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The Worst Tax Law Ever Enacted?

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The Worst Tax Law Ever Enacted?

By Reuven Avi-Yonah

1. Introduction

Some tax laws are worse than others. The 1986 Tax Reform Act is generally considered one of the best.[1] The 2017 Tax Cuts and Jobs Act is generally considered one of the worst, although I would say it is too early to tell what its long-term impact might be, and some of its worst features (like the Code Sec. 199A deduction) might be repealed in the future.[2]

Another example of a generally condemned tax law is the American Jobs Creation Act of 2004.[3] This law was a must-pass piece of legislation because Congress needed to react to the sanctions imposed upon the United States by the EU as the result of its victory in the ETI litigation at the WTO. The AJCA included such beauties as a temporary participation exemption that did not create any jobs, a significant increase in the potential for cross-crediting in the foreign tax credit, a manufacturing deduction that extended to software and film production, and a deeply flawed anti-inversion rule that immediately gave rise to a second wave of inversions.[4]

But these bad features were not particularly lasting. The participation exemption only lasted one year, the cross-crediting provisions were significantly revised in 2017, the manufacturing deduction was repealed in 2017, and the anti-inversion provision became less relevant after 2017. Any damage that was done was temporary.

To get to a bad tax law whose effects were really long-lasting, one should go much farther back to the Revenue Act of 1918. This law was the last major tax law of the Wilson administration, but despite its name was only enacted in 1919 and therefore was the first post-war tax law. During WW1 the income tax had grown from a largely symbolic measure with rates in the single digits to the major revenue source of the Federal government, with a top individual tax rate of 77%. The Revenue Act of 1918 maintained the high rate for 1918 but reduced it for 1919 and 1920. This reduction was the work of the GOP-controlled Senate and reflected the desire to return to "normalcy" after the war ended. As a contemporary article explained:

> The Revenue Act of 1918 which was signed by the President February 24, 1919, is the fourth great revenue measure of a notable series enacted during the present administration. The long delay in its passage has greatly

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> handicapped the Treasury Department in the administration of collection and has been a cause of uncertainty and annoyance to business and taxpayers of all classes. In May, 1918, the President addressed the Congress urging that body to give prompt attention to this problem even at the cost of the customary summer vacation; on June 5, the Secretary of the Treasury advised Mr. Kitchin, chairman of the Ways and Means Committee, that the bill should provide for raising eight billion dollars, one third of the estimated expenses of the government for the coming year on a war basis; on September 3, the committee presented to the House of Representatives a bill estimated to raise this amount. In presenting his report Mr. Kitchin said: "In making the decision to recommend that one third of the expenditures for the current year be raised by taxes and two thirds from the sale of bonds, your Committee has been guided by conditions existing at the present time." The bill was passed by the House September 20, and the next day was referred by the Senate to the Committee on Finance.
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> The [Democratic majority] House increased existing tax rates, added new taxes and evinced some appreciation of the desirability of raising a substantial part of the government's requirements by taxation. But its hasty action and the radical revision of its bill by the Senate in connection with the Revenue act of 1917 led the public to expect similar results in connection with this measure so that it discounted the House bill and looked forward to the [GOP majority] Senate's action.
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> While the measure was under consideration by the Senate Committee two important events occurred which necessitated changing plans. One was the passage of an act regulating the sale and manufacture of alcoholic beverages from July 1, 1919, until after the demobilization of the army. This prohibition measure reduced the estimated yield from the tax on beverages by 500 million dollars. The other event was the signing of the armistice, which brought with it a reduction in the estimated expenditures of the government from approximately 24 billion dollars to 18 billion dollars. As a result, the bill as submitted to the Senate provided for raising 6 billion dollars. "*Taxes which can be easily borne amid the feverish activity and patriotic fervor of war times are neither so welcome nor so easily sustained amid the uncertainties, the depreciating inventories and the falling markets which are apt to mark the approach of peace*," said Mr. Simmons in his report upon presenting the bill to the Senate December 6. After the bill had been passed by the Senate and while it was in conference, the Department of State announced that the prohibition amendment to the Constitution had been ratified by the requisite number of states so that the estimated yield of the new measure was again reduced by over half a billion dollars.
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> The chief objection to the bill on the part of the Senate [Democratic] minority when it was before that branch of Congress was to the provision which fixed the rates for 1920. They argued that it was advisable to wait until conditions for that year could be ascertained, while the [GOP] majority held that the taxpayers were entitled to know in advance what they were to pay. Another consideration which the advocates of this provision might well have mentioned is the administrative advantage of being able to plan for the collection of the tax. Senator La Follette presented a report in which he made a plea for increasing the amount to be raised by taxation, and for eliminating the proposed taxes on occupations, amusements (especially the cheaper kind), freight and passenger rates, and consumption taxes generally, substituting therefore a heavy tax on luxuries and war excess profits. Senator Smoot presented some additional views in which he advocated raising practically the entire revenue from a 1 per cent sale tax on consumption goods. Senator Thomas described the excess profits feature as "arbitrary, unjust, and indefensible" and objected to the inheritance tax on the ground that it was an encroachment upon the taxing power of the states.
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> The Senate finally passed the bill December 23. About six hundred changes had been made in the House bill, hence the Conferees had a difficult undertaking. The greatest difficulties were with the rates of the excess profits tax. The Conferees managed to reach an agreement on February 1 and the bill was signed by the President and became law February 24.[5]

What the article does not mention were two important background facts. First, President Wilson was in Europe for the Paris peace conference during the whole period that the act was debated in the Senate. Second, there was an influenza pandemic sweeping the country, so that regular Americans (who were in any case not subject to the income tax) were not paying attention. These conditions paved the way for rampant lobbying by corporate and other interests that resulted in major provisions being added to the bill. Those provisions represent some of the worst tax rules ever enacted, but because they were very pro-taxpayer, they are all still with us over a century later. In what follows, I will focus on four: Tax-free reorganizations, percentage depletion, the foreign tax credit, and consolidated returns.

2. Tax-Free Reorganizations

Section 202 of the Revenue Act of 1918 provided as follows:

> SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and
> (2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203.
>
> (b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; but *when in connection with the reorganization, merger, or consolidation of a corporation a person receives in place of stock or securities owned by him new stock or securities of no greater aggregate par or face value, no gain or loss shall be deemed to occur from the exchange, and the new stock or securities received shall be treated as taking the place of the stock, securities, or property exchanged.*
>
> *When in the case of any such reorganization, merger or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, a like amount in par or face value of the new stock or securities received shall be treated as taking the place of the stock or securities exchanged, and the amount of the excess in par or face value shall be treated as a gain to the extent that the fair market value of the new stock or securities is greater than the cost (or if acquired prior to March 1, 1913, the fair market value as of that date) of the stock or securities exchanged.*

This was the origin of all subsequent tax-free reorganizations provisions.

There are several obvious problems with this provision. First, the crucial terms "reorganization, merger or consolidation" are not defined, and it was left for Treasury to define them by regulation. Regulation No. 45, promulgated pursuant to the 1918 Act, eventually outlined the types of transactions that were eligible for this nonrecognition treatment to include cases where:

> corporations unite their properties by either (a) the dissolution of corporation B and the sale of its assets to corporation A, or (b) the sale of its property by B to A and the dissolution of B, or (c) the sale of the stock of B to A and the dissolution of B, or (d) the merger of B into A, or (e) the consolidation of the corporations.[6]

Second, the limitation to par value was already in 1919 meaningless because corporations could issue no-par stock. The key issue was not the par value but the fair market value, and that was not addressed.

Third, and most shockingly from a modern perspective, there was no limit on "boot," or cash, that could be received in the transaction, so that an exchange could qualify for tax-free treatment even if it was mostly a sale for cash. It is not even clear whether the cash portion would be taxable: The language "when in connection with the reorganization, merger, or consolidation of a corporation a person receives in place of stock or securities owned by him new stock or securities of no greater aggregate par or face value, no gain or loss shall be deemed to occur from the exchange, and the new stock or securities received shall be treated as taking the place of the stock, securities, or property exchanged" can also be read literally to include the cash portion in the "no gain or loss shall be deemed to occur from the exchange, especially since in 1919 it was not clear that capital gains were "income."

Finally, the entire provision ran counter to the spirit of the original corporate tax of 1909, which was designed to place limits on monopolization.[7] Tax-free mergers, especially those in which a large corporation acquires a smaller competitor, run directly counter to this spirit, as many subsequent commentators have pointed out.[8]

What was the rationale for the tax-free reorganization provision? Prof. Steven Bank has argued that it was crafting a compromise between an accrual model of taxation (in which capital gains are taxed when they occur) and a consumption or cash flow model (in which capital gains are only taxed when they are consumed).[9] But this is a very modern view of the debate, and does not explain the departure from the regulatory goals of the 1909 act. In addition, the debate about realization that culminated in the Supreme Court's *Eisner v. Macomber* decision (1920) and the capital gains cases (1921–1925) both happened *after* the original enactment of the reorganization provision in 1919, and therefore were not relevant to it. Jerome Hellerstein was right in pointing out that there was nothing in the original corporate or individual income tax that required such generous treatment of mergers.[10] The provisions should be seen, as Hellerstein implied, as reflecting the influence of lobbying by the corporations and their wealthy shareholders, especially since it was not limited to stock consideration. Nevertheless, they are still in the Code (Code Sec. 368), even though they are now viable under both Supreme Court case law and regulations only if they have at least 40% stock consideration.

3. Percentage Depletion

Section 214 of the Revenue Act of 1918 provided as follows:

> SEC. 214. (a) That in computing net income there shall be allowed as deductions: …
>
> (10) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise de- ducted: Provided, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further, That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter*; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee.

This provision is unique because unlike any other form of cost recovery in the Code, it permits taxpayers (both individual and corporate) to deduct a depletion allowance in excess of their cost of acquiring the property. In 1925, the provision was amended to provide for percentage depletion. Percentage depletion has been roundly condemned throughout its history as a pure tax subsidy to the oil and gas industry, but it is of course still with us (Code Sec. 613).[11]

4. The Foreign Tax Credit

Section 238 of the Revenue Act of 1918 provided as follows:

> SEC. 238. (a) That in the case of a domestic corporation the total taxes imposed, for the taxable year by this title and by Title III shall be credited with the amount of any income, war-profits and excess-profits taxes paid during the taxable year to any foreign country, upon income derived from sources therein, or to any possession of the United States.
>
> If accrued taxes when paid differ from the amounts claimed as credits by the corporation, or if any tax paid is refunded in whole or in part, the corporation shall at once notify the Commissioner who shall redetermine the amount of the taxes due under this title and under Title III for the year or years affected, and the amount of taxes due upon such redetermination, if any, shall be paid by the corporation upon notice and demand by the collector, or the amount of taxes overpaid, if any, shall be credited or refunded to the corporation in accordance with the provisions of section 252. In the case of such a tax accrued but not paid, the Commissioner as a condition precedent to the allowance of this credit may require the corporation to give a bond with sureties satisfactory to and to be approved by him in such penal sum as he may require, conditioned for the payment by the taxpayer of any amount of taxes found due upon any such redetermination; and the bond herein prescribed shall contain such further conditions as the Commissioner may require.
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> (b) This credit shall be allowed only if the taxpayer furnishes evidence satisfactory to the Commissioner

showing the amount of income derived from sources within such foreign country or such possession of the United States, as the case may be, and all other information necessary for the computation of such credit.

(c) If a domestic corporation makes a return for a fiscal year be- ginning in 1917 and ending in 1918, only that proportion of this credit shall be allowed which the part of such period within the calendar year 1918 bears to the entire period.

This is the origin of our current direct foreign tax credit (Code Sec. 901). The foreign tax credit ("FTC") has been the subject of much criticism by various academics such as Prof. Graetz, Prof. Shaviro, Prof. Hines and Prof. Shaheen.[12] I have been more sympathetic because of the role the FTC played in enabling the international tax regime to be created in the 1920s. But even I would acknowledge that a refundable credit for foreign taxes that reduces U.S. tax liability dollar for dollar and therefore creates no incentive for the taxpayer to reduce foreign taxes is a very generous unilateral measure. Moreover, what is most striking in the 1918 version of the FTC is that it is not limited to the U.S. tax rate, and so if the foreign country increases its tax rate, it can do so at the expense of the U.S. Treasury that would be obligated to issue the taxpayer a bigger refund. This state of affairs only lasted until 1921, but it illustrates more than any other provision how pro-taxpayer the Revenue Act of 1918 was.

5. Consolidated Returns

Section 240 of the Revenue Act of 1918 provided as follows:

SEC. 240. (a) That corporations which are affiliated within the meaning of this section shall, under regulations to be prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income and invested capital for the purposes of this title and Title III, and the taxes thereunder shall be computed and determined upon the basis of such return: Provided, That there shall be taken out of such consolidated net income and invested capital, the net income and invested capital of any such affiliated corporation organized after August 1, 1914, and not successor to a then existing business, 50 per centum or more of whose gross income consists of gains, profits, commissions, or other income, derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive. In such case the corporation so taken out shall be separately assessed on the basis of its own invested capital and net income and the remainder of such affiliated group shall be assessed on the basis of the remaining consolidated invested capital and net income.

In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. There shall be allowed in computing the income tax only one specific credit of $2,000 (as provided in section 236); in computing the war-profits credit (as provided in section 311) only one specific exemption of $3,000; and in computing the excess-profits credit (as provided in section 312) only one specific exemption of $3,000.

(b) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or (2) if substantially all the stock of two or more corporations is owned or controlled by the same interests.

(c) For the purposes of section 238 a domestic corporation which owns a majority of the voting stock of a foreign corporation shall be deemed to have paid the same proportion of any income, war-profits and excess-profits taxes paid (but not including taxes accrued) by such foreign corporation during the taxable year to any foreign country or to any possession of the United States upon income derived from sources without the United States, which the amount of any dividends (not deductible under section 234) received by such domestic corporation from such foreign corporation during the taxable year bears to the total taxable income of such foreign corporation upon or with respect to which such taxes were paid: Provided, That in no such case shall the amount of the credit for such taxes exceed the amount of such dividends (not deductible under section 234) received by such domestic corporation during the taxable year.

This provision stemmed from Regulation 41, Articles 77 and 78, of the War Revenue Act of 1917, which gave the Commissioner authority to require related corporations to file consolidated returns "whenever necessary to more equitably determine the invested capital or taxable income."[13] The provision was designed as a tax avoidance prevention measure in order to protect the excess profits tax on corporations from being manipulated by splitting up affiliated corporations, since in that way the excess would be lower and the credit for capital invested would be higher. The definition of affiliated corporations is very broad and similar to current Code Sec. 482 (which was enacted when mandatory consolidation was repealed in 1928). Notably, foreign corporations are not included in consolidation, a problem that is still with us (if they were, the whole deferral vs exemption debate would have looked very different). Also note the invention of the indirect foreign tax credit (also still with us in Code Sec. 960) in the last sub-section.

Despite the anti-avoidance nature of this provision, it too runs contrary to the anti-monopolization spirit of the corporate tax of 1909, because it encourages acquiring loss corporations to offset the profits of the acquiring corporation (a practice only first limited in 1969). Moreover, in 1928 consolidated returns were made elective, and that rule has been with us ever since (Code Sec. 1504). More than any other provision of the Code, consolidated returns encourage the growth of monopolies because it allows for offsetting the losses of some companies against the profits of their affiliates while maintaining limited liability.

6. Conclusion

These are only a few examples of the extreme pro-taxpayer features of the Revenue Act of 1918. Others could be added (*e.g.*, the original excise tax on the gross premium income foreign insurers of U.S. risks, now Code Sec. 4371, designed to protect U.S. insurers from foreign competition, and the unlimited corporate interest deduction, the source of many later problems).[14] The lesson for Congress should be, do not enact tax laws when nobody is looking.[15] Since we are now again in the midst of a global pandemic, this is a useful lesson to remember as Congress spends trillions of dollars in an attempt to bolster our faltering economy.

ENDNOTES

1. *See, e.g.*, Andrew Chamberlain, *Twenty Years Later: The Tax Reform Act of 1986*, THE TAX FOUNDATION (Oct. 23, 2006): "Yesterday marked the 20th anniversary of the nation's most recent federal tax overhaul—the Tax Reform Act of 1986. Although much of what that reform accomplished has been unwound over the years by lawmakers eager to reward constituents with tax preferences, it stands as a rare example of bipartisan support for fundamentally sound tax policy."
2. On Code Sec. 199A, *see* Shaviro Daniel, *Evaluating the New US Pass-Through Rules*, BRITISH TAX REVIEW, Issue 1, Mar. 15, 2018; NYU Law and Economics Research Paper No. 18-08; NYU School of Law, Public Law Research Paper No. 18-25, available at SSRN *https://ssrn.com/abstract=3141521*. On the 2017 tax reform as a whole *see* R.S. Avi-Yonah, *How Terrible Is the New Tax Law? Reflections on TRA17*, U of Michigan Public Law Research Paper No. 586; U of Michigan Law & Econ Research Paper No. 18-002, Jan. 2, 2018, available at SSRN *https://ssrn.com/abstract=3095830* or *http://dx.doi.org/10.2139/ssrn.3095830*.
3. *See, e.g.*, Hui Chen, Katherine Gunny and Karthik Ramanna, *Return on Political Investment in the American Jobs Creation Act of 2004*, HBS Working Paper (Dec. 30, 2014): "What are the real economic returns of corporate political spending? Here the authors apply a more rigorous approach for a clearly delimited time period by examining the returns to corporate political spending on what became the American Jobs Creation Act ('the AJCA') of 2004. Findings differ sharply from those generated in prior studies. Specifically, for the median politically active firm in the sample 1) an increase in $1 million in lobbying expenditures is associated with about $32.35 million in taxes saved; 2) an increase in $100,000 of PAC contributions is associated with about $15.64 million in taxes saved; and 3) the additional filing of ten tax-related lobbying reports is associated with about $21.08 million in taxes saved. These results are particularly relevant in light of continued corporate attempts to generate support in the Congress for another 'one-time' tax break on repatriated foreign income in line with the AJCA of 2004. Overall, the study suggests that the very high returns to political investment heralded in the press—obtained through descriptive methods—are, in fact, nearly an order of magnitude smaller when more rigorously estimated via instrumentation."
4. *See* Code Secs. 199, 965, 904 and 7874, as added or amended by AJCA. On Code Sec. 199 *see* CRS, *The Section 199 Production Activities Deduction: Background and Analysis* (July 6, 2017). On Code Sec. 965 *see, e.g.*, Donald J. Marples & Jane G. Gravelle, *Tax Cuts on Repatriation Earnings as Economic Stimulus: An Economic Analysis* (CRS, May 27, 2011). On Code Sec. 904 *see, e.g.*, Kimberly Clausing, *Options for International Tax Policy After the TCJA* (CAP, Jan. 30, 2020). On Code Sec. 7874 *see, e.g.*, Reuven Avi-Yonah, *Reflections on the "New Wave" Inversions and Notice 2014-52*, 145 TAX NOTES 95 (Oct. 6, 2014); 76 TAX NOTES INT'L 63 (Oct. 6, 2014).
5. Roy G. & Gladys C. Blakey, *The Revenue Act of 1918*, 9 AMER. ECON. REV. 213 (1919).
6. Reg. §45, art. 1567, 21 T.D. 170, 395 (1919). Importantly, this rule was not limited to stock consideration.
7. *See* Avi-Yonah, *Corporations, Society and the State: A Defense of the Corporate Tax*, 90 VA. L. REV. 1193 (2004).
8. *See, e.g.*, Jerome R. Hellerstein, *Mergers, Taxes, and Realism*, 71 HARV. L. REV. 254 (1957); Milton Sandberg, *The Income Tax Subsidy to "Reorganizations"*, 38 COLUM. L. REV. 98 (1938).
9. Steven A. Bank, *Mergers, Taxes, and Historical Realism*, 75 TUL. L. REV. 1 (2000).
10. Hellerstein, *supra* note 8.
11. *See, e.g.*, Johnson, Calvin Harsha, *Accurate and Honest Tax Accounting for Oil and Gas*, 125 TAX NOTES 5, 573–583 (Nov. 2, 2009); The Shelf Project, available at SSRN *https://ssrn.com/abstract=1503574*.
12. Michael J. Graetz & Michael M. O'Hear, *The Original Intent of US International Taxation*, 46 DUKE L. J. 1021 (1996); Daniel Shaviro, *The Case Against Foreign Tax Credits*, 3 J. LEGAL

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58 Reg. §1.385-4(b)(6).

59 Reg. §1.385-3(f)(3)(i).

60 Reg. §1.385-4(b)(1).

61 Reg. §1.385-3(b)(3)(iii)(A).

62 *FP* is deemed to transfer the note to *USCo* alone because only *USCo* made a regarded distribution triggering the funding rule. Reg. §1.385-3(f)(4)(iii).

63 Reg. §1.385-3(f)(4)(iii).

64 See Reg. §1.385-3(h) Ex. 16.

65 Reg. §1.385-3(f)(5)(i).

66 Reg. §1.385-3(f)(5)(iii). Whether a transaction is a specified event is determined "immediately after the transaction and taking into account all related transactions."

67 Reg. §1.385-3(f)(5)(iii)(A). For instance, if *DSub* in the example transferred its interest in *PRS* to a foreign subsidiary of *FP*, the transfer would be a specified event, even though *PRS* continues to be a controlled partnership, because the foreign subsidiary, although a member of the expanded group, is not a covered member (domestic corporation).

68 Reg. §1.385-3(f)(5)(iii)(B). More specifically, this specified event occurs if the holder-in-form and deemed holder cease being members of the same expanded group for a reason described in Reg. §1.385-3(d)(2).

69 Reg. §1.385-3(f)(5)(iii)(C).

70 Reg. §1.385-3(f)(5)(iii)(D). This rule applies whether the transfer is direct or indirect "through one or more partnerships."

If an expanded group partner transfers only a portion of its interest in a controlled partnership, only a portion of the expanded group partner's deemed transferred receivable "is deemed to be distributed in redemption of an equal portion of the deemed partner stock." This portion equals the entire principal amount of the transferred receivable deemed held by the expanded group partner, multiplied by a fraction. The numerator of the fraction is "the portion of the expanded group partner's capital account attributable to the interest that is transferred," and the denominator of the fraction is the partner's entire capital account immediately before the specified event. Reg. §1.385-3(f)(5)(iv).

71 Reg. §1.385-3(f)(5)(iii)(F). If a holder-in-form transfers a disregarded debt instrument to a member of the expanded group or a controlled partnership, the transfer is not a specified event, but the holder-in-form is deemed to transfer the retained receivable and the deemed partner stock to the transferee. Reg. §1.385-3(f)(4)(v).

72 Reg. §1.385-3(f)(5)(i).

73 Reg. §1.385-3(f)(5)(i). This rule does not apply if any portion of a deemed transferred receivable is deemed to be retransferred under Reg. §1.385-3(f)(5)(ii), discussed *infra* text accompanying note 75.

74 Reg. §1.385-3(f)(5)(iii)(E). This rule applies whether the transfer is direct or indirect through one or more partnerships. For a transfer of less than all of a partnership interest, *see* Reg. §1.385-3(f)(5)(iv), discussed *supra* note 70.

75 Reg. §1.385-3(f)(5)(ii).

76 *See* Reg. §1.385-3(h) Ex. 17.

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Islands. For example, the EU's decision of removing the Cayman Islands from the EU Blacklist should be welcomed. However, businesses and investment fund groups having the Cayman Islands entities in their group structures should still stay alert, as the removal of a blacklisted jurisdiction from the EU Blacklist does not necessarily mean the removal from a "local" blacklist in an EU member state. Relevant stakeholders should stay vigilant and react promptly in line with the tax developments in such jurisdictions.

ENDNOTES

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1 OECD (1998), *Harmful Tax Competition: An Emerging Global Issue*, *www.oecd-ilibrary.org/taxation/harmful-tax-competition_9789264162945-en*.

2 OECD (2015), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5—2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, *https://doi.org/10.1787/9789264241190-en*.

3 OECD (2018), *Resumption of Application of Substantial Activities Factor to No or Only Nominal Tax Jurisdictions—Inclusive Framework on BEPS: Action 5*, *www.oecd.org/tax/beps/resumption-of-application-of-substantial-activities-factor.pdf*.

4 Official website of Department for International Tax Corporation, Cayman Islands Government, *www.ditc.ky/es/es-legislation-resources/*.

5 Cayman Islands International Tax Co-operation (Economic Substance) Law (2020 Revision), Supplement No.3 published with Legislation Gazette No. 5 dated 14 January 2020, *www.ditc.ky/wp-content/uploads/2020/06/The_International_Tax_Cooperation_Economic_Substance_Law_2020_Revision.pdf*.

6 Cayman Islands International Tax Co-operation (Economic Substance) (Amendment) Law, 2020 (Law 7 of 2020), Supplement No.4 published with Legislation Gazette No. 10 dated 12 February, 2020, *www.ditc.ky/wp-content/uploads/2020/06/International_Tax_Co-operation_Economic_SubstanceAmendment_Law_2020.pdf*.

7 Cayman Islands Tax Information Authority, Economic Substance for Geographically Mobile Activities Guidance, Version 3.0, *www.ditc.ky/wp-content/uploads/Economic_Substance_-_Guidance_-_v3.0190713.pdf*.

8 Official website of Department for International Tax Cooperation, Cayman Islands Government, *www.ditc.ky/es/es-legislation-resources/*.

9 Ministry of Financial Services of the Cayman Islands Government, Update on Economic Substance Forms, *www.mfs.ky/news/industry-advisory/update-on-economic-substance-forms/*.

10 Department for International Tax Cooperation, Cayman Islands Government, DITC portal, *https://ditcportal.secure.ky/login*.

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Analysis 65 (2011); James Hines, *Reconsidering the Taxation of Foreign Income*, 62 Tax L. Rev. 269–298, (2009); Fadi Shaheen, *International Tax Neutrality: Revisited*, 64 Tax L. Rev. 131 (2011).

13 T.D. 2694, 20 Treas. Dec. Int. Rev. 294, 321 (1918). *See also* War Revenue Act of 1917, ch. 63, 40 Stat. 300 (1917).

14 On the interest deduction *see* Steven A. Bank, *Historical Perspective on the Corporate Interest Deduction*, 18 Chapman Law Review 29 (Mar. 24, 2014); UCLA School of Law, Law-Econ Research Paper No. 14-04, available at SSRN *https://ssrn.com/abstract=2413968*; on the later problems from an unlimited interest deduction *see* Daniel N. Shaviro, *Decoding the Corporate Tax*, 44, 48 (2009); Alvin C. Warren, Jr., *The Corporate Interest Deduction: A Policy Evaluation*, 83 Yale L. J. 1585, 1585 (1974).

15 Arguably, the same was true when AJCA was enacted in October 2004; because of the war in Iraq and the focus on the impending presidential election, nobody paid much attention to the "Christmas tree" nature of the legislation.