their tax benefits[26]—further reducing revenue generated from taxes levied on corporations to only 6.2% of total revenue generated from taxes in 1983.[27] Safe harbor leasing was repealed just one year later when Congress (rightfully) concluded that it "enabled some taxpayers to avoid their equitable share of tax."[28] That attention, in turn, led some public interest groups and researchers to investigate the extent to which large U.S. corporations had been able to avoid paying taxes while remaining profitable.[29] Citizens for Tax Justice (CTJ), a Washington D.C.-based think tank and advocacy group, for example, issued an August 1985 report titled *Corporate Taxpayers and Corporate Freeloaders* (the Report) and opened it with the following line:

> 1984 was a banner year for corporate profits. They were up 26% over 1983, reaching an all-time high of $286 billion. Their share of national income fell just short of 10%,

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of New York, and Senator Bill Roth, a Republican of Delaware, who had long supported the supply chain economics Reagan campaigned on, were behind the ERTA, which would also be known as the Kemp-Roth Act. The bill received bipartisan support in Congress and represented a major shift in federal tax policy.

23. STAFF OF THE JOINT COMM. ON TAX'N, 98TH CONG., STUDY OF 1982 EFFECTIVE TAX RATES OF SELECTED LARGE U.S. CORPORATIONS, 10 (U.S. Gov't Printing Office 1983). *See* Chester Pach, *Ronald Reagan and Supply-Side Economics*, BILL RTS. INST., https://billofrightsinstitute.org/essays/ronald-reagan-and-supply-side-economics (last visited Apr. 5, 2024).

24. *See* STUDY OF 1982 EFFECTIVE TAX RATES, *supra* note 23. In 1982, the federal government receipts from corporate income tax was 8% of the total tax revenues, down from 10.2% in 1981, and down from 12.5% in 1980. *Federal Tax Revenue by Source, 1934–2018*, *supra* note 5.

25. STAFF OF THE JOINT COMM. ON TAX'N, 97TH CONG., DESCRIPTION OF SAFE HARBOR LEASING PROVISIONS UNDER THE ACCELERATED COST RECOVERY SYSTEM (Joint. Comm. Print 1981); *see also* Margaret Riley, *Safe Harbor Leasing, 1981 and 1982*, IRS, https://www.irs.gov/pub/irs-soi/81-82sahale.pdf (last visited Apr. 29, 2023).

26. *See* Clyde P. Stickney et al., *Income Taxes and Tax-Transfer Leases: General Electric's Accounting for a Molotov Cocktail*, 58 ACCT. REV. 439, 439–59 (1983). This kind of transaction allowed profitable corporations to buy tax benefits from nonprofitable corporations, and in exchange the nonprofitable corporations received money and equipment. *See generally id.* One corporation who did that, for example, was General Electric, who paid about $350 million for tax benefits, which eventually led to a federal income tax refund of almost $100 million. *See generally id.*

27. *Federal Tax Revenue by Source, 1934–2018*, *supra* note 5.

28. S. REP. NO. 97–494, at 148 (1982).

29. *See Corporate Taxpayers and Corporate Freeloaders*, CITIZENS FOR TAX JUST. (Aug. 11, 1985), https://ctj.org/corporate-taxpayers-and-corporate-freeloaders/.

> the highest level since 1978. Despite this spectacular rebound in profitability, 1984 was yet another banner year for corporate income tax avoidance.[30]

The Report later identified fifty major U.S. corporations who paid no federal income tax between the years 1981 and 1984[31]—a number remarkably close to the number of U.S. corporations that did not pay any federal income tax in 2020.[32] Even further, the report calculated the effective income tax rates by industry based on data from 275 major U.S. corporations between the years 1981 and 1984,[33] concluding that these corporations' overall effective income tax rate was 15%—far lower than the statutory federal corporate income tax rate, which at the time was 46%.[34]

The Report argued at length that meaningful tax reform was needed,[35] even directly attacking President Reagan's "supply side economy" and "trickle-down" ideas:

> The President's plan, it is now clear, would not only fail to put most tax-avoiding corporations back on the tax rolls, it would, as the Congressional Budget Office has concluded, "probably provide a corporate income tax cut over time." It calls for a new brand of accelerated depreciation that is even more generous and costly than our current system. . . . And it would leave intact most of the loopholes which make both corporate income tax avoidance and upper-income tax shelters possible.[36]

The suggested reforms would both end corporations' special credits and deductions and tax corporations on what they really earn.[37] Hence, by 1984, with a large number of U.S. corporations paying little or no federal income tax despite reporting huge book income to shareholders, critics began to argue that corporations were not "paying their fair share."[38]

This increasing media criticism and public outcry eventually pushed Congress to pass the Tax Reform Act of 1986 (TRA86), the most meaningful and comprehensive tax reform since World War II.[39] In fact, the TRA86 struck the corporate world so hard that that its impact was felt in other countries as

30. *Id* at 1.

31. *Id.* at 3.

32. *See* Andrea Miller, *How Companies like Amazon, Nike and FedEx Avoid Paying Federal Taxes*, CNBC (June 14, 2023), https://www.cnbc.com/2022/04/14/how-companies-like-amazon-nike-and-fedex-avoid-paying-federal-taxes-.html.

33. *See* CITIZENS FOR TAX JUST., *supra* note 29, at 14.

34. *Historical U.S. Federal Corporate Income Tax Rates & Brackets, 1909–2020*, TAX FOUND. (Aug. 24, 2021), https://taxfoundation.org/historical-corporate-tax-rates-brackets/.

35. *See* CITIZENS FOR TAX JUST., *supra* note 29, at 16–18.

36. *Id.* at 18.

37. *Id.* at 19.

38. Alan J. Auerbach & Joel Slemrod, *The Economic Effects of the Tax Reform Act of 1986*, 35 J. ECON. LIT. 589, 592 (1997).

39. *Id.* at 589.

corporations adjusted their businesses.[40] One of its most important provisions was the Corporate Alternative Minimum Tax (AMT), which was enacted to

> serve one overriding objective: to ensure that no taxpayer with substantial economic income can avoid significant tax liability by using exclusions, deductions, and credits. Although these provisions may provide incentives for worthy goals, they become counterproductive when taxpayers are allowed to use them to avoid virtually all tax liability.[41]

The Joint Committee Report put it more bluntly, stating that "[i]n particular, Congress concluded that both the perception and the reality of fairness have been harmed by instances in which corporations paid little or no tax in years when they reported substantial earnings, and may even have paid substantial dividends, to shareholders."[42]

The AMT, however, was not a new concept. It had been developed by the Treasury Department in 1969[43] in connection with high-income individuals who nonetheless managed to pay little-to-no federal income tax.[44] According to the Joint Committee Report, TRA86 was expected to shift approximately $120 billion of federal income taxes from individuals to corporations between fiscal years 1987 and 1991.[45] Today, though, it appears that the TRA86 failed to get corporations to pay their fair share, with a 2004 report by the General Accounting Office (GAO) finding that 61% of corporations reported no tax liabilities between the years 1996 and 2000.[46]

How could the TRA86 fail? One culprit may lie in the fact that, sometime during the 1990s, corporations began seeking tax advice not only regarding how to comply with the complex tax code, but also "[to] enhance shareholder value," that is, they sought to increase their earnings per share by minimizing tax

40. *See generally* John Whalley, *Foreign Responses to US Tax Reform* (Univ. Mich. Ross Sch. Bus. Off. Tax Pol'y Rsch., Working Paper No. 1990-9, 1989). A similar effect happened after the United States passed the Tax Cuts and Jobs Act in 2017. *See* Jeff Hoopes, *The TCJA Effects Tracker: What Do We Know About the Effects of the Tax Cuts and Jobs Act?*, UNIV. N.C. TAX CTR., https://tax.kenaninstitute.unc.edu/what-do-we-know-about-the-effects-of-the-tax-cuts-and-jobs-act/#:~:text=First%2C%20the%20TCJA%20caused%20domestic,substantially%20following%20the%20law%20change (last visited Jan. 24, 2024).

41. STAFF OF THE JOINT COMM. ON TAX'N, 100TH CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986 432 (Joint Comm. Print 1987). The Corporate AMT was repealed in the Tax Cuts and Job Act of 2017; BOWLES RICE LLP, *Changes to Alternative Minimum Tax for Corporations and Individuals*, https://www.bowlesrice.com/tax-cuts-and-jobs-act-2018-changes-Alternative-Minimum.html#:~:text=The%20Tax%20Cuts%20and%20Jobs%20Act%20repealed%20the%20AMT%20on,have%20for%20any%20tax%20year (last visited Jan. 25, 2024).

42. *Id.* at 433.

43. U.S GOV'T ACCOUNTABILITY OFF., GAO/GGD-95-88, EXPERIENCE WITH THE CORPORATE ALTERNATIVE MINIMUM TAX, at 20.

44. *See The Alternative Minimum Tax*, CONG. BUDGET OFF., (Apr. 15, 2004), https://www.cbo.gov/sites/default/files/108th-congress-2003-2004/reports/04-15-amt.pdf.

45. STAFF OF THE JOINT COMM. ON TAX'N, 100TH CONG., *supra* note 41, at 9.

46. U.S. GOV'T ACCOUNTABILITY OFF., GAO-04-358, COMPARISON OF THE REPORTED TAX LIABILITIES OF FOREIGN- AND U.S.-CONTROLLED CORPORATIONS, 1996–2000, at 2 (2004).

liability.[47] Many of these strategies were aimed at reducing the corporation's effective income tax rate (ETR) by, for example, shifting income earned in high-tax jurisdictions to low-tax jurisdictions, using "corporate income tax shelters," and architecting developments in legal doctrines related to the corporation's status as a separate legal entity that could be dealt with at arm's length.[48] Corporate actors, however, can't take all of the credit. While corporations adjusted to the new tax regime, leading law firms and accounting partnerships leveraged their massive workforces and international connections to develop so-called "Tax Innovations Center[s]."[49]

It was common practice among the leading law and accounting firms of the 1990s and 2000s to accrue tax benefits to their corporate clients by creating "tax shelters."[50] The Internal Revenue Service (IRS) was, for its part, mostly powerless to intervene. Even where the agency identified abuses sufficient to warrant the expenditure of its limited resources on audits and litigation,[51] corporate taxpayers (or, rather, non-taxpayers), buoyed by the ever-lenient economic substance doctrine,[52] faced little difficulty in convincing the courts that they had followed the letter of the law. Even firms whose practices were at the very margin of permissibility managed to escape liability, persuading the judiciary that, if the government thought that their practices were particularly problematic, it was up to Congress to change the law accordingly.[53] As the Court of Federal Claims put it, "where a taxpayer has satisfied all statutory requirements established by Congress . . . the use of the 'economic substance' doctrine to trump 'mere compliance with the Code' would violate the separation of powers."[54]

The failure of the IRS's enforcement efforts had predictable effects on the players involved. Finding that their litigation positions would receive little pushback from the judiciary, corporate taxpayers found that these types of tax planning

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47. Donohoe et al., *supra* note 13, at 856.

48. *See generally* Joseph L. Andrus & Richard S. Collier, *Transfer Pricing and the Arm's-Length Principle After the Pillars*, TAX NOTES (Jan. 31, 2022), https://www.taxnotes.com/special-reports/base-erosion-and-profit-shifting-beps/transfer-pricing-and-arms-length-principle-after-pillars/2022/01/28/7d40m.

49. KPMG's "Tax Innovation Center," for example, was an entire department whose sole mission was to design and promote different tax products. S. Rep. No. 109-54, at 13 (2005).

50. "Tax shelters" are arrangements structured to create an operating loss, deductible business expense, or reduction in the corporation's gross income. The label often carries the negative inference that the underlying arrangement lacks economic substance or was entered into purely or primarily due to the desire to manufacture a tax advantage. Marvin A. Chirelstein & Lawrence A. Zelenak, *Tax Shelters and the Search for a Silver Bullet*, 105 COLUM. L. REV. 1939, 1939 (2005).

51. *See, e.g.*, *2022 Annual Report to Congress*, TAXPAYER ADVOC. SERV. 26 (2022), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2023/01/ARC22_MSP.pdf. (discussing challenges taxpayers face due to the IRS' lack of resources).

52. See Chirelstein & Zelenak, *supra* note 50 at 1946.

53. *Id.* at 1940.

54. *Coltec Indus., Inc. v. United States*, No. 01-672T, slip op, at 55 (Fed. Cl. filed Oct. 29, 2004).

strategies carried very little risk.[55] The government, for its part, found itself in an increasingly complex game of Whac-A-Mole: amending the tax code in in order to close loopholes. As a result, the IRC and its regulations became longer, more complicated and, in certain cases, contradictory or ambiguous. Consequently, tax planners were able to overcome such legislative measures with ease.[56]

Unamused, Congress finally introduced comprehensive legislation to forestall the abusive practices. Passed between 2003 and 2004, The Abusive Tax Shelter Shutdown and Taxpayer Accountability Act of 2003,[57] Tax Shelter Promoter Liability Act of 2004,[58] and The American Jobs Creation Act of 2004[59] created new disclosure requirements and enhanced penalties for using and/or failing to report arrangements which, in Congress's judgment, abused the tax system.[60] In response to academic research, Congress pushed further, aiming to tackle the tax shelters by codifying an enhanced economic substance doctrine.[61] At the time, however,[62] The logic behind the codification of this judicial doctrine[63] was to try and provide more room for the IRS and the courts to push down formal structures that had limited economic substance and to take away taxpayers' ability to simply get away with merely complying with the letter of the law.[64] However, Congress chose to leave the decision whether to apply it or not to the courts by adding Code Section 7701(o)(5)(C) which states "[t]he determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if this subsection had never been enacted."[65]

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55. *See* David Elkins, Embracing Tax Avoidance 46 (Nov. 27, 2022) (preliminary draft) ("When the law effectively incentivizes taxpayers to adopt certain patterns of behavior, it is naïve to expect that they will refrain from doing so.") (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4287175).

56. *See, e.g.*, Herbert N. Beller, *Section 355 Revisited: Time for a Major Overhaul?*, 72 TAX LAW. 131 (2018) (discussing the legislative history of Code Section 355, and specifically 355(d) and (e)).

57. H.R. 1555, 108th Cong. (2003).

58. H.R. 4351, 108th Cong. (2004).

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

60. Press Release, U.S. Dep't. Treasury, April 15th Tax Day Reminder: Treasury & IRS Continue to Crackdown on Abusive Tax Shelters (Apr. 9, 2004) (available at https://home.treasury.gov/news/press-releases/js1314).

61. *See* Ellen P. Aprill*, Tax Shelters, Tax Law, and Morality: Codifying Judicial Doctrines*, 54 SMU L. REV. 9, 34 (2001); Martin J. McMahon Jr., *Beyond a GAAR: Retrofitting the Code to Rein in 21st Century Tax Shelters*, 98 TAX NOTES 1721, 1734–37 (2003). The contemporaneous effort to codify an enhanced economic substance doctrine died in the House of Representatives, although it would be finally enacted in 2010 as Section 7701(o) in Section 1409 of the Health Care and Education Reconciliation Act of 2010.

62. Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1409, 124 Stat. 1029, 1067–70 (2010).

63. *See* I.R.C. § 7701(o)(5)(A) ("The term 'economic substance doctrine' means the common law doctrine under which tax benefits under subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose.").

64. *See* Martin J. McMahon Jr., *Beyond a GAAR: Retrofitting the Code to Rein in 21st Century Tax Shelters*, 98 TAX NOTES 1721, 1723–24 (2003).

65. I.R.C. § 7701 (o)(5)(c).

In essence, the economic substance doctrine is just another attempt to implement into tax law the long-standing principle of "substance over form" when analyzing transactions, which goes back to the early days of the federal income tax system[66] and eventually became somewhat of a guiding principle for testing every transaction.[67] The idea behind incorporating an anti-avoidance principle was that—unlike detailed standards that close specific loopholes successfully but fail to achieve the same impact on new planning strategies—the codification of an anti-avoidance principle such as the economic substance doctrine may be applicable to various planning strategies and may prevent what Congress felt were attempts for tax evasions by allowing the IRS and the courts to ignore certain transactions and to disallow certain tax benefits from taxpayers even though they were in compliance with the black letter law.[68] However, as Congress passed these provisions and others–mostly designed to better identify tax shelters,[69] or in other cases penalize taxpayers who engage in the shelters or perhaps design them–[70]the result is often times similar to putting a bandage on a broken bone.

This tax-shelter saga grants a glimpse of the tax system's *modus operandum*: corporations, law firms, and accounting firms find ways to avoid paying federal income tax and, after the IRS identifies the private actors' abusive strategy, the Treasury Department issues new regulations or asks Congress to amend the applicable code sections. Far from shutting down "innovations" in the tax product industry, the cycle instead ends by adding more nuance to an already complicated tax code—ultimately increasing the costs associated with both compliance and enforcement.

A. *The Corporate Income Tax Avoidance Industry*

Why do corporations, law firms, and accounting firms keep focusing on finding loopholes in the tax code? The main reason, of course, is to sell their services

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66. *See, e.g.*, S. Pac. Co. v. Lowe, 247 U.S. 330, 337 (1918) ("We base our conclusion in the present case upon the view that it was the purpose and intent of Congress, while taxing 'the entire net income arising or accruing from all sources' during each year commencing with the 1st day of March, 1913, to refrain from taxing that which, in mere form only, bore the appearance of income accruing after that date, while in truth and in substance it accrued before; and upon the fact that the Central Pacific and the Southern Pacific were in substance identical because of the complete ownership and control which the latter possessed over the former, as stockholder and in other capacities.").

67. *See, e.g.*, Estate of H. H. Weinert v. Comm'r of Internal Revenue, 294 F.2d 750, 755 (5th Cir. 1961) ("The principle of looking through form to substance is no schoolboy's rule; it is the cornerstone of sound taxation, especially of oil and gas transactions which do not fit snugly into common law conveyancing forms. 'Tax law deals in economic realities, not legal abstractions.' . . . Resort to substance is not a right reserved for the Commissioner's exclusive benefit, to use or not to use — depending on the amount of the tax to be realized. The taxpayer too has a right to assert the priority of substance—at least in a case where his tax reporting and actions show an honest and consistent respect for the substance of a transaction.").

68. *See* Philip Sancilio, *Clarifying (or is it Codifying?) The "Notably Abstruse": Step Transactions, Economic Substance, and the Tax Code* 113 COLUM. L. REV., 138, 138–80 (2013).

69. *See* I.R.C. § 6011(g).

70. *See* I.R.C. § 6662.

to clients who want to pay less in taxes. At some point in the 1990s it became apparent to law firms and accounting firms that there was a lot of business in selling tax minimization strategies to corporations.[71] Most such strategies involved sophisticated hybrid financial instruments, trust entities, foreign affiliates embedded in complex corporate structures, arbitrage, and the like.[72] One contemporary indication of the industry's prevalence came in 1999 when representatives of the American Bar Association testified before the House Ways and Means Committee. These representatives asserted that they were becoming increasingly "alarm[ed] [by] the aggressive use by large corporate income taxpayers of tax 'products' that have little or no purpose other than the reduction of Federal income taxes," and separately signaled the organization's disapproval of, in the representatives' words, the "blatant, yet secretive marketing" of tax products.[73]

Notwithstanding this reproach, tax professionals brought in (and bring in) significant profits from marketing tax minimization strategies. KPMG, one of the largest global accounting firms,[74] for example, earned approximately $53 million from selling a single tax minimization strategy to 186 individuals.[75] These firms' ability to sell these services to clients often depends on their ability to demonstrate "added value," that is, their ability to show that the client will pay less tax.[76] Sometimes, the legal and accounting firms find themselves exposed to liability for their efforts in engineering and marketing these tax products to corporate taxpayers.[77] Perhaps of more concern is the phenomenon whereby leading experts leave their firms for a position with a government agency responsible for supervising the industry, only to return to private practice a few years later.[78]

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71. *See* Chirelstein & Zelenak, *supra* note 50 and accompanying text.

72. *See* Joseph Bankman, *The New Market in U.S. Corporate Tax Shelters,* TAX NOTES (June 28, 1999), https://www.taxnotes.com/tax-notes-international/tax-policy-issues/new-market-us-corporate-tax-shelters/1999/06/28/1ts4j.

73. DEP'T OF TREASURY, THE PROBLEM OF CORPORATE INCOME TAX SHELTERS DISCUSSION, ANALYSIS AND LEGISLATIVE PROPOSALS i (1999), https://home.treasury.gov/system/files/131/Report-Corporate-Tax-Shelters-1999.pdf.

74. Kathryn Wright, *KPMG Reports Global Revenues of $32.13 Billion for FY21, Focus on Strategy Enables 10% Growth,* KMPG (Dec. 9, 2021), https://kpmg.com/be/en/home/media/press-releases/2021/12/kpmg-reports-global-revenues-of-usd-32-billion-for-fy21.html.

75. TANINA ROSTAIN, LEGAL ETHICS: LAW STORIES: TRAVAILS IN TAX: KPMG AND THE TAX-SHELTER CONTROVERSY 101 (Deborah L. Rhode & David J. Luban eds., 1st ed. 2006).

76. *See* Tanina Rostain, *Sheltering Lawyers: The Organized Tax Bar and the Tax Shelter Industry* 23 (N.Y.L. SCH., RSCH. PAPER SERIES 04/05 # 20, 2005).

77. *See*, *e.g.*, Alex Cobham, *Big Four Accounting Firms are Key Drivers of Tax Haven Use, New Research Says,* TAX JUST. NETWORK (Nov. 13, 2017), https://taxjustice.net/2017/11/13/big-four-accounting-firms-arekey-drivers-tax-haven-use-new-research-says/; Leon Lazaroff & Andrew Zajac, *KPMG Admits to $2.5 Billion Tax Fraud*, CHI. TRIB. (Aug. 30, 2005, 12:00 AM), https://www.chicagotribune.com/news/ct-xpm-2005-08-30-0508300152-story.html; Thom Weidlich, *Ernst & Young Partners Charged in Tax-Shelter Fraud,* ORLANDO SENTINEL. (May 31, 2007), https://www.orlandosentinel.com/news/os-xpm-2007-05-31-loophole31-story.html.

78. Jesse Drucker & Danny Hakim, *How Accounting Giants Craft Favorable Tax Rules from Inside Government,* N.Y. TIMES (Sept. 19, 2021), https://www.nytimes.com/2021/09/19/business/accounting-firms-tax-loopholes-government.html.

Extensive bipartisan congressional investigations[79] into Enron's 2001 collapse[80] offer unique insight into the attitude of American corporate executives with respect to corporate tax planning. Of particular significance here, the Enron scandal also precipitated the collapse of Arthur Andersen, a member of one of the five largest accounting firms in the world known colloquially (at the time) as the "Big Five." Andersen, Enron's auditor, is widely considered to have facilitated Enron's fraudulent accounting, but congressional investigations also uncovered the firm's efforts to structure and implement illegal corporate tax shelters on the corporation's behalf.[81] An investigation by the Joint Committee on Taxation, for example, produced thousands of pages detailing Enron's tax practices.[82] Over four of the Enron's last five years, for example, it formed 3,500 domestic and offshore entities,[83] with 441 in the Cayman Islands alone,[84] as well as dozens of abusive tax shelters in its efforts to dodge its tax obligations despite reporting billions of dollars in profits to its shareholders.[85] Somewhat surprisingly, Enron continued to generate tax losses even after the company's poor economic condition made it unlikely that they could ever be used.[86]

Subsequent work has demonstrated that the corporate attitudes which engendered these practices hasn't been unique to Enron. In 2015, for example, Gabriel Zucman found that approximately 55% of the foreign profits of U.S. corporations were "parked" outside the United States—mostly in "tax havens"[87]—in order to avoid U.S. federal (and state) income taxes. Similarly, the Tax Justice Network[88]

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79. *See* Scott Green, *A Look at the Causes, Impact and Future of the Sarbanes-Oxley Act*, 3 J. INT'L BUS. & L. 33 (2004).

80. *See* Michael Peregrine & Charles Elson, *Twenty Years Later: The Lasting Lessons of Enron,* HARVARD L. SCH. F. CORP. GOVERNANCE (Apr. 5, 2021), https://corpgov.law.harvard.edu/2021/04/05/twenty-years-later-the-lasting-lessons-of-enron/. Prior to its collapse, Enron was the seventh largest publicly traded Corporation in the United States. *Enron: The Joint Committee on Taxation's Investigative Report: Hearing Before the Comm. on Fin.,* 108th Cong. (2003).

81. *Lessons Learned from Enron's Collapse: Auditing the Accounting Industry: Hearing Before the H. Comm. on Energy and Comm.*, 107th Cong. 19–21 (2002) (Statement of Chairman Tauzin).

82. *Portraits in Oversight: Congress and the Enron Scandal*, LEVIN CENTER FOR OVERSIGHT & DEMOCRACY, https://levin-center.org/what-is-oversight/portraits/congress-and-the-enron-scandal, (last visited Jan. 25, 2024).

83. *Id.*

84. *Id.*

85. *See Enron: The Joint Committee on Taxation's Investigative Report: Hearing Before the Comm. on Fin.*, *supra* note 80.

86. April Witt & Peter Behr, *Enron's Other Strategy: Taxes*, WASH. POST (May 22, 2002, 1:00 AM), https://www.washingtonpost.com/archive/politics/2002/05/22/enrons-other-strategy-taxes/9d96c5be-932d-4026-88e4-48847f608afb/.

87. GABRIEL ZUCMAN, THE HIDDEN WEALTH OF NATIONS: THE SCOURGE OF TAX HAVENS 105 (Univ. of Chicago Press Econ. Books, 2015).

88. The Tax Justice Network is an advocacy group consisting of a coalition of researchers and activists with a shared concern about tax avoidance, tax competition, and tax havens. *See Core Funding Prospectus 2018–2021*, TAX JUST. NETWORK, *https://www.taxjustice.net/wp-content/uploads/2018/07/TJN-Core-Funding-Prospectus.pdf* (last visited Nov. 9, 2022).

has estimated that corporations move about 25% of U.S. corporate profits into jurisdictions where they do not have any real economic activity.[89] The Tax Justice Network estimated that this practice alone has led to a $130 billion reduction in federal revenue.[90]

Perhaps the biggest participants in the tax product industry are the (now) "Big Four," the international accounting firms Deloitte, PwC, EY, and KPMG. By some estimates, profit shifting by global corporations leads to an annual tax revenue loss of $500 billion globally.[91] It is perhaps unsurprising, then, that, in 2021 alone, corporations were willing to pay approximately $38 billion[92] to the Big Four accounting firms' tax services segments. One can only estimate that the amounts paid to tax jurists and bankers to maintain complex corporate structures could have easily been better used if paid in the form of corporate income taxes.

Major document leaks like the "Paradise Papers"[93] and the "LuxLeaks"[94] have shed light on the Big Four's significant role in planning and implementing corporate tax minimization strategies. Those leaks also made it clear that corporations which made use of a Big Four accounting firm's services tax havens more frequently and in a more significant way than corporations that did not use the firms' services.[95] Thus, it appears that corporations seek the services of a Big Four accounting firm in order to minimize their federal income tax liability. Perhaps accordingly, one senior tax partner at KPMG instructed team members to ignore federal tax disclosure requirements in order to obstruct the IRS's efforts to identify its use of certain tax minimization strategies, expressing his attitude that, even if the IRS were able to uncover the arrangements, any resulting penalties would be the "cost of doing business."[96]

This is by no means a uniquely American problem. Tax minimization is a global issue that can only be resolved through international cooperation. In 2009, for example, tax authorities in the United Kingdom identified EY as "probably

89. *Id.*

90. *See* Chris Jones et al., *Tax Haven Networks and the Role of the Big 4 Accountancy Firms*, 53 J. WORLD BUS., 177, 177–193 (2018).

91. *See* Cobham, *supra* note 77.

92. *See Revenue of the Big Four Accounting/Audit Firms Worldwide in 2021, by Function,* STATISTA (Dec. 2023), https://www.statista.com/statistics/250935/big-four-accounting-firms-breakdown-of-revenues/.

93. *See generally Paradise Papers: Secrets of the Global Elite*, INT'L CONSORTIUM INVESTIGATIVE JOURNALISTS; Madison Marriage, *Paradise Papers Line Up Big Four Accountancies for Criticism*, FIN. TIMES (Nov. 15, 2017), https://www.ft.com/content/90befed2-c954-11e7-ab18-7a9fb7d6163e.

94. Michael Hudson et al., *Big 4 Audit Firms Play Big Role in Offshore Murk*, INT'L CONSORTIUM INVESTIGATIVE JOURNALISTS (Nov. 5, 2014), https://www.icij.org/investigations/luxembourg-leaks/big-4-audit-firms-play-big-role-offshore-murk/.

95. *See* Jones et al., *supra* note 90, at 190.

96. Mark W. Everson, *Lawyers and Accountants Once Put Integrity First,* N.Y. TIMES (June 18, 2011), https://www.nytimes.com/2011/06/19/opinion/19everson.html?pagewanted%C2%BCall.

the most aggressive, creative, abusive provider" of tax minimization strategies.[97] The country's courts, meanwhile, have ruled that PwC engaged in a "circular, self-cancelling scheme designed with no purpose other than to avoid tax."[98]

Big law firms also play a significant role in the tax product "industry."[99] The Pandora Papers,[100] for example, revealed that the firm Baker McKenzie advised several major U.S. corporations on different tax minimization strategies and assisted with their implementation, including Nike's Dutch tax shelter[101] and Facebook's Irish tax structure.[102] Through this latter arrangement, Facebook was able to route billions of dollars outside of the U.S., far from the reach of the IRS.[103]

Overall, multinational corporations are more sensitive to changes in their effective corporate income tax rates than they are to the concerns of the communities and countries in which they operate.[104] It appears that, for many global corporations, the logic is simple. As long as gains can be made through tax minimization strategies, corporations are willing to pay accounting and law firms to plan and implement those strategies. That being the case, it further appears that governments have three available avenues of response. First, and most obviously, governments can amend their tax codes to close loopholes and create new methods of taxing corporations. Alternatively, as some well-respected scholars have argued, governments could abolish the corporate income tax entirely.[105] Finally, governments can offer incentivizes to global corporations that pay corporate

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97. *Gilt-Edged Profits for Profession's 'Big Four,'* GUARDIAN (Feb. 6, 2009, 7:01 PM), https://www.theguardian.com/business/2009/feb/07/tax-gap-avoidance-schemes.

98. Richard Evans, *Tax Avoidance: HRMC Could Gain Billions as Court Rules Against 'Artificial' Scheme,* TELEGRAPH (July 18, 2012, 3:49 PM), https://www.telegraph.co.uk/finance/personal-finance/tax/9409219/Tax-avoidance-HMRC-could-gain-billions-as-court-rules-against-artificial-scheme.html.

99. *See* Sydney P. Freedberg et al., *How America's Biggest Law Firm Drives Global Wealth into Tax Havens,* INT'L CONSORTIUM INVESTIGATIVE JOURNALISTS, (Oct. 4, 2021), https://www.icij.org/investigations/pandora-papers/baker-mckenzie-global-law-firm-offshore-tax-dodging/.

100. *Read the Pandora Papers Documents*, INT'L CONSORTIUM INVESTIGATIVE JOURNALISTS (Dec. 6, 2021), https://www.icij.org/investigations/pandora-papers/read-the-pandora-papers-documents/.

101. *See* Simon Bowers, *How Nike Stays One Step Ahead of the Regulators*, INT'L CONSORTIUM INVESTIGATIVE JOURNALISTS (Nov. 6, 2017), https://www.icij.org/investigations/paradise-papers/swoosh-owner-nike-stays-ahead-of-the-regulator-icij/.

102. Josh White, *The IRS Takes Facebook to Court over Its Irish Tax Structure*, INT'L TAX REV. (Feb. 19, 2020), https://www.internationaltaxreview.com/article/2a6a544fgrgchygketc00/the-irs-takes-facebook-to-court-over-its-irish-tax-structure.

103. *Id.*

104. Hines, James R., Jr., *Corporate Taxation and International Competition*, in TAXING CORPORATE INCOME IN THE 21ST CENTURY (A.J. Auerbach ed., 2007); James R. Hines, Jr., *On the Sensitivity of R&D to Delicate Tax Changes: The Behavior of U.S. Multinationals in the 1980s* (Nat'l Bureau Econ. Rsch., Working Paper No. 3930, 1991).

105. *See*, *e.g.*, Yariv Brauner, *The Non-Sense Tax: A Reply to New Corporate Income Tax Advocacy*, 2008 MICH. ST. L. REV. 591, 595 (2008); Edwin G. Dolan, *The Progressive Case for Abolishing the Corporate Income Tax*, MILKEN INST. REV. (Jan 12, 2017), https://www.milkenreview.org/articles/the-progressive-case-for-abolishing-the-corporate-income-tax-2; Nathan Boidman, *Is Corporate Income Tax Abolition Unrealistic?*, 96 TAX NOTES INT'L 433, 433–34 (2019).

income taxes and/or that avoid employing aggressive and questionable tax minimization strategies.

As discussed above, Congress and the Treasury have attempted for decades to amend the tax code in its efforts to close loopholes and create new methods of taxing corporations.[106] This strategy, however, has proven to be highly ineffective.[107] Instead, the current corporate income tax law fails to achieve its main goal—*i.e.*, raising tax revenue. In 2019, for example, the overall revenue generated from the federal corporate income tax was approximately $230 billion—less than 7% of the total revenue generated from the federal income tax, which had been $3.4 trillion.[108] Aside from its failure to raise revenue, congressional efforts to forestall tax avoidance strategies have resulted in a more complicated, more costly, and more inefficient corporate income tax regime.[109] Thus, it is time to seriously consider the alternative—using the tax code to incentivize, control, and regulate global corporations.

As for getting rid of the corporate income tax altogether, although at least some scholars feel it is possible that a future president may argue that we should abolish the corporate income tax,[110] it still seems very unlikely, especially in an era where the public is growing more and more upset about corporations who avoid paying their fair share of taxes.[111]

II. How Is It Possible (That Easy)? Theories of the Corporate Form

Though the corporate form dates back to the Roman empire,[112] it had to undergo several transformations in order to become what it is today.[113] Three

106. *See*, *e.g.*, Jason Loden, *Executive Compensation, Professional Perspective – Congress Continues Focus on Carried Interest Loophole*, BLOOMBERG L. (Aug. 2021), https://www.bloomberglaw.com/external/document/X2B3233O000000/executive-compensation-professional-perspective-congress-continu.

107. *See* MATTHEW GARDNER, LORENA ROQUE & STEVE WAMHOFF, INST. ON TAX'N & ECON. POL'Y, CORPORATE TAX AVOIDANCE IN THE FIRST YEAR OF THE TRUMP TAX LAW 4, 7 (2019); *see also* Robert S. McIntyre & Robert Folen, *Corporate Income Taxes in the Regan Years: A Study of Three Years of Legalized Tax Avoidance,* CITIZENS FOR TAX JUST. (Oct. 1984), https://ctj.sfo2.digitaloceanspaces.com/pdf/1984ReaganYears.pdf.

108. Reuven S. Avi-Yonah, *A New Corporate Tax*, TAX NOTES (July 27, 2020), https://www.taxnotes.com/tax-notes-federal/corporate-taxation/new-corporate-tax/2020/07/27/2cq8m?highlight=Reuven%20S.%20Avi-Yonah.

109. *See id.*

110. *Id.* at 654.

111. J. Baxter Oliphant, *Top Tax frustrations for Americans: The Feeling That Some corps., Wealthy People Don't Pay Fair Share*, PEW RSCH. CTR. (Apr. 7, 2023), https://www.pewresearch.org/short-reads/2023/04/07/top-tax-frustrations-for-americans-the-feeling-that-some-corporations-wealthy-people-dont-pay-fair-share/#:~:text=About%20six%2Din%2Dten%20adults,conducted%20from%20March%2027%20to.

112. *See generally* Jeffery L. Patterson, *The Development of the Concept of Corporation from Earliest Roman Times to A.D. 476*, 10 ACCT. HISTORIANS J. 87 (1983).

113. *See* Reuven S. Avi-Yonah, *The Cyclical Transformations of the Corporate Form: A Historical Perspective on Corporate Social Responsibility*, 30 DEL. J. CORP. L., 767, 772 (2005).

theories, however, remained relevant throughout the evolution of the corporate form: (1) the aggregate theory, (2) the artificial entity theory, and (3) the real entity theory.[114]

According to the aggregate theory, a corporate income tax is viewed as an indirect way to tax the corporation's shareholders.[115] Because a corporation is treated as a separate legal entity from its shareholder owners, corporate shareholders will be able to defer income taxation on their allocable earnings by directing their operations to corporate vehicles unless income is taxed as it's earned by the corporation. Otherwise, the shareholders' earnings would remain untaxed unless and until the corporation authorized a distribution, paid its shareholders for managerial or other services (including servicing corporate debts that these shareholders granted), liquidated, or until the shareholders sold their shares. Importantly, a shareholder could avoid taxation on her built-in gains altogether by passing the corporation's stock on to her heirs.[116]

Some proponents of the aggregate theory also argue that it is less costly to administrate, alleging that it is easier to collect tax from corporations than shareholders.[117] Although this may be true for a publicly traded corporation, it is certainly not the case for closely-held corporations.[118] To the contrary, most closely-held companies are chartered as S-Corporations or Limited Liability Companies (LLCs), which are treated as pass-through entities, meaning their earnings are taxed entirely at the owner level. Some scholars have further argued that all closely held corporations should be treated this way for tax purposes.[119]

The artificial entity theory conceives of the corporate form as a privilege granted by the state that, among other things, shields the corporation's shareholders with limited liability. Accordingly, under this theory, the corporate income tax is thought of as a "payment" that the corporation makes in return for the

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114. *See* Michael J. Phillips, *Reappraising the Real Entity Theory of the Corporation*, 21 FLA. ST. UNIV. L. REV. 1061, 1063 (1994).

115. CHARLES E. MCLURE JR., MUST CORPORATE INCOME BE TAXED TWICE? 20 (1979).

116. *See* I.R.C. § 1014(a)(1). The shareholder's heirs will enjoy a step-up in basis for stock received through inheritance, meaning that any appreciation on the stock that occurred during the shareholder's lifetime will not be taxed if and when her heirs choose to sell the stock. Herbert R. Fineburg et al., *Avoiding an Adverse Tax Impact on Death of an S Corporation Shareholder*, 40 ABA TAX TIMES (2021), https://www.americanbar.org/groups/taxation/publications/abataxtimes_home/21win/21win-prp-fineburg-mccauley-s-corps/; *See also* Roger H. Gordon & Jefferey K. Mackie-Mason, *Why Is There Corporate Income Taxation in a Small Open Economy? The Role of Transfer Pricing and Income Shifting*, *in* THE EFFECTS OF TAXATION ON MULTINATIONAL CORPORATIONS 67 (Martin Feldstein, James R. Hines Jr., & R. Glenn Hubbard eds., 1995).

117. *See* Richard M. Bird, *Why Tax Corporations?*, 9–12 (Int'l Centre for Tax Stud., Univ. Toronto, Working Paper No 96-2, 1996), https://publications.gc.ca/collections/Collection/F21-4-96-2E.pdf.

118. Which are, in fact, the majority of corporations.

119. *See, e.g.*, George K. Yin, *The Future Taxation of Private Business Firms*, 4 FLA. TAX REV. 141, 151–153 (1999).

benefits granted to its shareholders.[120] This theory, however, fails to account for several developments in business organizations law over the past several decades. For example, if the same shareholders who chose the corporate form opted instead for an unincorporated entity like a limited liability company, limited partnership, or limited liability partnership, they would receive the same limited liability without the entity having to make an analogous "payment."[121] The artificial entity theory, though, fails to address this phenomenon.

Finally, the real entity theory views the corporation as a "real" entity, meaning that it exists separately from not only its owners but also the state.[122] Under this view, the corporation is a being with real characteristics and features that cannot be found in individuals.[123] While this proposition may seem obvious when viewed against the backdrop of the modern "global" corporation, which is so profitable, powerful, multinational, and well-known that it can be (or behave like) a simultaneous citizen of multiple nations, the theory's underpinnings date back to as early as 1911 when Arthur Machen wrote the following:

> A corporation is an entity – not imaginary or fictious, but real, not artificial but natural. Its existence is as real as that of an army or of the Church. This is the element of truth in the reality theory of corporate personality . . . a corporation is a real and natural entity, recognized but not created by the law.[124]

This seems to have never been truer than it is today, when global corporations routinely act like entities separate from their shareholders and even the state and, in most day-to-day affairs, are accountable only to their own directors and officers.[125] Currently, management routinely makes decisions for the benefit of the corporation[126] but not apparently for the direct or immediate benefit of its shareholders.[127]

This Article relies on the real entity theory since it is the most specific with respect to the state's relationship to the entities that are the focus of this Article—namely, large-scale multinational corporations. However, because the corporate income tax of 1909 was seen, for the most part, as a tool to regulate and control

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120. *See generally* Katherine Pratt, *The Debt-Equity Distinction in a Second-Best World*, 53 VAND. L. REV. 1055, 1098-1100 (2000).

121. *Choose a Business Structure*, U.S. SMALL BUS. ADMIN., https://www.sba.gov/business-guide/launch-your-business/choose-business-structure (last visited Jan. 25, 2024).

122. *See generally* Phillips, *supra* note 114 at 1087.

123. William W. Bratton Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471, 1475 (1989); *see also* Arthur W. Machen Jr., *Corporate Personality*, 24 HARV. L. REV. 347 (1910-11).

124. Arthur W. Machen Jr., *Corporate Personality*, 24 HARV. L. REV. 253, 262 (1910–1911).

125. Avi-Yonah, *supra* note 16, at 1208.

126. Management may also make decisions for the benefit of the corporation's executives when the corporation is poorly managed and/or the corporate structure lacks adequate protocols to check management's self-interest.

127. *See* Lynn A. Stout, *The Problem of Corporate Purpose*, BROOKINGS INST.: ISSUES GOVERNANCE STUD. (June 2012), https://www.brookings.edu/wp-content/uploads/2016/06/Stout_Corporate-Issues.pdf.

the corporations dominating society at the turn of the twentieth century[128] it seems reasonable to consider a return to the corporate income tax's origins not only to remedy the current system's failure to raise significant revenue but also to regulate and control corporate activity.[129] In the words of President Taft's 1909 message to Congress:[130]

> Another merit of this tax is the federal supervision which must be exercised in order to make the law effective over the annual accounts and business transactions of all corporations… If now, by a perfectly legitimate and effective system of taxation we are incidentally able to possess the Government and the stockholders and the public of the knowledge of the real business transactions and the gains and profits of every corporation in the country, we have made along [sic] step toward that supervisory control of corporations which may prevent a further abuse of power.

III. The Carrot

Amazon founder Jeff Bezos, one of the richest people in the world, has pledged to donate $2 billion in funding to help restore the environment and transform food systems.[131] The funding, which will come out of Bezos' private funds, is part of his $10 billion commitment to fight climate change.[132] Bezos is not alone in his philanthropy. According to the Chronicle of Philanthropy, the fifty largest private donors gave approximately $25 billion to charity in 2020 alone.[133] While these individuals clearly want to make the world a better place, their philanthropy also confers significant personal tax benefits and a healthy dose of positive publicity.[134] In other words, it's a win-win. There is no reason, however, why this "carrot" should be limited to private philanthropy. Instead, the corporate income tax regime should leverage these lessons toward a tax code that incentivizes corporations to hire more employees, pay higher salaries, invest in new factories, conduct cutting-edge research and development, and otherwise contribute to the economy and their own communities.

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128. *Id.*

129. *See* Marjore E. Kornhauser, *Corporate Regulation and the Origins of the Corporate Income Tax*, 66 Ind. L.J. 53, 113 (1990).

130. President William Taft, Message to Congress Regarding Income Tax (Jun. 16, 1909) (available at https://millercenter.org/the-presidency/presidential-speeches/june-16-1909-message-regarding-income-tax).

131. Chloe Taylor, *Jeff Bezos Pledges $2 Billion to Protect the Environment*, CNBC (Nov. 2, 2021, 8:23 AM), https://www.cnbc.com/2021/11/02/jeff-bezos-pledges-2-billion-to-protect-the-environment.html.

132. *Id.*

133. Theodore Schleifer, *America's Billionaire Philanthropists Gave Away More During the Pandemic. But There's a Catch*, VOX (Feb. 10, 2021, 9:00 AM), https://www.vox.com/recode/2021/2/10/22275101/billionaire-charity-jeff-bezos-chronicle-of-philanthropy-coronavirus.

134. *See* Renu Zaretsky, *Who Gets the Tax Benefit for Those Checkout Donations?* Urb. Inst. & Brookings Inst.: Tax Pol'y Ctr. (Nov. 4, 2020), https://www.taxpolicycenter.org/taxvox/who-gets-tax-benefit-those-checkout-donations-0.

A. *What Should the Carrot Look Like?*

For some time now, different countries have been considering meaningful changes to the fundamental rules of international income taxation in response to the growing use of tax havens by global corporations. In October 2021, for example, 136 countries signed a historic agreement[135] outlining two major initiatives, Pillar 1, which focuses on how and where big corporations will pay corporate income tax, and Pillar 2, which proposes a global minimum corporate income tax.[136]

In general, Pillar 1 regulates the taxation of entities with income that meets the characteristics of the classification, "Amount A."[137] Specifically, the initiative applies to corporations with more than €20 billion in revenue and a profit margin that exceeds 10%.[138] Under Pillar 1, a corporation that meets the criteria of "Amount A" is subject to taxation on a percentage of its profits in jurisdictions where it in fact has sales.[139] Additionally, it would be subject to taxation on 25% of its profits in excess of 10% of its profit margin.[140] According to the initiative, the Amount A threshold of €20 billion may drop to €10 billion after seven years.[141]

Pillar 2 is often referred to as the "global minimum corporate income tax." The initiative includes two primary rules[142] that apply to corporations with more than €750 million in annual revenue.[143] The initiative's main import, however, is that the 136 participating countries agreed to set a minimum effective corporate income tax rate at 15%.[144] Given that, as of the time that this Article is being

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135. Out of the 140 countries who took part in these negotiations, only Kenya, Nigeria, Pakistan, and Sri Lanka, chose not to sign it. Alan Rappeport & Liz Alderman, *Global Deal to End Tax Havens Moves Ahead as Nations Back 15% Rate*, N.Y. TIMES (Oct. 8, 2021), https://www.nytimes.com/2021/10/08/business/oecd-global-minimum-tax.html.

136. *See* Daniel Bunn & Sean Bray, *The Latest on the Global Tax Agreement*, TAX FOUND. (Dec. 15, 2023), https://taxfoundation.org/blog/global-tax-agreement/.

137. "Amount A" is a partial redistribution of tax revenues from countries that currently tax large multinationals based on the location of their headquarters and operations to countries where those corporations have their sales. This will probably impact many U.S. corporations. *Id.*

138. Billy Joubert, *Interaction Between Pillar One and Pillar Two and Transfer Pricing*, DELOITTE (Jan. 31, 2023), https://www.deloitte.com/za/en/services/tax/perspectives/interaction-between-pillar-one-and-pillar-two-and-transfer-pricing.html.

139. *Id.*

140. *Id.*

141. *Id.*

142. *Id.* Pillar 2 includes a third rule primarily relevant to tax treaties between participating countries. *Id.*

143. *See id.*

144. *OECD Releases Model Rules on the Pillar Two Global Minimum Tax: Detailed Review*, ERNST & YOUNG LLP (Dec. 22, 2021), https://globaltaxnews.ey.com/news/2021-6413-oecd-releases-model-rules-on-the-pillar-two-global-minimum-tax-detailed-review.

written, the U.S. corporate income tax rate is a flat 21%[145] with a Corporate Alternative Minimum Tax ("CAMT") rate of 15%,[146] it seems that conditions in the international tax environment are favorable enough to afford Congress the latitude to shift its focus from "tax havens" and "tax shelters" to tax incentives.

In other words, the global minimum corporate income tax should reduce the profitability of sophisticated, risk-bearing, and expensive tax planning such that corporations will comply with the lower corporate income tax rate without engaging in tax avoidance and engendering all the complications it entails. The current corporate tax regime fails to address the problem posed by powerful multinational corporations who can easily dodge the tax by shifting profits to lower tax jurisdictions, financing, and strategically expensing research and development.[147] By shifting the tax code's intellectual underpinnings from the aggregate theory back to the real entity theory, however, the tax regime can better replicate the win-win scenario exemplified by Bezos's private philanthropy. Transplanting that mindset to the tax code will require offering tax benefits to corporations in return for hiring more employees, paying higher salaries, reducing environmental impact, and a host of other public benefits.

B. *Implementing the Carrot*

The "carrot" proposal quickly runs into the quandary that, while income taxes on businesses raise tax revenue, they also discourage business activity.[148] As a consequence, meaningful tax reform is particularly susceptible to the shortcomings of the political process.[149]

Important lessons, therefore, can be learned from evaluating the history of TRA86—the most significant tax legislation since World War II—in order to identify how it was introduced, passed, and codified. As a result of tax shelters and the large number of corporations who were able to avoid paying any federal income tax at all, Americans' confidence in the income tax system was low at the time TRA86 was introduced.[150] In particular, the fact that middle-class income

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145. *See* Garrett Watson, *Combined Federal and State Corporate Income Tax Rates 2022*, TAX FOUND. (Sep. 27, 2022), https://taxfoundation.org/combined-federal-state-corporate-tax-rates-2022/#:~:text=Corporations%20in%20the%20United%20States,11.5%20percent%20in%20New%20Jersey.

146. *See* Steve Wamhoff, *Unfinished Tax Reform: Corporate Minimum Taxes*, INST. ON TAX'N & ECON. POL'Y (Oct. 4, 2022), https://itep.org/unfinished-tax-reform-corporate-minimum-taxes/.

147. Avi-Yonah, *supra* note 108.

148. *See* James R. Hines, *Business Tax Burdens and Tax Reform*, BROOKINGS PAPERS ON ECON. ACTIVITY 1 (2017), https://www.brookings.edu/wp-content/uploads/2017/09/5d_hines.pdf.

149. *See generally* Charles E. McLure, Jr., & George R. Zodrow, *Treasury I and the Tax Reform Act of 1986: The Economics and Politics of Tax Reform*, 1 J. ECON. PERSP. 37, 37–58 (1987) (discussing various tax policy ideas and their political feasibility in a review of the lead-up to the Tax Reform Act of 1986).

150. *See* Julia Kagan, *Tax Reform Act of 1986: Overview and History*, INVESTOPEDIA (Sept. 11, 2023), https://www.investopedia.com/terms/t/taxreformact1986.asp; Lydia Saad, *Gallup Vault: 1986 Tax Bill a Legislative Success, PR Failure*, GALLUP (Dec. 8, 2017), https://news.gallup.com/vault/223361/gallup-vault-1986-tax-bill-legislative-success-failure.aspx.

taxpayers were subject to a higher effective tax rate than were large corporations and high net-worth individuals created strong feelings of resentment.[151] In addition, the tax code's complexity left many taxpayers feeling that the system was almost rigged against them.[152] Accordingly, TRA86 was marketed as a way to fix the system, making it fairer, simpler, and more efficient.[153] Notably, these reasons are equally relevant today. But, whereas the TRA86 targeted contemporary symptoms of the tax code's failures, here reform must target the causes by crafting incentives to increase the attractiveness of wealth redistribution, domestic job creation, economic growth, and environmental sustainability and protection.

To that end, the corporate tax code should incorporate income tax benefits in the form of, for example, reduced rates at the corporate and/or shareholder level(s), accelerated deductions, or flex limitations (e.g., better strategizing when, how, and what expenses can be deducted, losses can be offset, and the like). Most importantly, when shaping the tax policies that are applied to a corporation and its shareholders, the tax code should consider the company's contributions to the U.S. economy. When calculating the size of those contributions, the code should look at the size of the corporation's investment—since, to some extent, it reflects the risk taken on by investors—as well as how the investment is financed—including, for example, the extent to which the local tax base is eroded as a result of extensive debt financing. Distinctions can be drawn to benefit corporations engaged in, for example, the innovative (and probably riskier) technological industry over corporations engaged in other industries, or vice-versa, depending on what investments and activities most benefit domestic or local infrastructure, workforces, and financiers; whether the capital is directed at the corporate level or at the shareholder level; and whether profits from the investment are reinvested in the local economy, reinvested overseas, or distributed to local or non-local shareholders.

Obviously, this is not a closed list of considerations. It should be apparent, however, that each shares a common feature in that they are motivated by the objective to maximize the degree of contribution by corporate investments in the domestic economy's development and growth. Thus, for example, the tax code could similarly operationalize incentives that promote environmental sustainability and protection; reward upward departures from minimum wage; close gaps in pay based on gender or race; or even reign in management compensation.

Perhaps more controversially, the tax code could also adopt "compensation" mechanisms that reward a corporation and/or its shareholders for engaging in qualifying activities. Such mechanisms would grant a full or partial reprieve from tax on the return from a qualifying investment adjusted with respect to the amount invested. This feature, however, must be treated with care and accompanied by

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151. *See id.*

152. *See id.*

153. Joseph A. Pechman, *Tax Reform: Theory and Practice*, 1 J. ECON. PERSP. 11, 17–25 (1987).

mechanisms ensuring full transparency to investors and the public such that the proliferation of qualifying criteria will not create an overly complex model that would offer a broad cushion for tax planning on the one hand and generate high reporting and enforcement costs on the other.

This model is an extension of Pigouvian tax policy.[154] Arthur Pigou was among the first economists' philosophers to introduce the idea that the costs and benefits of welfare externalities (negative and positive) can be corrected through the levy of specific taxes.[155] These taxes—also referred as "Pigouvian taxes," "sin taxes," or "corrective taxes"—have seen the most use in the health and environmental contexts in the form of taxes levied to correct undesirable or inefficient illness, waste, or pollution or to otherwise correct a perceived market failure.[156] Generally, Pigouvian taxes are incurred upon consumption of goods and products perceived to be undesirable pursuant to the rationale that increasing the market price of these goods will have a chilling effect on consumption while also covering the costs of negative externalities imposed on society by the consumption of these goods.[157] Empirical work conducted on the effectiveness of these taxes, however, shows that, at least with respect to products, Pigouvian taxes fail to affect demand—possibly because the products are addictive or because there is no good alternative or substitute—and thus any reduction in consumption is often insignificant. Yet, such taxes do successfully cause the taxed party to internalize the costs associated with the undesirable conduct and potentially generate entry barriers to those who would otherwise have entered the market for the taxed product.[158]

This proposal takes the concept of Pigouvian taxes a step further by structuring the corporate tax regime around rewarding the creation of positive externalities, rather than simply penalizing those who engage in activities that are considered harmful.[159] Accordingly, incorporating such corrective taxes must be justified by the following criteria. First, the legislators must determine that a given objective is one that, as a result of market or other systemic failures, cannot be achieved without

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154. *See generally* ARTHUR C. PIGOU, THE ECON. OF WELFARE (4th ed. 1932).

155. *Id.* at 213–29.

156. *See* Julie Kagan, *Pigouvian Tax: Definition, Purpose, Calculation, and Examples*, INVESTOPEDIA (Feb. 20, 2024), https://www.investopedia.com/terms/p/pigoviantax.asp.

157. Pigouvian taxes are generally set at a level that will equal the cost of the negative externality associated with consumption of the product. *See* Jonathan Gruber & Bötond Koszegi, *Is Addiction Rational? Theory and Evidence*, 116 Q.J. ECON. 1261 (2001); Austan Goolsbee et al., *Playing with Fire: Cigarettes, Taxes and Competition from the Internet*, 2 AM. ECON. J: ECON. POL'Y, 131, 131–53 (2010) (discussing cigarette tax rates).

158. *See, e.g.,* Frank Chaloupka & Kenneth Warner, *The Economics of Smoking*, 1 HANDBOOK OF HEALTH ECON., 1541, 1547–48, 1568–69 (2000) (discussing the price elasticity of demand for cigarettes and the degree of the burden of cigarette taxation on consumers); Gary S. Becker et al., *An Empirical Analysis of Cigarette Addiction*, 20, 24, 35 (Nat'l Bureau Econ. Rsch., Working Paper No. w3322, 1990), https://ssrn.com/abstract=226658.

159. Pigouvian taxes are more familiar on carbon, gasoline, fat, sugar, guns, cigarettes, alcohol, traffic, and zoning but were also introduced regarding executive pay and financial transactions. Victor Fleischer, *Curb Your Enthusiasm for Pigouvian Taxes* (San Diego Legal Stud. Working Paper No. 14-151, 2014).

offering a tax incentive. Second, it should be possible to calculate the value of the positive externality generated by the activity such that the size of the tax incentive can be rationalized. Alternatively, it should be possible to calculate the cost of the negative externality incurred from the activity such that the size of the tax penalty can be rationalized. Third, the incentive should be initially offered on a temporary basis following which a government agency can evaluate the necessity, efficacy, and impact of the measure. The preliminary period, however, must be sufficiently long and definite such that a taxpayer could conduct a cost-benefit analysis and rely on the promise of the tax benefit in structuring its conduct. Fourth, the incentive should be limited by the total amount of tax revenue spared or tax subsidy granted and, importantly, with regard for the manner in which it is allocated among the different players. Finally, the tax benefit should correspond to the amount invested and the risk inherent in the corporation's investment (for example, an investment in researching and developing innovative processes could be rewarded more or less than an investment in real estate). In no case, however, should the tax benefit jeopardize the minimum 15% effective tax rate.

For example, the United States has increased funding for research and development.[160] Rather than just funding research and development, however, the United States could incentivize domestic corporations to focus even more on innovation by amending the definition of "industrial company"[161] to include certain innovative activities. While offering "subsidization" or incentives to certain corporations undoubtedly entails some impact on market competition, large corporations in the U.S. market already enjoy an advantage over other corporations because they have more resources to invest in tax planning. Thus, any critique should instead focus on whether the subsidy is able to accomplish its purpose—namely, incentivizing corporations to shift their efforts from tax planning to investment in the domestic economy in order to foster economic growth and international competition. Thus, laws that offer subsidies or incentives to certain corporations must do so to the extent they motivate the recipient to focus on long term investment, sustainable business practices, and higher pay for employees.

The factors relevant to determining whether (and to what extent) an incentive is warranted reveal that the system could be thought of as a true form of trickle-down economics. For instance, allowing a U.S. multinational corporation with an annual ETR of around 20%, such as Sherwin Williams,[162] to pay a 15% corporate income tax rate on the condition that it pays non-management employees twice the minimum wage, employs a certain number of individuals in the United States, and domestically manufactures a certain percentage of its inventory reallocates money from tax

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160. Gary Anderson et al., *U.S. R&D Increased by $51 Billion in 2020 to $717 Billion; Estimate for 2021 Indicates Further Increase to $792 Billion*, NAT'L CTR. FOR SCI. & ENG'G. STAT. (Jan. 25, 2024), https://ncses.nsf.gov/pubs/nsf23320.

161. *See* Ty Haqqi, *15 Largest Industrial Companies in the U.S.*, YAHOO! (Jan. 17, 2021), https://finance.yahoo.com/news/15-largest-industrial-companies-us-092431309.html#:~:text=An%20industrial%20company%20is%20a,in%20either%20manufacturing%20or%20construction.

162. *The Sherwin Williams's Annual Effective Tax Rate*, CSIMARKET https://csimarket.com/stocks/singleProfitabilityRatiosy.php?code=SHW&itx (last visited Feb. 19, 2024).

planning and cost-cutting to the company's employees and the communities in which it operates. Further, adopting tax policy that promotes saving and investment stimulates economic growth by incentivizing corporations to participate in the element most fundamental to creating economic growth—capital investment.[163]

One real-world precursor to this approach can be found in India's Companies Act 2013 ("Companies Act") that mandates corporate social responsibility. Although the "carrot," differs in many ways from India's approach,[164] comparison is still useful because the two approaches share a common purpose: spurring social and economic growth and progress.[165] The Companies Act, for example, incentivizes corporate behaviors and business activities that ensure and promote environmental sustainability and ecological balance, foster education (including special education), and contribute to a state fund earmarked for social and economic development and relief.[166] No matter what activities are identified, however, the underlying logic is that, as the incentive to engage in domestic economic activity becomes larger, the loss of tax revenue becomes smaller.[167] Thus, if the new tax policy introduces strong incentives to invest in domestic activity—hiring more domestic employees, paying higher salaries, and reducing environmental impact—then economic growth will remain positive, and corporations will have fewer incentives to devote resources to tax avoidance. Further, publicizing the corporations that take advantage of these tax incentives and the benefits to local communities and the national economy produced by the subsidized activities may pressure other leading players to follow suit.

Another key to the "carrot" lies in significantly strengthening the "stick," that is, tightening the current corporate income tax. While the Tax Cuts and Jobs Act of 2017, for example, repealed the corporate AMT ("CAMT") discussed earlier,[168] calls for its revival have already been forthcoming.[169] This comes as no surprise since a 15% effective corporate income tax imposed on the roughly

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163. Dale W. Jorgenson, *The Agenda for U.S. Tax Reform*, 29 CAN. J. ECON. (SPECIAL ISSUE) S649, S650 (1996).

164. India chose to implement in its Companies Act 2013 what is considered to be a somewhat far-reaching approach for mandatory CSR that essentially affects corporations' way of conducting business, formations, and corporate governance. *See* Hency Thacker, *CSR Policies Around the World*, CSR J. (Nov. 21, 2019), https://thecsrjournal.in/csr-policies-around-the-world.

165. *See generally* DEZAN SHIRA & ASSOCS., *Corporate Social Responsibility in India*, INDIA BRIEFING (Mar. 23, 2020), https://www.india-briefing.com/news/corporate-social-responsibility-india-5511.html/#:~:text=India%20is%20the%20first%20country,part%20of%20any%20CSR%20 compliance.

166. *See* Gaurika Nigam, *Corporate Social Responsibilities: Global and Indian Perspective*, LEGAL SERV. INDIA: E-J., (last visited Feb. 19, 2024), https://www.legalserviceindia.com/legal/article-13305-corporate-social-responsibilities-global-and-indian-perspective.html#google_vignette.

167. Joel Slemford, *Is This Tax Reform, or Just Confusion?*, 32 J. ECON. PERSP., 73, 73, 82 (2018).

168. BOWLES RICE LLP, *supra* note 41, at *1.

169. See *Senate Bill Would Create Corporate Alternative Minimum Tax*, TAX NOTES (Oct. 26, 2021), https://www.taxnotes.com/research/federal/legislative-documents/proposed-legislation/senate-bill-would-create-corporate-alternative-minimum-tax/7cjwf.

200 corporations with book income of over $1 billion over the preceding three years would have produced $90 billion in tax revenue.[170] Combining the "carrot" with a revived CAMT, offers those 200 corporations a way to achieve the minimum effective tax rate without expensive tax planning, thus incentivizing them to choose the route that not only benefits their bottom line but also the domestic economy. This combination, however, will only be effective if the corporate income tax laws are enforced. It seems that after years of Congress declining to invest in tax enforcement,[171] however, the U.S. has recently begun to shift its approach, investing in the IRS's ability to enforce the tax code, especially with respect to abusive tax deals and schemes.[172] Publishing information related to such enforcement efforts could also incentivize corporations to favor investing in incentivized activities over tax planning.

IV. Red Herring: Unlawful Tax Discrimination

Under what circumstances would the proposed policy constitute unlawful tax discrimination? Although what constitutes "tax discrimination" is far from clear, courts and academics have pointed to the requirement of "competitive neutrality" or "economic efficiency" with regard to tax policies reaching both domestically and across borders.[173] Although the objection that a policy is discriminatory is often justified with reference to notions of equality or neutrality (as, almost 250 years ago, Adam Smith described as one of the "four canons of taxation")[174] providing preferential treatment through the income tax laws—as noted by Professor Douglass A. Kahn—differs little from direct payments, which don't necessarily violate neutrality or constitute an unideal income tax system.[175]

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170. *See generally* Press Release, Off. Sen. Elizabeth Warren, New Report from Senator Warren: Tax Dodgers: How Billionaire Corporations Avoid Paying Taxes and How to Fix It *Tax Dodgers: How Billionaire Corps. Avoid Paying Taxes and How to Fix It* (Nov. 18, 2021) (available at https://www.warren.senate.gov/newsroom/press-releases/new-report-from-senator-warren-tax-dodgers-how-billionaire-corporations-avoid-paying-taxes-and-how-to-fix-it).

171. *See* Galen Hendricks & Seth Hanlon, *Better Tax Enforcement Can Advance Fairness and Raise More Than $1 Trillion of Revenue*, CTR. FOR AM. PROGRESS (Apr. 19, 2021), https://www.americanprogress.org/article/better-tax-enforcement-can-advance-fairness-raise-1-trillion-revenue/.

172. *See IRS Chief Counsel Looking for 200 Experienced Attorneys to Focus on Abusive Tax Deals; Job Openings Posted*, IRS (Jan. 21, 2022), https://www.irs.gov/newsroom/irs-chief-counsel-looking-for-200-experienced-attorneys-to-focus-on-abusive-tax-deals-job-openings-posted.

173. *See OECD Model Tax Treaty*, art. 24, Nov. 21, 2017; Daniel Shaviro, *An Economic and Political Look at Federalism in Taxation*, 90 MICH. L. REV. 895, 929 (1992) (discussing the nondiscrimination doctrine under the dormant Commerce Clause in the United States); s*ee also* Ruth Mason & Michael S. Knoll, *What is Tax Discrimination?*, 121 YALE L.J. 1014, 1034–1036, 1051–1072 (2012).

174. *See* ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 225-228 (P.F. Collier & Son, ed. 1909) (1776) (explaining the additional three canons of taxation are certainty, convenience, and economy).

175. Douglas A. Kahn, *The Two Faces of Tax Neutrality: Do They Interact or Are They Mutually Exclusive?*, 18 N. KY. L. REV. 1, 5 (1990); s*ee also The Concept of Neutrality in Tax Policy, Testimony Before the U.S. Senate Committee on Finance Hearing on "Tax: Fundamentals in Advance*

Therefore, with respect to the domestic context, the question should not turn on whether policymakers may implement preferential tax treatment, but rather on when incorporating such a provision in the tax code becomes justified, and how policymakers can ensure that it isn't discriminatory? In any case, offering a tax benefit should constitute neither tax discrimination per se nor necessarily abusive policy, especially where, as we propose here, the policy aims at encouraging domestic corporate investment.

Even if crafting nondiscriminatory legislation to incentivize domestic investment were more tricky in the international context (when also considering the strictures of, for example, legislative or treaty undertaking), resolving the issue becomes simple where, as here, the proposed legislation draws no distinction between inbound and outbound investments or domestic and foreign investors.[176] When a state offers preferential tax treatment to *any* investor in order to encourage domestic investment and to accrue the benefits such activities offer to its economy, the tax policy is decidedly nondiscriminatory.

A tax policy would certainly be nondiscriminatory and nonabusive if it satisfied the following five conditions, but, in our view, a tax policy that failed to satisfy the following conditions would be unjustified in the first instance. First, there must be a connection between the tax benefit and the desired behavior. Second, the "desired" behavior must offer a material contribution to the local or national economy.[177] Third, the size of the tax benefit must correspond with that of the contribution to the local economy. Fourth, the tax benefit must be limited in duration and reviewable at the end of each agreed upon period (and not perpetually). Finally, the income tax benefit should be limited in amount and can be allocated neutrally among local and foreign players.

V. WHY OPT FOR THE "CARROT" TAX POLICY?

Questions regarding whether and to what extent this proposal will actually change corporate behavior can be answered with reference to lessons learned from passage of TRA86. By lowering the marginal individual income tax rate to 28% and the marginal corporate income tax rate to 34%,[178] TRA86 created, for the first time in U.S. history, a tax regime in which the marginal individual income tax rate

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of Reform" (Apr.15, 2008) (testimony of Jason Furman, Senior Fellow & Dir. of The Hamilton Project, The Brookings Institution).

176. Alvin C. Warren, Jr., *Income Tax Discrimination Against International Commerce*, 54 TAX L. REV. 131, 149–158 (2001).

177. In other words, the economic benefit should not be limited to a simple increase in domestic tax revenue. For example, while employing local workers would constitute a meaningful contribution to the local or national economy, incorporating dormant companies for the main purpose of accruing legal, accounting, and corporate fees would, if it didn't constitute an outright abuse of the tax system, be at least insufficient to qualify for preferential tax treatment.

178. *See* Jialu L. Streeter, *How Do Tax Policies Affect Individuals and Businesses?*, STAN. INST. FOR ECON. POL'Y RSCH., (Oct. 2022), https://siepr.stanford.edu/publications/policy-brief/how-do-tax-policies-affect-individuals-and-businesses.

was lower than the marginal corporate income tax rate.[179] As a result, as early as 1987, the use of S-Corporations soared while the number of newly incorporated C-Corporations stagnated.[180] Thus, it appears that TRA86 motivated high income taxpayers to shift to a different business entity in order to capture tax savings. Nor is this the only time a change in the tax law changed behavior.[181] A study conducted on the effect of the Jobs and Growth Tax Relief Reconciliation Act of 2003, which significantly reduced the tax rate applicable to dividend distributions, for example, found a 20% increase in dividend distributions, reversing two decades of consistent decline in the number and frequency of distributions.[182]

It appears as well that the objection that the tax code should not be used to shape behavior is past its expiration date. The tax code frequently, and has for decades, used special tax provisions that trade deductions, credits, deferrals, or other tax benefits for the promotion of non-tax goals that Congress found desirable.[183] Further, as discussed earlier, the rationale underlying the tax code has, from as early as 1909, demonstrated an understanding that tax can and should be used to promote desirable corporate behavior.[184] Whereas Congress' ability to promote significant tax reforms has been historically strong when different economic forces, such as inflation, recession, and budget deficits, were taking their toll on the U.S. economy,[185] the time is ripe to consider a fundamental change in the way we have come to think about corporate income tax. In any case, there can be little doubt that officers and directors factor the tax code into corporate decision-making. In fact, there is evidence that they use the ETR as a benchmark for cost-benefit analyses.[186] Thus, combining a 15% minimum tax rate with the possibility of achieving a lower ETR by offering positive contributions to the domestic economy, along with the positive publicity such contributions carry, will likely effectively encourage corporate actors to shift their capital from tax planning to investments in their workforces, environmentally sustainable practices, and the communities in which they operate.

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179. *See* George A. Plesko & Eric J. Toder, *Changes in the Organization of Business Activity and Implications for Tax Reform,* 66 NAT'L TAX J. 855, 857 (2013).

180. Joel Slemrod, *Income Creation or Income Shifting? Behavioral Responses to the Tax Reform Act of 1986*, 85 AM. ECON. REV. 175, 175–80 (1995).

181. *See* Katrine Marie Jakobsen & Jakob Egholt Søgaard, *Identifying Behavioral Responses to Tax Reforms: New Insights and a New Approach*, 212 J. PUB. ECON. no. 6 (Aug. 2022).

182. Raj Chetty & Emmanuel Saez, *Dividend Taxes and Corporate Behavior: Evidence from the 2003 Dividend Tax Cut*, 120 Q. J. ECON. 791, 793 (2005).

183. *See generally* Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705 (1970).

184. *See* Avi-Yonah, *supra* note 16, at 1208.

185. James M. Verdier, *The President, Congress, and Tax Reform: Patterns over Three Decades*, 499 ANNALS AM. ACAD. POL'Y. & SOC. SCI. 114, 114–117 (1998).

186. *See* John R. Graham et al., *Tax Rates and Corporate Decision-Making*, 30 REV. FIN. STUD. 3128, 3128–29 (2017).

CONCLUSION

While the corporate income tax raises tax revenue, the evidence indicates that one of its original purposes was to create a tool by which the federal government could control corporations.[187] Over time, that goal was forgotten, and the focus shifted to forcing corporations to pay their "fair share."[188] For decades now, however, the tax code has failed to meet even this objective. Instead, many of the largest corporations, assisted by accounting and law firms, have avoided paying any corporate income tax at all. Under the new approach, an entire industry devoted to finding creative (and, for the most part, legal) ways to plan around corporate tax obligations was born and nurtured in the wake of amendments to close loopholes in the tax code. Thus assisted, corporate actors have easily lowered their firm's ETR or completely avoided paying any tax at all, despite reporting significant profits to shareholders.[189]

Despite several decades of comprehensive tax reform meant to make the corporate income tax system simpler and fairer, [190] Congress and Treasury have, unfortunately, thus far failed.[191] A new approach is needed—one that is sensitive to and capitalizes on the unique features of the current corporate and political climate.

Specifically, while corporate earnings are at all-time high,[192] the percentage of overall federal revenue raised through taxes attributable to corporations is at a historical low.[193] In addition, technological and social changes over the last several decades have granted the public an unprecedented capacity to track whether and to what extent corporations are paying their "fair share"[194] Meanwhile, nations are collaborating on novel international approaches to the cooperative taxation of the large-scale, multinational corporations that have come to dominate in the twenty-first century. [195] Most notably, these efforts have produced a global minimum corporate income tax which, at 15%, closely follows the former CAMT, de facto setting the benchmark for what is considered to be corporations' "fair share" of our collective tax obligations.[196]

Thus, now is the time to consider a new, positive tax policy—one that offers corporations an alternative to the significant outlays they currently funnel to the law and accounting firms that make up the tax product industry—a policy that

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187. *See supra* Part III.

188. *See supra* Part II.

189. *See supra* Part II.

190. *See supra* Part II.

191. *See* supra Part IV.

192. *See* Orlik et al., *supra* note 4.

193. *See* Joel Friedman, *The Decline of Corporate Income Tax Revenues*, CTR. ON BUDGET & POL'Y PRIORITIES (Oct. 24, 2003), https://www.cbpp.org/research/the-decline-of-corporate-income-tax-revenues.

194. *See* CITIZENS FOR TAX JUST., *supra* note 29.

195. *See supra* Part IV.

196. *Id.*

awards significant tax benefits to corporations that invest in the domestic economy, local employees, and communities in which corporations do business.

Although they represented different approaches, both the Trump and Biden administrations have agreed on at least one thing: investing in America is the surest way to secure the country's future.[197] Whether motivated by patriotism,[198] national security,[199] or economics,[200] this goal can be achieved by the tax code. Our proposal aims to significantly change corporate attitudes toward tax and domestic investment. Corporate actors will seek tax incentives, like the receipt of a tax benefit or a discount, in order to boost their bottom line and consequently, the share price. Making these benefits certain to follow activity that positively contributes to the domestic economy will channel corporate capital from planning and implementing risky tax avoidance strategies into domestic investment. Whereas the economic benefits and positive publicity accruing from pursuing the tax incentive is guaranteed, tax evaders—those, at least, who successfully reach an ETR of less than 15%—will face the threat of enforcement and public backlash. Thus, our proposal leverages human behavior as well as the current economic and political moment to significantly alter corporate attitudes and the world.

197. *See President Joe Biden: Investing in America*, THE WHITE HOUSE (Apr. 1, 2024), https://www.whitehouse.gov/invest/; President Donald Trump, *Remarks to the World Economic Forum*, THE WHITE HOUSE (Jan. 21, 2020), https://trumpwhitehouse.archives.gov/briefings-statements/remarks-president-trump-world-economic-forum/.

198. According to a 2015 report prepared by Consumer Reports, about 80% of American buyers said they would rather purchase goods made in the United States. *Made in America*, CONSUMER REP. (May 21, 2015, 6:00 AM), https://www.consumerreports.org/cro/magazine/2015/05/made-in-america/index.htm. Perhaps even more surprising is that more than 60% said they would even pay 10% more for an American-made product. *Id.*

199. *See generally Fact Sheet: Chips and Science Act Will Lower Costs, Create Jobs, Strengthen Supply Chains, and Counter China,* THE WHITE HOUSE (Aug. 9, 2022), https://www.whitehouse.gov/briefing-room/statements-releases/2022/08/09/fact-sheet-chips-and-science-act-will-lower-costs-create-jobs-strengthen-supply-chains-and-counter-china/ ("U.S. leadership in new technologies—from artificial intelligence to biotechnology to computing—is critical to both our future economic competitiveness and our national security."); Steven R. Schmid & Shreyes N. Melkote, *Manufacturing and National Security*, AM. SOC'Y MECH. ENG'RS (Apr. 19, 2021), https://www.asme.org/topics-resources/content/manufacturing-and-national-security; Marcus Weisgerber, *US Manufacturing Decline is Hurting National Security, Report Warns*, DEF. ONE (Nov. 16, 2021), https://www.defenseone.com/threats/2021/11/us-manufacturing-decline-hurting-national-security-report-warns/186861/; Tim Shinbara, *The U.S. Industrial Base and National Security*, PROD. MACHINING (Mar. 16, 2021), https://www.productionmachining.com/articles/the-us-industrial-base-and-national-security.

200. *See* Jim Tankersley et al., *Factory Jobs Are Booming Like It's the 1970s*, N.Y. Times (Sept. 26, 2022), https://www.nytimes.com/2022/09/26/business/factory-jobs-workers-rebound.html.