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Michael S. Knoll
University of Pennsylvania Law School

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Michael S. Knoll is the Theodore K. Warner Professor of Law at the University of Pennsylvania Law School, professor of real estate at the Wharton School, and co-director for the Center for Tax Law and Policy at the University of Pennsylvania. He thanks Matthew Caulfield, the Penn Law Library (especially Al Dong and Evan Silverstein), and the Wharton Public Policy Initiative (especially Rohan Verma) for assistance with research, and Wei Cui for comments.

In this report, Knoll argues that the inversion situation is more nuanced, complex, and ambiguous than Edward D. Kleinbard acknowledges, and he challenges Kleinbard's claim that U.S. multinationals are on a tax par with their foreign competitors.

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The ongoing wave of corporate inversions has generated substantial debate in academic, business, and policy circles. Inversions are cross-border acquisitions in which a U.S. corporation acquires a foreign target in such a manner that the foreign corporation emerges as the parent of the group that includes the U.S. corporation as a wholly owned subsidiary.

Critics of corporate inversions have described inverting companies as "unpatriotic"[1] and as shirking their obligations to pay their fair share of taxes,[2] and have called for federal action to stem corporate inversions.[3] Over its last few years, the Obama administration took a series of steps to prevent more U.S. corporations from inverting.[4] Most recently, on April 4, 2016, Treasury released two sets of proposed and temporary regulations

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[1] *E.g.*, Max Baucus, "Corporate Tax Shelters: Looking Under the Roof," Senate Finance Committee Hearing, 107th Cong., 2d Sess. 1:

> Some prominent U.S. companies are literally re-incorporating offshore tax havens in order to avoid U.S. taxes. They are, in effect, renouncing their U.S. citizenship to cut their taxes. A partner in one of the firms marketing these so-called "inversion deals" admitted that some companies may be concerned that it is unpatriotic to abandon their U.S. corporate citizenship, but she went on to say that some companies are coming to the conclusion that "the improvement on earnings is powerful enough that maybe the patriotism issue needs to take a back seat." You heard that right: "Maybe the patriotism issue needs to take a back seat." Obviously, very troubling, especially now as we all try to pull together, most particularly since September 11, as a nation and work together to help our people meet the problems that we are facing.

[2] *E.g.*, in reference to inversions, Rep. Peter Welch, D-Vt., quoted in Renae Merle's article, "Obama Criticizes Companies That Leave U.S. for Lower Taxes," WashingtonPost.com, Apr. 5, 2016 ("We're just hemorrhaging the resources that we need from companies to pay their fair share.").

[3] J. Clifton Fleming Jr. et al., "Getting Serious About Cross-Border Earnings Stripping: Establishing an Analytical Framework," 93 *N.C.L. Rev.* 673, 678-680 (2015); and Reuven S. Avi-Yonah, "Corporate Taxation and Corporate Social Responsibility," 11 *N.Y.U.J.L. & Bus.* 1 (2014).

[4] For a recent explication of this history, see Donald J. Marples and Jane G. Gravelle, "Corporate Expatriation, Inversions, and Mergers: Tax Issues," Congressional Research Service report R43568 (Apr. 27, 2016).

designed to discourage inversions. Two days later, Pfizer and Allergan announced that they were abandoning their proposed merger.

The derailed Pfizer-Allergan transaction was the largest corporate acquisition announced in 2015 (with a total enterprise value of $160 billion and a total equity value of $152 billion). Had it been completed, the Pfizer-Allergan merger would have been the largest pharmaceutical transaction ever, the third largest corporate acquisition on record, and the largest corporate inversion to date.[5] Under the merger agreement, Pfizer, a U.S. domiciliary and the larger of the two companies, would have become a subsidiary of Allergan, an Irish domiciliary, thus converting Pfizer from a U.S.-domiciled parent into a U.S.-domiciled subsidiary of a foreign parent (Allergan).

To critics of inversions, the scuttled Pfizer-Allergan transaction epitomizes why inversions need to be stopped. Pfizer holds $148 billion of untaxed profits abroad, which, if brought back to the United States, would incur a $35 billion tax liability.[6] If, however, Pfizer had successfully inverted, it would have been able to get access to those earnings, which it could use to pay dividends or repurchase shares, without paying any U.S. corporate tax on those earnings.[7] By some estimates, there is as much as $2.4 trillion in untaxed profits ($1 trillion of which is in cash) held abroad by U.S. corporations that could escape taxation if inversions were freely permitted.[8] Also, some critics of inversions argue that inverted companies are less closely connected with the United States than are U.S. corporations that have not inverted and as a consequence, inverted companies are more likely to move their headquarters, employment, investment, and research and development away from the United States.[9]

In contrast with the critics of corporate inversions, who have generally applauded the federal government's efforts to stem inversions (and frequently encouraged the government to go further to prevent them), managers of inverting corporations protest loudly, claiming they are not the villains they have been made out to be, but rather are the victims of an unfair and antiquated U.S. tax system that dates from a time when business was much more national than international.[10] These managers blame the U.S. tax laws — which, they say, hamper their ability to compete with foreign rivals[11] — and call for fundamental tax reform, including the elimination of U.S. taxation of active foreign income.[12] At the

[5]Leslie Picker, "How the Pfizer-Allergan Deal Ranks," New York Times Dealbook, Nov. 23, 2015 (the equity value of Pfizer-Allergan deal is $152 billion, which makes the deal the third largest deal by equity value after Vodafone AirTouch's $183 billion takeover of Mannesmann of Germany and AOL's $165 billion purchase of Time Warner).

[6]Americans for Tax Fairness, *Pfizer: Price Gouger, Tax Dodger* 5, Table 1 (2016).

[7]*Id*. at 4-6. Americans for Tax Fairness further argues that Pfizer is not hampered by its tax situation, but that its effective tax rate is actually quite low, closer to 7.5 percent than the 25.4 percent that Pfizer claims, once an adjustment is made for deferred taxes on overseas earnings. *Id*. at 4.

[8]Citizens for Tax Justice, "Fortune 500 Companies Hold a Record $2.4 Trillion Offshore" (Mar 3, 2016) ($2.4 trillion unrepatriated profits of U.S. MNCs); Eric Platt, "Top 50 Boardroom Hoarders Sit on $1 Trillion in Cash," *Financial Times*, May 11, 2015 (citing a company analysis that U.S. companies hold about $1.1 trillion in cash overseas). Those earnings are often said to be "locked out" of the United States. For thoughtful analysis of what it means for earnings to be locked out, see Fadi Shaheen, "Understanding Lockout," 69 *Tax L. Rev*. 231 (2016); and Shaheen, "The GAAP Lockout Effect and the Investment Behavior of Multinational Firms," 67 *Tax L. Rev*. 211 (2014).

[9]*E.g.*, statement of Peter R. Merrill, principal, PwC, hearing before the Senate Finance Committee, 113th Cong., 2d Sess., at 7-8 (July 22, 2014); and Jeff Malehorn, "Why Corporate Headquarters Matter to Chicago," World Business Chicago, Feb. 16, 2016. *See also* Arturs Kalnins and Francine Lafontaine, "Too Far Away? The Effect of Distance to Headquarters on Business Establishment Performance," 5 *Am. Econ. J*. 157 (2013) (distance from headquarters weakens monitoring, thereby encouraging companies to locate operations closer to their headquarters); and Vanessa Straus-Kahn and Xavier Vives, "Why and Where Do Headquarters Move?" IESE Business School CEPR working paper no. 650 (Sept. 2006) (noting the importance of headquarters agglomeration effects).

[10]*E.g.*, Walter Galvin, "Why Corporate Inversions Are All the Rage," *The Wall Street Journal*, July 27, 2014.

[11]*Id*. *See also* Bret Wells, "What Corporate Inversions Teach About International Tax Reform," *Tax Notes*, June 21, 2010, p. 1345 (arguing that the corporate inversions provide "clear and noncontroversial evidence" that non-U.S. MNCs have a tax advantage over U.S.-domiciled MNCs in both U.S. and foreign markets).

[12]*E.g.*, Galvin, *supra* note 10.

center of their complaint, U.S. corporations claim that they are taxed more heavily than their foreign rivals on the same income.[13] By inverting, U.S.-domiciled companies avoid the U.S. tax system's disadvantageous treatment of resident businesses and place themselves on the same footing as their overseas competitors. Accordingly, the desire of Pfizer and other U.S.-domiciled corporations to invert is a signal that the U.S. international tax system is punitive in its treatment of U.S. corporations and needs to be reformed so U.S.-based multinational corporations (MNCs) will not want to shift their domiciles.[14]

Proponents of this view argue that if U.S. companies are prevented from inverting through transactions in which the U.S. parent retains control, they would instead become takeover targets for foreign corporations as long as the U.S. tax system continues to favor foreign ownership over domestic ownership of corporate assets. Thus, unless and until the U.S. federal government is ready for fundamental tax reform, the unintended but foreseeable effect of discouraging inversions is to encourage foreign takeovers of U.S. companies.[15] Moreover, takeovers would likely produce larger shifts in headquarters, employment, investment, and R&D away from the United States than would inversions.[16]

As the above arguments suggest, the central factual issue in the debate between proponents of stricter anti-inversion rules and their critics is whether the U.S. tax laws disadvantage U.S. domiciled companies relative to their foreign competitors. Proponents of stricter anti-inversion rules generally deny there is any such disadvantage. Accordingly, stricter anti-inversion rules would not hamper U.S.-domiciled companies in their competition against foreign rivals and would not encourage foreign companies to acquire U.S. companies. In contrast, the opponents of stricter anti-inversion rules generally accept that there is a disadvantage. Accordingly, tightening those rules (without engaging in fundamental tax reform to eliminate the tax disadvantage) would make it more difficult for U.S. companies to compete and encourage foreign takeovers of U.S. companies.

In a 2014 article,[17] Professor Edward D. Kleinbard leaped into the center of that debate. In that article, he contended that competitiveness arguments for corporate inversions are "almost entirely fact-free"[18] and constitute "a false narrative,"[19] and that "international business 'competitiveness' has nothing to do with the reasons for these deals."[20] He concluded that although the current U.S. tax system "is highly distortive and inefficient . . . one of the few deficiencies it has avoided is imposing an unfair international business tax competitive burden on sophisticated U.S. multinationals."[21]

Kleinbard and his article have played and continue to play a highly visible role in public policy debates over inversions. His article has been cited for the propositions that U.S.-domiciled companies are not tax-disadvantaged relative to their foreign competitors and that U.S.-domiciled companies do not improve their competitive position by inverting.[22] Kleinbard is also one of the authors of a September 25, 2015, letter to Congress signed by 24 international tax experts urging lawmakers not to align the United States' international tax system more closely to those of other major advanced economies by

[13] Joshua Simpson, "Analyzing Corporate Inversions and Proposed Changes to the Repatriation Rule," 68 *N.Y.U. Ann. Surv. Am. L.* 673, 703 (2013). *See also* Wells, *supra* note 11.

[14] *See, e.g.*, Andrew Ross Sorkin, "Reluctantly, Patriot Flees Homeland for Greener Tax Pastures," *The New York Times*, July 14, 2014 (discussing testimony of Mylan CEO Heather Bresch); and Wells, *supra* note 11.

[15] Testimony of Michelle Hanlon, the Howard W. Johnson Professor at the MIT Sloan School of Management, before the House Ways and Means Committee, at 3-4 (Feb. 24, 2016). *See also* Merrill, *supra* note 9.

[16] Hanlon, *supra* note 15, at 6-8. *See also* Merrill, *supra* note 9.

[17] Edward D. Kleinbard, "'Competitiveness' Has Nothing to Do With It," *Tax Notes*, Sept. 1, 2014, p. 1055.

[18] *Id*. at 1056.

[19] *Id*.

[20] *Id*. at 1055.

[21] *Id*. at 1061.

[22] *E.g.*, Avi-Yonah and Omri Y. Marian, "Inversions and Competitiveness: Reflections in the Wake of Pfizer-Allergan," 41 *Int'l Tax J*. 39, 40 (Nov.-Dec. 2015) ("This inversion, in our opinion, provides the clearest rebuke to the frequently made argument that the reason for the wave of inversions is that the U.S. corporate tax system is uncompetitive. We agree with Professor Edward Kleinbard that 'competitiveness has nothing to do with it.'"); Marian, "Home-Country Effects of Corporate Inversions," 90 *Wash. L. Rev*. 1, 10 n.44 (2015) (directing readers to see Kleinbard's article "for a full-blown rebuttal of the argument according to which inversions are driven by competitiveness concerns").

exempting the active foreign income of U.S. MNCs, advocating instead that the United States move its international tax system further away from those of its major trading partners by adopting "a true worldwide tax system — without deferral."[23] One of the rationales offered by the letter's signatories for their proposal is that U.S. MNCs are not at a tax-induced competitive disadvantage relative to their foreign rivals.[24]

In this report, I offer a response to Kleinbard. I argue that the situation is more nuanced, complex, and ambiguous than he acknowledges, that his claim that U.S. MNCs are on a tax par with their foreign competitors is not well supported, and that attaining a more level playing field is one — albeit not the only — plausible rationale for inversions.[25]

Ultimately, the claim that U.S. MNCs are on a tax par with their foreign rivals is an empirical claim. Unfortunately, there is little, if any, empirical work directly determining whether U.S.-based MNCs are tax-advantaged, tax-disadvantaged, or roughly on par with their foreign rivals and measuring the amount by which, if any, U.S.-based MNCs improve their competitive position by inverting.[26] As a result, one cannot at this time clearly and convincingly describe the magnitude or even the direction of any such advantage or disadvantage, let alone the effect of inverting. That said, the stronger case would seem to be that U.S.-domiciled corporations are often tax-disadvantaged relative to their non-U.S. rivals and that they can improve their competitive position by inverting. In other words, not only has Kleinbard not established his claim that U.S. companies are not at a competitive disadvantage relative to their foreign rivals, that claim is more likely than not wrong.

I. Improving Competitiveness Abroad

However, before responding directly to Kleinbard's arguments, I briefly set forth the two closely connected arguments to which he is responding: (1) that U.S. international tax law hampers the competitiveness of U.S.-based MNCs relative to that of non-U.S.-based MNCs and (2) that U.S. corporations, by inverting, eliminate or reduce that disadvantage. The first argument begins with the recognition that the United States is unique among G-8 countries (and an outlier among large, market-oriented economies) in that it taxes the worldwide income of its corporations (with a tax credit for taxes paid to foreign governments on that income[27]).[28] Under U.S. law, the active non-U.S. income earned directly by a U.S. corporation (or by a branch, an unincorporated entity owned by a U.S. corporation) is taxed by the United States as it is earned, whereas the active foreign income earned by a foreign subsidiary of a U.S. parent corporation is taxed by the United States only when that income is repatriated to the United States.[29] Thus, the U.S. tax system encourages U.S. companies with foreign-source income that has not been taxed at a rate as high as the U.S. tax rate to earn income through a foreign corporation and defer repatriation. It is, however, costly for U.S. companies to defer U.S. taxes by avoiding repatriation.[30] Accordingly, some U.S. MNCs repatriate and pay the U.S. corporate tax (at which point they can use the money as they see fit), whereas other U.S. MNCs defer repatriation and

[23] Americans for Tax Fairness, "24 International Tax Experts Address Current Tax Reform Efforts in Congress," at 3 (Sept. 25, 2015).

[24] *Id*. at 2 ("there is no factual basis for the assertion that U.S. multinationals cannot compete globally because of the U.S. tax system").

[25] Kleinbard is not the only proponent of the view that competitiveness concerns are not a reason for inversions. Other scholars have also argued that U.S. MNCs are not at a tax-induced disadvantage relative to their non-U.S. competitors. *See, e.g.*, Marian, "Meaningless Comparisons: Corporate Tax Reform Discourse in the United States," 32 *Va. Tax. Rev*. 133, 165-167 (2012) (discussing a hearing with statements from Avi-Yonah); Fleming, Robert J. Peroni, and Stephen E. Shay, "Worse Than Exemption," 59 *Emory L.J*. 79 (2009) (arguing that the United States' tax treatment of foreign income is more generous than the taxation of foreign income under territorial taxation).

[26] *See* testimony of Leslie Robinson, associate professor, Tuck School of Business at Dartmouth University, before the Finance Committee, "The U.S. Tax Code: Love It, Leave It, or Reform It!" (July 22, 2014).

[27] Sections 901-904 (provides a tax credit for foreign taxes paid up to the U.S. tax liability on that income).

[28] Philip Dittmer, "A Global Perspective on Territorial Taxation," Tax Foundation special report No. 202, at 2 (Aug. 10, 2012) (of the 34 OECD member countries, the number of countries that had worldwide tax systems declined from 17 in 2000 to seven in 2010; as of 2010, the only OECD states that had worldwide systems were Chile, Greece, Ireland, Israel, Korea, Mexico, and the United States).

[29] Section 954(c).

[30] *See infra* discussion.

incur the implicit tax costs of doing so and any explicit taxes (such as having to pay U.S. tax on interest earnings).

In contrast with the United States and its worldwide tax system, most countries use territorial tax systems that exempt the active foreign income of domestic corporations. Accordingly, the argument goes, U.S. corporations are subject to higher taxes than are many of their competitors on income from non-U.S. sources. Moreover, because corporations (regardless of domicile) raise capital in a global marketplace, they must pay investors the same (risk-adjusted) rate of return for their capital.[31] Thus, the U.S. taxes that a U.S.-based MNC pays on its foreign-source income are essentially a toll charge, an incremental tax that is paid when capital holders invest in the equity of projects that produce non-U.S. income through U.S. corporations rather than through non-U.S. corporations.[32] Because U.S. MNCs must earn a higher before-tax rate of return than their foreign rivals to achieve the same rate of return after payment of corporate taxes, the toll charge raises investment hurdle rates on non-U.S. investments for U.S. corporations relative to hurdle rates for foreign corporations, thus rendering U.S. MNCs less competitive than their foreign rivals in non-U.S. markets.[33] This is the outbound argument that U.S. tax law reduces the competitiveness of U.S.-domiciled MNCs.

The argument that inversions are a rational response to that disadvantage begins by recognizing that U.S. tax law considers a corporation to be domiciled where it is incorporated (regardless of the extent of its activities in that location).[34] Thus, a corporation incorporated in the United States is a U.S. corporation and is subject to worldwide taxation on its income; in contrast, a corporation incorporated outside the United States is a non-U.S. corporation and is subject to U.S. taxation only on its income from U.S. sources. Moreover, if a non-U.S. corporation is domiciled in a country that has a territorial tax system, it generally will not pay home-country tax on active income earned outside its home jurisdiction.

Following an inversion, the parent of the group is a non-U.S. corporation; however, the U.S. corporation that inverted is still a U.S. corporation. As before the inversion, non-U.S.-source income earned directly by a U.S. corporation is subject to immediate U.S. taxation, whereas non-U.S.-source income earned by a subsidiary of a U.S. corporation is subject to U.S. tax when that income is repatriated by the U.S. corporation. Accordingly, if this were all that there were to an inversion, inversions would not ameliorate the tax disadvantage incurred by U.S. corporations. That is because the foreign income earned by U.S. corporations and their subsidiaries would still be subject to tax by the United States.[35]

However, following an inversion, corporate groups often use a variety of tax planning techniques to shift income that would otherwise be taxed by the United States to the non-U.S. parent (or to non-U.S. corporations that are not subsidiaries of a U.S. corporation) in order to avoid ever subjecting that income to tax by the United States. These tactics include shifting income from subsidiaries of a U.S. corporation to corporations that are not subsidiaries of a U.S. corporation,[36] allowing the businesses operated by subsidiaries of a U.S. corporation to wither

[31] There is a strand of academic literature combining taxation and corporate governance that views the U.S. worldwide tax system as the price for the U.S. corporate governance system. *E.g.*, Mitchell A. Kane and Edward B. Rock, "Corporate Taxation and International Charter Competition," 106 *Mich. L. Rev*. 1229 (2008); and Eric L. Talley, "Corporate Inversions and the Unbundling of Regulatory Competition," 101 *Va. L. Rev*. 1649 (2015). However, most of the tax literature on inversions implicitly assumes that the corporate governance benefits of incorporating in the United States are small or nonexistent.

[32] Corporations that fund their investments using third-party debt are not disadvantaged to the extent they use that capital. Because interest payments are deductible, the earnings on that capital are not taxed at the corporate level, so differential taxation of corporations domiciled in different jurisdictions does not affect their cash flow from third-party debt. Internal debt is different because the income remains within the corporate group.

[33] Readers familiar with the academic literature on capital ownership neutrality might recognize the argument.

[34] A notable exception to this general rule is section 7874, which treats a foreign corporation as a U.S. corporation if the owners of the U.S. corporation own more than 80 percent of the combined entity after a merger of a U.S. corporation and a foreign corporation.

[35] The foreign income earned by the foreign parent not through the U.S. corporation would escape U.S. tax, but that income was not subject to U.S. tax before the inversion and would not have been subject to U.S. tax had the MNCs not merged. However, that income would be subject to U.S. tax if the U.S. MNC acquired the foreign MNC.

[36] Transfer pricing restrictions are imperfect.

while growing the businesses operated by subsidiaries of the foreign parent,[37] and extensively using borrowing and other "hopscotch techniques" that shift cash and income from foreign subsidiaries of the U.S. corporation to the foreign parent without passing through the U.S. corporation.[38] To the extent that those tactics are effective, the foreign-source income of the U.S. corporation is, after the inversion, no longer subject to U.S. tax. That, in turn, reduces the hurdle rate on foreign investments and, with it, the tax-induced competitive disadvantage experienced by U.S. corporations in foreign markets.

The above represents what could be called the outbound account for how the U.S. worldwide tax system disadvantages U.S. companies in the competition to earn income in foreign markets, and how inversions operate as a self-help mechanism that U.S. corporations use to achieve territorial taxation and hence eliminate the disadvantage. The outbound account described above is the principal target at which Kleinbard takes aim in his 2014 article. Moreover, of the two arguments described above — first, that the U.S. worldwide tax system places U.S.-based MNCs at a competitive disadvantage relative to their foreign rivals, and second, that inversions are effective in eliminating that disadvantage — Kleinbard takes issue with the first argument only. He would seem to accept that inversions could be used to improve the competitiveness of U.S. MNCs relative to their foreign rivals if it were correct that U.S. MNCs are at a tax-induced disadvantage relative to foreign MNCs.[39]

Before addressing Kleinbard's arguments, however, there are several aspects of the outbound account of how the U.S. tax system disadvantages U.S. corporations in competition with non-U.S. corporations in foreign markets that warrant attention. First and most obviously, the claim is comparative. The claim takes the form that U.S. corporations are taxed more heavily than their foreign rivals on their earnings in foreign markets, and so they have a more difficult time competing in those markets than their foreign rivals. Thus, at its heart, Kleinbard's claim is that U.S.-based MNCs are taxed no higher than their foreign rivals.

Second, the comparatively high U.S. statutory corporate tax rate of 35 percent (the highest among OECD countries) does not enter directly into the argument that the U.S. tax system disadvantages U.S.-domiciled MNCs relative to their foreign rivals. The relatively high U.S. corporate tax rate exacerbates that disadvantage but does not cause it. The disadvantage comes from the U.S. worldwide tax system, which subjects foreign income to U.S. taxation, as long as the U.S. tax rate on that income exceeds the source-state tax on that income. Any incremental tax would have that effect, although the larger the tax, the larger the effect. Accordingly, but for deferral, which reduces the present value of the tax, the disadvantage faced by U.S. corporations would equal the difference between the U.S. statutory rate (35 percent) and the tax rate in the jurisdiction where the income is earned.

Third, as with all such comparative arguments, there is an implicit assumption that other considerations are equal. An obvious example here is the operation of states' antiabuse (controlled foreign corporation) regimes, which have the potential to tax foreign income — especially income that is shifted across jurisdictions — at the parent corporation's tax rate. This is an issue to which I return later.

Fourth, any claim to the effect that the U.S. tax system either does or does not disadvantage U.S. MNCs in their competition with foreign rivals is ultimately an empirical claim and potentially quantifiable. Establishing that claim requires articulating the basis on which companies make capital budgeting decisions, describing how the tax law affects those decisions, taking into account how parties structure their operations in light of the tax law, and then comparing results across jurisdictions for companies based in different jurisdictions.

[37] Kleinbard, *supra* note 17, at 1067.

[38] *Id*. at 1065-1066. To some extent, these techniques have been curtailed over the last two years since publication of Kleinbard's article. *See* Marples and Gravelle, *supra* note 4, at 6-13 (describing recent Treasury notices that have reduced some of the benefits of inversions).

[39] That acceptance is as a factual matter, not as a policy matter.

II. Improving Competitiveness at Home

The above represents what I have called the outbound account of inversions and competitiveness. Under that account, U.S.-domiciled MNCs have an incentive to invert because an inversion improves their ability to compete with their foreign rivals outside the United States. There is a second argument that has been getting more attention recently, that U.S.-based MNCs improve their competitive position in the United States by inverting. Under this account, inversions improve the ability of U.S. companies to compete with non-U.S.-based MNCs for investments in the United States.

The argument is as follows. The United States taxes all corporations, regardless of domicile, on their U.S.-source income — with large, successful businesses taxed at what is an effectively flat rate of 35 percent. Income, however, is a net concept, and all corporations regardless of domicile can, in calculating their net income, deduct their expenses against their gross income. Generally deductible expenses include royalties paid on licenses of intellectual property and interest paid on debt. Moreover, with some limitations, these expenses are deductible even if the royalties and interest payments are paid to the parent (or a corporation up the chain of ownership) of the U.S. corporation or another member of the same group of related corporations. As has long been recognized, interest and royalty payments are very effective in shifting the source of income for tax purposes but otherwise have no economic significance when transfers are made within the same group of companies (as long as the ultimate ownership is the same).

These and similar techniques, which range from the simple illustrations above to much more complex transactions with colorful names, such as the Double Dutch Irish sandwich, create what Kleinbard calls "stateless income."[40] Stateless income captures the notion that corporate managers have flexibility in determining where a corporation's income is recognized for tax purposes.[41] And economic studies show that corporations shift large amounts of taxable income from high-taxed states (where many income-producing activities and sales take place) to low-taxed states (where little economic activity and few sales occur).[42]

Although U.S.-based MNCs can and do shift income from within the United States to outside, there is an important difference when foreign-based MNCs engage in income shifting and when U.S.-based MNCs do so. The difference is that when a U.S.-based MNC engages in such a shift, the income shifted out of the United States is still ultimately subject to U.S. worldwide taxation when it is repatriated back to the United States.[43] In contrast, once U.S.-source income has been successfully stripped out of the United States by a non-U.S.-domiciled corporation, the income can be repatriated back to the parent at no U.S. tax cost. Thus, a non-U.S. corporation that strips income out from the United States permanently escapes U.S. tax on that income. In contrast, a U.S. corporation that strips income out from the United States only defers (possibly indefinitely) that income from U.S. taxation.

Under U.S. tax law, it is relatively easy for non-U.S.-based MNCs to strip large amounts of income out of the United States, thereby completely and permanently escaping U.S. tax on that income at very little tax or economic cost. One simple technique is for the non-U.S. parent to capitalize the U.S. subsidiary with debt rather than equity. If the foreign parent were to capitalize the U.S. entity with equity, the income earned by the U.S. entity would be taxed in the United States. In contrast, to the extent the parent uses debt, the U.S. income is reduced by the interest payment, with the income generally taxed where the interest is received.[44]

[40] Kleinbard, "Stateless Income," 11 *Fla. Tax Rev.* 699 (2011); Kleinbard, "The Lessons of Stateless Income," 65 *Tax L. Rev.* 99 (2011).

[41] Kleinbard, *supra* note 17, at 1056.

[42] *E.g.*, Kevin S. Markle, "A Comparison of the Tax-Motivated Income Shifting of Multinationals in Territorial and Worldwide Countries," 33 *Contemp. Acct. Res.* 7 (2016) (and sources cited within).

[43] That income is also potentially subject to subpart F, which currently taxes income from passive investments held by CFCs of U.S.-domiciled corporations.

[44] Section 163(j). The limit is effectively 50 percent of earnings before interest taxes, depreciation, and amortization, leaving little taxable income after depreciation and amortization. Kleinbard, *supra* note 17, at 1066 (citing Martin A. Sullivan, "Untangling Corporate Effective Tax Rates," *Tax Notes*, Mar. 16, 2015, p. 1299).

A U.S.-domiciled MNC can also use debt to reduce its U.S. taxable income, but there is an important difference. When a U.S.-domiciled MNC shifts income out from the United States, that income is still subject to U.S. taxation when it is repatriated. For the interest payments on the debt to reduce a U.S.-domiciled corporation's income ultimately subject to U.S. tax, the debt cannot come from the corporate parent or a related party. To strip the income permanently beyond the reach of U.S. taxation, the debt must come from a third party. When debt is provided by an unrelated third party rather than a related party, the borrower incurs the economic risks associated with debt. In contrast, when a U.S. subsidiary of a foreign parent is financed with debt from a foreign parent, there is no real economic difference between using debt or equity, as long as the parent holds the securities and thus the economic risks of debt are avoided.

Accordingly, there can be a substantial U.S. tax advantage from having a foreign-domiciled parent rather than a U.S.-domiciled parent. In those circumstances, non-U.S.-based MNCs will have a tax-induced competitive advantage over U.S. companies in the competition to own assets, make investments, and take advantage of opportunities in the United States. This, in turn, provides an incentive for U.S.-domiciled MNCs to invert to improve their competitiveness (not outside the United States, but rather) inside the United States.[45]

It follows that there are two potential competitiveness accounts that can be told about inversions. U.S.-based MNCs might invert to improve their ability to compete with their foreign rivals for opportunities outside the United States (the outbound account) or inside the United States (the inbound account). Moreover, these two accounts are largely independent of one another. Both might be true, either one might be true, or neither one might be true. Accordingly, it is possible that U.S. tax laws disadvantage U.S.-based MNCs relative to their foreign rivals both without and within the United States. Although Kleinbard's focus is on the outbound account, he also addresses the inbound account (although he does not describe it as a competitiveness concern).[46] Following Kleinbard, I focus mostly on the outbound account, but I also consider the inbound account as his broad claim — that competitiveness has nothing to do with inversions — denies the possibility that either account is correct. I now turn to Kleinbard's arguments for why those accounts are wrong.

III. Inversions and the Competitiveness of U.S. MNCs

Kleinbard's 2014 article is erudite, witty, forceful, and wide-ranging. Yet, for all the complex issues and concepts Kleinbard addresses and the numerous contemporary business practices and academic studies he weaves into his narrative, the logical structure of Kleinbard's main argument is straightforward. Kleinbard's central claim is that U.S.-based MNCs are not at a competitive disadvantage relative to their foreign rivals. That claim, in turn, rests on the premise that when properly viewed through the lens through which businesses make investment or capital budgeting decisions, U.S.-based MNCs are taxed no heavier than their foreign rivals. As Kleinbard describes it:

> Sophisticated U.S. firms operate today, not under a worldwide tax system, but rather in an ersatz territorial environment, without any of the antiabuse rules a thoughtful territorial tax system would impose, but subject to a bizarre constraint that they must park their foreign earnings offshore to remain within the ersatz territorial system. This means that in practice, U.S. firms do capture the benefit of operating in lower-tax jurisdictions, both as a cash matter and more importantly for the purpose of U.S. generally accepted accounting principles, which is the lens through which investors and corporate executives measure a firm's performance.[47]

[45] *E.g.*, Wells, *supra* note 11, at 1352-1356.

[46] *See* Kleinbard, *supra* note 17, at 1066-1068.

[47] *Id*. at 1056.

Accordingly, because U.S.-domiciled MNCs are not at a tax-induced competitive disadvantage relative to their foreign rivals, Kleinbard concludes they cannot improve their relative position by inverting.

To advance his claim that U.S. tax law does not disadvantage U.S. MNCs in their competition with foreign rivals, Kleinbard purports to show that U.S. companies are not at a disadvantage from either a financial accounting perspective or a cash flow perspective. Thus, Kleinbard's argument reduces to the claim that the tax rate on U.S. corporations' non-U.S. income is non-positive (zero or negative).[48] Indeed, the claim that there is no disadvantage faced by U.S. companies is an argument that the incremental tax is not merely small, but that it is non-positive.

Moreover, Kleinbard's main thesis in his 2014 article, that the U.S. tax laws do not disadvantage U.S.-domiciled MNCs relative to their foreign rivals from either a financial accounting or cash flow perspective, implies the following four claims:

1. U.S.-domiciled MNCs are not disadvantaged relative to their foreign rivals from a financial accounting perspective in the competition to earn income in foreign markets (outbound/financial accounting perspective);
2. U.S.-domiciled MNCs are not disadvantaged relative to their foreign rivals from a cash flow perspective in the competition to earn income in foreign markets (outbound/cash flow perspective);
3. U.S.-domiciled MNCs are not disadvantaged relative to their foreign rivals from a financial accounting perspective in the competition to earn income in the U.S. market (inbound/financial accounting perspective); and
4. U.S.-domiciled MNCs are not disadvantaged relative to their foreign rivals from a cash flow perspective in the competition to earn income in the U.S. market (inbound/cash flow perspective).

In his 2014 article, Kleinbard argues that all four claims are true and that each claim is supported by the weight of evidence.

By making his case under both financial accounting and cash flow principles, Kleinbard is acknowledging the possibility that companies incorporate taxes into their business and investment decisions in different ways. Support for that divergence can be found in a manuscript posted after publication of Kleinbard's article.

In a recent working paper, John R. Graham, Michelle Hanlon, Terry Shevlin, and Nemit Shroff surveyed tax executives at nearly 2,800 corporations, most of which are domiciled in the United States, about how their companies incorporate tax considerations into their business decisions.[49] The tax executives were asked under various circumstances what is the primary tax rate their respective companies use to incorporate taxes into their business decisions, and in each case they were given a choice of the following options: "(i) U.S. statutory tax rate [STR], (ii) [generally accepted accounting principles] effective tax rate [ETR], (iii) jurisdiction-specific [STR], (iv) jurisdiction-specific [ETR], (v) marginal tax rate [MTR], and (vi) other."[50] Averaging across all responses of the 800 responding companies, the surveys indicated the following pattern of choice of a primary tax rate: "25.8 percent use GAAP ETRs, 23.1 percent use STRs, 19.6 percent use jurisdiction-specific STRs, 17.0 percent use jurisdiction-specific ETRs, 11.2 percent use MTRs, and 3.2 percent use some other rate."[51] Thus, the most common tax rate to use is the GAAP ETR followed by the STR.[52] Further, Graham et al. find that public companies are more

[48] There is an important qualification to this statement regarding antiabuse rules that I take up later in the discussion: whether U.S. MNCs face a tax disadvantage from a cash flow perspective.

[49] Graham et al., "Tax Rates and Corporate Decision Making," working paper (Mar. 2016) (roughly 750 companies provided usable responses).

[50] *Id*. at 10.

[51] *Id*. at 13. The use of jurisdiction-specific ETRs is slightly higher for mergers and acquisitions (20.1 percent) and slightly lower for investment decisions (16 percent). *Id*. at 45, Table 3, panel A.

[52] *Id*. at 11.

likely than private companies to use ETRs rather than STRs or MTRs;[53] however, larger companies, high R&D-intensity companies, and companies with higher institutional ownership are more likely to use MTRs and less likely to use ETRs for decision-making.[54] However, companies with large numbers of analysts following them are more likely to use ETRs and are less likely to use STRs or MTRs.[55] Graham et al. interpret their results to mean "that companies are more likely to use the MTR and less likely to use the ETR when external monitoring mechanisms discipline managers and curb agency problems."[56]

The recent work by Graham et al. demonstrates that there is no single method that all (or almost all) corporations use to incorporate taxes into their decision-making. Rather, their work suggests that there is substantial diversity in the way businesses incorporate taxes into their decision-making. Thus, some companies might use a financial accounting approach, whereas others use a cash flow approach, and still others likely use both approaches.[57] Such a wide divergence in practice makes it difficult to describe precisely how taxes affect the capital budgeting decisions of U.S.-domiciled corporations, which in turn makes it more difficult to draw strong conclusions about how taxes affect the capital budgeting decisions of U.S.-domiciled MNCs relative to those of foreign-domiciled MNCs. With this caveat in mind, I take the financial accounting (ETR) and cash flow (MTR) approaches in turn, assuming in each case that domestic and foreign MNCs incorporate taxes into their decision-making in the same manner (potentially differing only in the rates they use).

[53]*Id.* at 13.

[54]*Id.* at 14-16.

[55]*Id.* at 16.

[56]*Id.* at 16-17.

[57]Graham et al. asked tax executives what tax rate their business "primarily" used, making it unlikely that companies using more than one tax rate would indicate that they use multiple tax rates. Another potential problem with the study is that the authors asked tax managers what tax rate the company used to make various business and investment decisions. However, those decisions are not typically made by tax managers but rather by corporate investment or development officers.

A. The Financial Accounting Claim

Although Kleinbard argues that U.S. MNCs do not face a competitiveness disadvantage from either an accounting or a cash flow perspective, he expends most of his effort developing the financial accounting claim. According to Kleinbard, GAAP "is the lens through which investors and corporate executives measure a firm's performance."[58] There are two versions of Kleinbard's financial statement argument.

The simpler version begins with the premise that both U.S.- and non-U.S.-based companies evaluate investments (including acquisitions) by applying their overall worldwide ETRs to expected earnings regardless of where those earnings arise and are taxed. According to this view, U.S. corporations are not at a competitive disadvantage because their overall ETRs are as low as (if not lower than) their non-U.S. rivals' ETRs.

The more sophisticated version of the argument posits that companies apply market-specific ETRs — rates that vary across national markets — to expected earnings. According to this view, U.S. corporations are not at a competitive disadvantage relative to their foreign rivals because U.S. companies have as low (if not lower) ETRs than do foreign companies in all national markets.

Although, at various places in his 2014 article, Kleinbard makes both arguments, he generally favors the more sophisticated argument on the ground that such an approach more closely reflects the manner in which companies make investment decisions. I begin with the simpler argument and then address the more sophisticated argument.

1. Global ETRs.

Kleinbard at times suggests that companies make investment decisions based on their global or overall ETR.[59] From this perspective, according to Kleinbard, U.S.-based MNCs are not at a competitive disadvantage relative to their foreign

[58]Kleinbard, *supra* note 17, at 1056. Kleinbard also describes GAAP as "the lens through which all relevant private parties view a company." Kleinbard, *supra* note 17, at 1058.

[59]For example, in his discussion of Emerson's unsuccessful attempt to acquire American Power Conversion (APC), Kleinbard refers only to the companies' global ETRs.

rivals, and therefore, improving competitiveness cannot be a rationale for inverting because the overall ETRs of U.S.-based MNCs are as low if not lower than those of their rivals.[60]

This argument has the benefit that it rests on a few studies of global ETRs of corporations based in different states. According to Kleinbard, these studies show that U.S.-based MNCs do not have systematically higher ETRs than MNCs based in other nations[61]:

> Whether one measures effective marginal or overall tax rates, sophisticated U.S. multinational firms are burdened by tax rates that are the envy of their international peers. And this is true whether one studies cash taxes paid or — more important in the case of public firms — U.S. GAAP accounting for taxes.[62]

In a March 16, 2015, *Tax Notes* column,[63] Martin A. Sullivan reviews three well-known economic studies of MNCs' ETRs. Those studies are by Reuven S. Avi-Yonah and Yaron Lahav (2012),[64] by Kevin Markle and Douglas Shackelford (2012),[65] and by PricewaterhouseCoopers (2011).[66] All three studies sought to "measure under accounting rules, what the worldwide tax burden is of all the investments made by a corporation domiciled in country A compared with the same burden of a corporation domiciled in country B.[67]

The studies make these comparisons using different methods, data sources, and time periods. Nonetheless, all three studies conclude that the global ETR of the average U.S.-domiciled MNC either is no higher or is not substantially higher than that of the average non-U.S.-domiciled MNC. For example, the Avi-Yonah and Lahav study, which calculated global ETRs of the 100 largest U.S. and EU public companies from 2000 to 2010, found that the average profit-weighted global ETR for the 100 largest U.S. public companies was 31 percent and for EU companies, the corresponding average was 35 percent, a 4 percent advantage for the U.S. corporations. The PwC study, which calculated global ETRs for 2,000 companies in 59 countries between 2006 and 2009, found that the profit-weighted U.S. average global ETR was 27.7 percent, that the unweighted average of global ETRs for the other 58 countries was 19.5 percent, and that when each country was weighted by GDP, the average global ETR of non-U.S. MNCs went up to 24.8 percent. Weighting each country by the number of observations raised the average global ETR of non-U.S. MNCs further to 25.4 percent, still 2 percent below the U.S. average.[68] The Markle-Shackelford study, which calculated global ETRs for 11,000 companies domiciled in 82 countries, using data from between 2005 through 2009, found that the profit-weighted average global ETR of U.S. domiciled MNCs was 25.9 percent, the unweighted average global ETR of foreign jurisdiction MNCs was 20 percent, and the GDP weighted average was 25.2 percent — 0.7 percent less than the U.S. average. Accordingly, because all three studies conclude that the global ETR of the average U.S. MNC is either no higher than or only slightly higher than that of the average non-U.S. MNC, these three studies would all seem to support the argument that U.S.-domiciled MNCs do not face a tax-induced competitive disadvantage than their foreign rivals. However, a closer look at these studies leans in the opposite direction.

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[60] Avi-Yonah and Lahav, "The Effective Tax Rates of the Largest U.S. and EU Multinationals," 6 *Tax L. Rev*. 375 (2012); statement of Avi-Yonah before the Ways and Means Committee, "How Other Countries Have Used Tax Reform to Help Their Companies Compete in the Global Market and Create Jobs," 112th Cong., 1st Sess. (May 24, 2011). Avi-Yonah and Marian make this argument as well in connection with the Pfizer-Allergan transaction. Avi-Yonah and Marian, *supra* note 22, at 40.

[61] Kleinbard, *supra* note 17, at 1057.

[62] *Id*.

[63] Sullivan, *supra* note 44.

[64] Avi-Yonah and Lahav, *supra* note 60.

[65] Markle and Douglas A. Shackelford, "Cross-Country Comparisons of Corporate Income Taxes," 65 *Nat'l Tax J*. 493 (2012).

[66] PwC, "Global Effective Tax Rates" (Apr. 14, 2011).

[67] Sullivan, *supra* note 44, at 1301.

[68] In a blog post, Kleinbard criticized the PwC study. *See* Paul Caron, "Kleinbard Critiques PwC Effective Tax Rate Study," TaxProf Blog, Apr. 18, 2011. One of Kleinbard's criticisms is that simple comparisons of global ETRs overstate the tax burden on U.S. companies relative to the burden on non-U.S. companies because the United States imposes a higher statutory tax rate but taxes on a smaller base as the result of accelerated depreciation and other faster write-offs. Although accurate as a characterization of the difference between U.S. and non-U.S. tax systems, the criticism seems misplaced for a study that is explicitly about global ETRs, not cash taxes. PwC, *supra* note 66, at 2 (describing method of study). It is also a surprising criticism to see from Kleinbard, who argues that the GAAP effects of taxation are more important than cash flow consequences of taxation, especially for public companies. Kleinbard, *supra* note 17, at 1056-1057. Of course, as Kleinbard describes at some length, timing differences do not reduce global ETRs. *Id*. at 1058-1060.

Although a corporation might do business in many countries, it is domiciled in only one country. The Avi-Yonah-Lahav study compares companies domiciled in the United States with those domiciled in Europe and compares the U.S. average global ETR to the European average global ETR. In contrast, the Markle-Shackelford and PwC studies calculate average global ETRs for MNCs domiciled in each country in the study. The following table, taken directly from Sullivan's column, provides average calculated global ETRs for MNCs domiciled in different jurisdictions, including the United States.

Table 1. Comparison From 2 Studies of Financial Accounting ETRs (across 14 jurisdictions and the United States)

Jurisdiction	PwC	Markle-Shackelford
Australia	27.1%	22%
Bermuda	18.4%	11.4%
Canada	21.6%	17.6%
Cayman Islands	4.7%	12.9%
France	23.1%	23.8%
Germany	27.9%	21.9%
India	25.1%	18.5%
Japan	38.8%	36.7%
Malaysia	22.8%	18.2%
South Africa	26.7%	22.8%
Sweden	22%	15.4%
Switzerland	20.7%	18.5%
Taiwan	14.4%	18.5%
United Kingdom	23.6%	21.8%
United States	27.7%	25.9%
Non-U.S. average (unweighted)	22.6%	20%
Non-U.S. average (weighted)	28.3%	25.2%

Source: Martin A. Sullivan, "Untangling Corporate Effective Tax Rates," *Tax Notes*, Mar. 16, 2015, p. 1299, at p. 1302, Table 3.

Looking at Table 1, we see that the lowest average global ETRs are for MNCs domiciled in nations with small populations and little economic activity (except for tourism and finance), such as Bermuda and the Cayman Islands. MNCs domiciled in industrial nations have substantially higher global ETRs. Among industrial nations, Japan is an outlier. MNCs domiciled in Japan, with ETRs in the mid-30 percent range, face the highest ETRs by far. Depending on the study, MNCs domiciled in the United States face either the second highest (Markle-Shackelford — 25.9 percent) or third highest (PwC — 27.7 percent) average global ETRs. According to PwC, German-domiciled MNCs face slightly higher average global ETRs than do U.S. MNCs (27.9 percent), whereas the Markle-Shackelford study concludes that German MNCs face global ETRs 4 percent lower than U.S. MNCs (21.9 percent).[69] For the other 10 jurisdictions covered in the table, including Australia, Canada, France, Sweden, Switzerland, Taiwan, and the United Kingdom, both the Markle-Shackelford and PwC studies conclude that MNCs domiciled in those nations face lower average global ETRs than their U.S. counterparts. Thus, it would appear that U.S.-domiciled MNCs face among the highest ETRs of companies domiciled in any country. Accordingly, if the impact of taxes on a company's competitiveness can be measured by the company's global ETR, U.S.-domiciled MNCs appear to be at a tax disadvantage relative to MNCs domiciled in many other jurisdictions. That is because U.S.-domiciled MNCs have higher average global ETRs than MNCs domiciled in most other advanced economies.

Further, in 2013 Markle and Shackelford updated their earlier study of global ETRs by extending their data through 2011 and reached similar conclusions.[70] They summarize their main result as follows:

[69] According to the PwC study, German-domiciled MNCs faced average ETRs of 27.9 percent, whereas U.S.-domiciled MNCs faced ETRs of 27.7 percent. According to the Markle-Shackelford study, German-domiciled MNCs faced average ETRs of 21.9 percent, whereas U.S.-domiciled MNCs faced ETRs of 25.9 percent.

[70] Markle and Shackelford, "The Impact of Headquarter and Subsidiary Locations on Multinationals' Effective Tax Rate," NBER working paper 19621 (Nov. 2013).

> Our primary finding is that, despite decades of international tax planning and continuing reports of elaborate innovative schemes to avoid taxes, the effective tax rates of multinationals vary considerably depending on the situs of the company. We find dramatic differences in effective tax rates based on the headquarters of the multinational. Japanese-headquartered multinationals face the highest ETRs, by far. After controlling for industry and size, their ETRs average 8.5 percentage points higher than their runner-up counterparts from the U.S. The ETRs of American multinationals are slightly ahead of those from two major trading partners, France and Germany. On the other end of the distribution, multinationals from the Middle East (Tax Havens) enjoy ETRs that average 12.5 (10.8) percentage points lower than American firms. In short, we find that differences continue to persist in ETRs between high-tax and low-tax countries despite vast investment in international tax avoidance.[71]

Thus, in their 2013 paper, Markle and Shackelford reaffirm their earlier conclusion that U.S.-domiciled MNCs generally have higher global ETRs than the MNCs from other countries with the notable exception of Japan. And they emphasize that this trend persists through 2011 and in the presence of extensive stateless income tax planning.

The above comparisons are more fine-grained than simple comparisons of average global ETRs for U.S.-domiciled and non-U.S.-domiciled MNCs. The two studies described immediately above compare the average global ETR of U.S.-domiciled MNCs with the average global ETR of MNCs domiciled in each one of several countries. In principle, we would want to dig still deeper and to compare global ETRs across rival MNCs domiciled in different jurisdictions.[72] The average U.S. MNC does not compete with the average European MNC or even the average German MNC. The industry makeup is likely to be different across countries, which could bias results. Moreover, most companies have numerous competitors, not just one major competitor,[73] and those competitors are often based in different states and might have very different global ETRs.[74] A given U.S.-based MNC might not have the lowest or the highest overall ETR in the industry. Thus, using global ETRs as a measure of how taxation affects competitiveness, a U.S.-based company that has neither the highest nor the lowest ETR among corporations in its industry is more competitive than some companies, but less competitive than others. If that company inverted and lowered its global ETR, it would improve its competitive position relative to all of its competitors. It would reduce or eliminate the disadvantage relative to those MNCs with lower global ETRs, while increasing its advantage over MNCs with higher ETRs.

One of the industries that has experienced a large number of inversions is healthcare. According to a report prepared by PwC, U.S.-domiciled MNCs have global ETRs that are not generally the lowest in the industry. In its 2009 report, "Pharma 2020: Taxing Times Ahead," PwC calculated five-year average global ETRs for leading companies in the pharmaceutical, biotechnology, generics, and medical device subsectors. That table is reproduced below.

[71] *Id*. at 4.

[72] *See generally* Marian, "Meaningless Comparisons: Corporate Tax Discourse in the United States," 32 *Va. Tax Rev*. 133 (2012) (arguing that cross-border comparisons are often used in debates about international taxation without giving sufficient attention to why the comparison is being offered or what other differences between jurisdictions might be relevant but are not acknowledged).

[73] The rivalry between Boeing and Airbus for large commercial aircraft is a notable exception.

[74] In their 2013 study, Markle and Shackelford find that industries are taxed similarly around the world in that high-taxed industries, such as transportation, construction, and finance tend to be highly taxed regardless of where they are headquartered, and low-taxed industries, such as information, manufacturing, and the professions, tend to be lightly taxed. Markle and Shackelford, *supra* note 70, at 28, Table 5.

Table 2. ETRs of Leading Companies in Four Sectors of the Pharmaceutical and Life Science Industry

Big Pharma			Top 10 Biotech Companies		
Company	Location	ETR (percentage)	Company	Location	ETR (percentage)
Bayer	DE	29.30%	Cephalon	U.S.	39.19%
GlaxoSmithKline	UK	29.27%	Genentech (pre-merger)	U.S.	36.87%
AstraZeneca	UK	28.21%	Biogen Idec	U.S.	31.60%
Wyeth (pre-merger)	U.S.	26.26%	Genzyme	U.S.	30.00%
Roche	CH	25.83%	Gilead Sciences	U.S.	29.20%
Schering-Plough (pre-merger)	U.S.	25.80%	UCB	BE	27.87%
Johnson & Johnson	U.S.	25.02%	CSL	AU	26.38%
Bristol-Myers Squibb	U.S.	24.24%	Amgen	U.S.	24.34%
Merck (pre-merger)	U.S.	23.24%	Celgene	U.S.	24.00%
Pfizer (pre-merger)	U.S.	18.21%	Actelion	CH	12.26%
Sanofi-aventis	FR	15.91%	Average		28.17%
Novartis	CH	14.44%			
Average		23.81%			
Top 10 Generics Companies			**Top 10 Medical Device Companies**		
Company	**Location**	**ETR (percentage)**	**Company**	**Location**	**ETR (percentage)**
Goldshield Group	UK	138.52%	Cardinal Health	U.S.	33.30%
Towa Pharmaceutical	JP	42.44%	Stryker	U.S.	30.50%
Sawai Pharmaceutical	JP	39.31%	Covidien	BM	30.00%
Mylan	U.S.	37.80%	Boston Scientific	U.S.	29.22%
Watson Pharmaceuticals	U.S.	35.93%	Becton, Dickinson & Co.	U.S.	27.57%
Nichi-iko Pharmaceutical	JP	33.96%	Siemens	DE	24.86%
Teva Pharmaceuticals	IL	24.69%	Medtronic	U.S.	24.28%
Pharco Pharmaceuticals	EG	12.61%	Baxter International	U.S.	20.32%
Dr. Reddy's Laboratories	IN	5.53%	Philips	NL	19.06%
EastPharma	TR	—	General Electric	U.S.	14.85%
Average		37.08%	Average		25.40%

Source: PwC, *Pharma 2020: Taxing Times Ahead* 7, Figure 5 (2009). East Pharma, established in 2006, had a pre-tax loss in each subsequent year before the report was published. ETRs for Siemens, Philips, and GE are those reported in their consolidated accounts.

Table 2 shows substantial variations in tax rates across the leading companies in four subsectors of the pharmaceutical and life science industry. Only in medical devices, does a U.S.-domiciled MNC, General Electric, have the lowest ETR.[75] Thus, if we also look at specific market sectors, we see that U.S. companies are not always those with the lowest ETRs. Note that many inverting companies are in the pharmaceutical and life science industry, where Swiss corporations have a large presence. In the PwC and Markle and Shackelford studies, Swiss-based MNCs consistently have substantially lower global ETRs than do U.S.-based MNCs; also, in the PwC study of taxation of the pharmaceutical and life science industry, Swiss healthcare companies often have lower global ETRs than their U.S. competitors.

Moreover, Kleinbard's claim that U.S. MNCs are not at a tax-induced competitive disadvantage relative to their foreign rivals and thus cannot improve their position by inverting is not well supported by the few academic studies that have looked at the impact of inverting on inverting corporations' global ETRs. In 2002 Mihir A. Desai and James R. Hines Jr. published the first empirical study of inversions.[76] Their article, which covered the 25 or so inversions that had been announced through early 2002, examined the financial statements of companies announcing inversions and the stock market's reaction to those announcements. Desai and Hines found that investors in the stock market expect inverting companies to reduce their taxes on both foreign- and U.S.-source income when they invert.[77] They further determined that some portion of the expected tax benefit from inverting is the opportunity to avoid U.S. rules on interest expense allocation.[78] Thus, they concluded that there were both outbound and inbound tax savings from inverting.

The next empirical study published on inversions was a 2004 article by Jim A. Seida and William F. Wempe.[79] Using a sample of 12 inverting companies and 24 matched non-inverting companies, Seida and Wempe found that inverting companies' global ETRs fell sharply after inverting. The global ETR for inverting companies fell 11.57 percent after inverting (from 32.01 to 20.44 percent), whereas the mean ETR for the control group fell only 3.98 percent (from 34.84 to 30.85 percent).[80] Seida and Wempe further hypothesized that much of the benefit came from the inverting companies' avoidance of U.S. taxation on U.S. earnings.[81]

To identify the source of the tax savings, Seida and Wempe closely examined four companies that inverted in 2002. They concluded that for two of them, the entire reduction in ETRs was a result of earnings stripping.[82] For the other two companies, they estimated that earnings stripping was responsible for 84 percent and 38 percent of the reduction.[83]

In a 2010 report, Bret Wells studied three companies in the oil field services industry that inverted in 2002. He compared the companies' pre-inversion global ETRs for 2000 to 2001 with their post-inversion global ETRs for 2003 to 2008. He found that each company's global ETR dropped substantially after inverting, with the drops ranging from 7 to 16 percent.[84]

The Desai-Hines, Seida-Wempe, and Wells articles all found tax savings from inverting. However, those studies all rely exclusively on data from inversions that took place before 2004. Before 2004, U.S. MNCs could invert through what are called "naked inversions." The U.S. company could change residence by merging into

[75]GE, of course, is a large conglomerate with businesses in many industries, not just healthcare. According to PwC, GE's global ETR is its ETR across the entire company, not GE's ETR for healthcare.

[76]Desai and Hines, "Expectations and Expatriations: Tracing the Causes and Consequences of Corporate Inversions," 55 *Nat'l Tax J.* 409 (2002).

[77]*Id.*

[78]*Id.*

[79]Seida and Wempe, "Effective Tax Rate Changes and Earnings Stripping Following Corporate Inversion," 57 *Nat'l Tax J.* 805 (2004).

[80]*Id.* at 820-821, Table 5.

[81]*Id.* at 806-814 (noting a sharp rise in foreign income, but a much smaller rise in foreign revenue, and a shift in pretax profit margins).

[82]*Id.* at 812-813, Table 2.

[83]*Id.*

[84]Wells, *supra* note 11, at 1352 (NBR's global ETR dropped 12 percentage points, from 37 percent to 25 percent; NE's global ETR fell 7 percentage points, from 25 percent to 18 percent; and WFT's global ETR declined 16 percentage points, from 38 percent to 22 percent).

a shell corporation registered in another jurisdiction. After 2004, the target corporation could no longer be a shell; instead, the inversion had to involve a substantial target corporation with significant assets and business activity. Those rules, which have been expanded and tightened since 2004, have made it more difficult for U.S. MNCs to invert by making it harder to find an appropriate target. Also, since 2005, when the repatriation holiday ended, successful U.S. MNCs have been piling up cash overseas in apparent anticipation of a new holiday and as they have become more effective in shifting income overseas. Thus, one might be reluctant to draw conclusions about the current situation from studies based on pre-2004 inversions.

It is therefore surprising, in light of the attention paid to inversions and the centrality of global ETRs to much of that debate, that there are so few recent studies on the impact of inversions on companies' global ETRs. In an article published in 2016, Doron Narotzki looked at 66 inversions that occurred between 1982 and 2015. He calculated the average global ETRs of inverting companies for the five years before they inverted and compared them with the average for the five years immediately following the inversion (or less if the inversion occurred less than five years ago). Narotzki found that inverting companies on average had ETRs of 20.35 percent for the five years before inverting. After inverting, the average global ETR dropped 14.5 percent to 5.82 percent.[85]

Such a large decline in global ETRs suggests that the result might be dominated by one or two very large corporations. However, Narotzki reports that global ETRs fell after inverting, regardless of the size of the inverting company. Corporations with FMVs below $100 million saw their global ETRs drop 1.94 percent; corporations between $100 million and $500 million saw their global ETRs fall 9.64 percent; corporations between $500 million and $1 billion saw their ETRs drop the most, 30.11 percent; corporations between $1 billion and $5 billion saw an average ETR drop of 21.4 percent; corporations between $5 billion and $10 billion experienced a drop of 13.89 percent; and for corporations with FMVs above $10 billion, their average ETR dropped 9.49 percent.[86] Thus, Narotzki's study shows persistent drops in global ETRs following inversions.

Narotzki's study raises several questions, however. The fall in global ETRs following inversions are surprisingly high, especially the 30.11 percent drop for companies with market values between $500 million and $1 billion. Moreover, Narotzki does not describe how he calculates his averages or what he does with outlier observations. He also does not compare his results to a control group of corporations that do not invert. Although his partitioning of transactions into different tranches based on market value makes it unlikely that differences in weighting drove his results, some of his results might be driven by unusually high or low (possibly negative) tax rates.

In contrast with Narotzki's conclusions, a 2016 working paper by Rita Nevada Gunn and Thomas Z. Lys finds that inversions increase U.S. tax revenue because inverting companies pay no less tax after inverting, whereas shareholders pay substantially more tax.[87] Gunn and Lys use a sample of 108 inversions and acquisitions of U.S. companies by foreign acquirers between January 1, 2004, and December 31, 2015.[88] Thus, Gunn and Lys combine inverting U.S. MNCs with acquisitions of U.S. companies by foreign acquirers.[89] They then compare those companies with a control sample of more than 200 foreign acquisitions by U.S. corporations in which the surviving parent entity remained a U.S. domiciliary.[90] Gunn and Lys do not report average global ETRs for either the inverting companies or the control group but instead report average ETRs on domestic and foreign income separately for both inverting companies and the control group. Using data from three years before the inversion and three years after (when available), Gunn and Lys report an average pre-inversion ETR of 22.3

[85] Narotzki, "The True Economic Effects of Corporate Inversions," *Tax Notes*, June 27, 2016, p. 1819.

[86] *Id*. at 1828, Table 10.

[87] Gunn and Lys, "The Paradoxical Impact of Corporate Inversions on US Tax Revenue" (Aug. 21, 2016).

[88] *Id*. at 8.

[89] Gunn and Lys lump inverting companies together with foreign acquisitions of U.S. companies presumably on the grounds that there are likely to be similar tax advantages from having a foreign parent.

[90] Gunn and Lys, *supra* note 87, at 8.

percent on domestic income and 27.5 percent on foreign income. They report an average post-inversion ETR of 19.3 percent on domestic income and 39 percent on foreign income.[91]

Gunn and Lys's results are concerning for several reasons, which are not explained in their study. For example, the highest non-U.S. statutory corporate tax rate in their sample comes from Japan, which is listed as having a 37 percent tax rate,[92] yet they report that after inverting, companies have an average ETR of 39 percent on foreign income. Also, Gunn and Lys report that of their 108 inversion transactions, U.S. shareholders ended up owning less than 50 percent of the combined entity's common stock in 99 of those transactions.[93] In common parlance, an inversion is a transaction in which the U.S. shareholders end up owning more than half of the common stock of the combined entity. In a foreign acquisition, the shareholders of the foreign corporation end up with more than half of the common stock. Thus, the Gunn and Lys study would not seem to be about inversions, but rather about foreign acquisitions.

Two other recent studies do not look explicitly and directly at the impact of inverting on corporations' global ETRs but report results that are broadly consistent with the idea that inverting companies lower their global ETRs. For example, a 2015 working paper by Elizabeth Chorvat finds that post-2004 inversions have produced economically significant excess returns in the years following an inversion, although the announcement of an inversion does not have an immediate effect on stock prices.[94] Chorvat also finds evidence of a strong correlation between the excess returns following an inversion and revenue growth attributable to intangibles held in non-U.S. subsidiaries. However, Chorvat cannot determine whether that growth is because of tax savings or whether those assets were undervalued by the market, so she does not offer an explicit conclusion on whether inversions yield tax benefits.

In a study published in 2013, Eric J. Allen and Susan C. Morse examine recent initial public offerings in which the company is listed on an exchange based in the United States but incorporated outside the United States.[95] Allen and Morse show that only a small portion of U.S.-headquartered companies that engage in IPOs are incorporated in tax haven countries. They further show that the recent increase in the number of U.S.-listed companies incorporated in tax havens is not attributable to a sharp rise in tax haven incorporations by U.S.-headquartered companies but rather is a result of a sharp increase in IPOs by Chinese-headquartered companies incorporated in tax havens.[96] Allen and Morse show that U.S.-headquartered companies account for only a small portion of the increase, which is the basis for their conclusion that there is not yet a substantial exodus of U.S.-headquartered companies away from incorporation in the United States. However, the authors do find that those U.S.-headquartered IPO companies that incorporate in tax havens have relatively more foreign income than those that incorporate in the United States. They interpret that result as suggesting that the companies that incorporate in tax havens expect to have larger tax benefits than would other companies from incorporating in a tax haven.[97] Presumably, if U.S. incorporation was as tax-efficient as tax haven incorporation, as Kleinbard argues, companies with larger foreign earnings should be no more likely than other companies to incorporate in tax havens.

In summary, the studies using pre-2004 data (when naked inversions were possible) consistently and uniformly showed substantial declines in global ETRs following inversions, with the savings likely arising from both U.S. and foreign markets. Unfortunately, there are only a few recent studies of the effect of inverting on corporations' global ETRs, and the studies that are available are neither uniform in their conclusions

[91] *Id*. at 28-29. Both the decrease in ETR on domestic income and the increase on foreign income are significant.

[92] *Id*. at 52, Table 1.

[93] *Id*. at 53, Table 3.

[94] Chorvat, "Expectations and Expatriations: A Long-Run Event Study," University of Chicago Public Law working paper no. 445 (Sept. 20, 2015).

[95] Allen and Morse, "Tax-Haven Incorporation for U.S.-Headquartered Firms: No Exodus Yet," 66 *Nat'l Tax J*. 396 (2013).

[96] *Id*. at 408-409.

[97] *Id*. at 409-412.

nor entirely convincing on the impact of inverting on a company's global ETR. Even so, the recent studies suggest (and are generally consistent with) the notion that many U.S.-domiciled companies lower their global ETRs by inverting. This would seem to be an area ripe for more work.

Another approach to the question of the expected effect of inverting on an MNC's global ETR is to see what the management of an inverting company publicly say they expect to happen to their firm's global ETR after inverting. Thus, Kleinbard begins his article by giving the example of Mylan,[98] which inverted by acquiring Abbot Laboratories, a Netherlands corporation.[99]

In 2014 Heather Bresch, the CEO of Mylan,[100] described herself as "reluctantly" inverting but having to do so because Mylan's global tax rate was too high relative to its competitors, and Bresch had given up hope that Congress would reform the tax law to make U.S.-domiciled corporations more competitive.[101] As Bresch describes it, by inverting, Mylan would reduce its global ETR from "about 25 percent,"[102] to around 20 percent in the year following the inversion and then into the high teens in following years. She offered that reduction in Mylan's expected global ETR as the reason why the company was inverting. However, as Kleinbard points out, Mylan's tax rate before inverting was not "about 25 percent," but substantially lower. Mylan's global ETR was 16.2 percent in 2013, 20 percent in 2012, and 17.7 percent in 2011, according to Kleinbard.[103] Thus, despite Bresch's claim that the inversion would reduce Mylan's global ETR, the inversion (assuming that the company's global ETR after inverting would be as Bresch predicted) would essentially leave Mylan's global ETR unchanged.

To determine whether the management of inverting companies expect to see a decline in their global ETRs, I looked at the inversion transactions announced since Mylan's 2015 inversion to see what management said about expected future tax rates. Although not all inverting companies publicly stated that they expected a decline in their global ETRs, many did. For example, Steris Corp., which also inverted in 2015 and had a global ETR averaging 32.1 percent for 2011 through 2013, said it expected its global ETR to be about 25 percent in 2016.[104] Also, Pfizer, whose merger with Allergan was canceled in 2016 after Treasury issued regulations designed to curb inversions, said it expected the inversion to reduce its global ETR from roughly 25 percent to about 17 to 18 percent.[105] Similarly, CF Industries Holdings Inc., which canceled its proposed merger with Dutch rival OCI after the release of the 2016 Treasury regulations curbing inversions, had expected to reduce its global ETR from about 35 percent to roughly 20 percent.[106] Also, Applied Materials, which in 2015 abandoned its proposed merger with Tokyo Electron,[107] had said its deal would have cut its ETR from 22 to 17 percent.[108] Another company whose management said it expected to see its global ETR fall after inverting is Johnson Controls, which is merging with Tyco (which inverted in 1997). Johnson Control's management said it expected the combined company's global ETR to be 18 or 19 percent. Since Tyco paid 12 percent of its income in taxes over the last three years, whereas Johnson Controls paid 29 percent over that period,[109] the expected global ETR of 18 or 19 percent would represent a 10 percent drop for Johnson Controls. Further, Waste Connections Inc. said it expects its inversion to reduce its global ETR from 40 percent

[98] Kleinbard, *supra* note 17, at 1056-1060.

[99] Patty Tascarala, "Mylan Inversion Deal Completed," *Pittsburgh Business Times*, Feb. 27, 2015.

[100] More recently, Bresch has been in the news for the sharp increase in the price of the EpiPen and Bresch's compensation package.

[101] *See* Sorkin, *supra* note 14.

[102] Kleinbard, *supra* note 17, at 1060 n.14.

[103] *Id*. at 1060.

[104] *Pittsburgh Post Gazette*, Feb. 13, 2015, at 2, section C.

[105] Chad Bray, "Pfizer to Merge With Allergan in $160 Billion Deal," *The New York Times*, Nov. 23, 2015; Denise Roland, "Is Pfizer's Deal Good for Ireland?" *The Wall Street Journal*, Nov. 25, 2015, at 2, section B.

[106] CF Industries Holdings Inc. at Morgan Stanley Global Chemicals Conference — Final FD (Fair Disclosure) Wire (Nov. 9, 2015).

[107] Brent Kendall and Don Clark, "Applied Materials, Tokyo Electron Cancel Merger Plan; Deal Collapses After Firms Give Up on Winning Antitrust Approval," *The Wall Street Journal*, Apr. 27, 2015.

[108] *Financial Times* (London), Sept. 8, 2014, at 17.

[109] Bob Tita and Dana Mattioli, "Tyco, Johnson Controls Bet Bigger Is Better — Merger Reflects a Growing Push Toward Companies That Are Larger, More Focused," *The Wall Street Journal*, Jan. 26, 2016, at 1, section B. However, Johnson Controls' tax rate before specific items was 19 percent over the prior two years.

to 27 percent.[110] Similarly, Baxalta, which is merging with Ireland's Shire, expects the combined company to have a global ETR of 16 to 17 percent, a substantial decline from Baxalta's current rate of 23 to 24 percent. Thus, according to public statements, the managers of many inverting corporations expect to see their companies' ETRs fall.

However, not all managers of inverting firms publicly stated that they expect to see their companies' global ETRs fall after inverting. In at least two inversions, management said it expected little change in ETR following the transaction. For example, IHS, which merged with the U.K.'s Markit, reported a global ETR of 20.54 percent for 2015. According to a statement from IHS, "IHS's tax rate might not change much" after the merger.[111] Another inversion transaction in which management said it did not expect a change in tax rates to occur was the 2014 Burger King-Tim Hortons merger. However, some observers expected Burger King's global ETR to fall after the inversion and believed that there were substantial tax benefits from the shift in corporate domicile.[112] In some cases, it can be difficult to tell what impact management expects an inversion to have on its global ETR because management declines to say or because pre-inversion ETRs have been volatile. Nonetheless, although not all inverting companies report that they expect to see their global ETRs fall,[113] based on managers' inversion announcements, it would appear that many U.S.-based MNCs expect to improve their competitive position (as measured by their global ETRs) by inverting.

In summary, although simple comparisons of average global ETRs of U.S.- and non-U.S.-domiciled MNCs might suggest that U.S. MNCs cannot reduce their global ETRs by inverting because the average global ETRs of U.S.-domiciled MNCs are roughly as high as the average global ETRs of non-U.S.-domiciled MNCs, more extensive and fine-grained data suggest the opposite. U.S.-domiciled MNCs have higher global ETRs than MNCs domiciled in most other market-oriented countries. Also, many U.S.-domiciled MNCs in the pharmaceuticals industry, an industry that has experienced many highly publicized inversions, have higher global ETRs than their foreign-domiciled rivals. Further, studies that looked at pre-2004 inversions, when naked inversions were still possible, consistently found substantial declines in global ETRs from inverting. Although the small number of post-2004 studies of the impact of inverting on global ETRs are not as uniform nor as persuasive as earlier studies, taken together those studies suggest that many companies see their global ETRs fall when they invert. That view is further supported by corporate inversion announcements, which often indicate that the management of inverting U.S. MNCs expect to see their global ETRs fall. Thus, viewed through the lens of corporations' global ETRs, Kleinbard's claim that inverting U.S.-domiciled companies do not improve their competitive position by inverting is not supported by the data and is inconsistent with most studies.

2. Market-specific ETRs.

It is easy to understand why commentators debating whether the U.S. tax system disadvantages U.S.-based MNCs relative to their foreign rivals frequently take refuge in global ETRs. That approach relies on readily available data (public companies report global ETRs in their public financial statements) and thus allows scholars, analysts, and commentators to compare global ETRs across rivals from different jurisdictions and look at what happens over time to global ETRs. However, that approach buries all the hard questions about how U.S. companies and their foreign rivals are taxed by subsuming those

[110] Scott Deveau et al., "Texas Trash Hauler Seeks Move to Canada in Inversion Deal," *DTR* (Jan. 21, 2016).

[111] Leslie Picker, "A Merger in Data and Analytics: All-Stock Deal Will Create Company With Annual Revenue of $3.3 Billion," *International New York Times*, Mar. 23, 2016.

[112] *E.g.*, John Carney, "Sparing Burger King Some Taxes," *The Wall Street Journal*, Aug. 27, 2014, at C14; and Zachary R. Mider, "Burger King Saying Move Won't Save Taxes Draws Criticism," Bloomberg Business, Sept. 3, 2014. Interestingly, Tim Hortons inverted to Canada in 2009 and gave as one reason the opportunity "to take advantage of lower Canadian tax rates." *Id*.

[113] One might be skeptical of managers' statements about what they expect the effect of an inversion to be on their companies' ETRs. Although there is likely some flexibility (after all, there is a long history of earnings management), there is also a risk to the managers from dissembling. Managers who knowingly make misleading statements can face civil and criminal liability under the federal securities law. *See generally* Amanda Athanasiou, "Eaton Corp. Sued Over Statements About Post-Inversion Spinoff," *Tax Notes*, Aug. 1, 2016, p. 663. There is likely little legal risk from being wrong about your prior global ETRs, because those numbers are public and available.

questions under a single, widely available number — the global ETR. But the main problem with that approach is that it is unclear why multinational companies, especially MNCs operating in countries with very different tax systems and tax rates, should make capital budgeting decisions in individual markets using global ETRs. Even assuming the managers of MNCs focused exclusively on reported accounting earnings in making business and investment decisions, as Kleinbard sometimes argues, it makes no sense for those companies to make investment decisions using their global ETRs.

Instead, it makes more sense for companies whose managers are focused exclusively on accounting earnings to make investment decisions using whatever accounting tax rates their managers expect their companies to incur on the earnings generated by those investments. Thus, only if a project was expected to produce the same geographic distribution of earnings as the company's current projects produce should the managers use the company's global ETR. Assuming the earnings from a project were expected to have a different distribution than the earnings of the company in general, managers of an MNC focused exclusively on after-tax earnings should use a tax rate that reflected the distribution of the expected earnings. In the special case, in which the earnings from an investment were expected to be taxed in only one jurisdiction, the managers should use the company's ETR from that jurisdiction. Hence, Kleinbard's more sophisticated financial accounting argument is that U.S.-based MNCs are not at a tax-induced competitive advantage relative to foreign rivals because their market-specific ETRs are no higher than those of their foreign rivals.[114]

Kleinbard's argument begins by noting that U.S. companies often report global ETRs as low as their foreign rivals. That premise then immediately leads to the heart of Kleinbard's argument, which is as follows: Because U.S. companies typically have a larger share of their operations in the United States than do their foreign rivals where tax rates are highest, presumably — as a simple matter of arithmetic — it follows that U.S. companies have lower ETRs on foreign-source income than their foreign rivals.[115] As for offering a substantive argument to the effect that U.S.-domiciled MNCs have low or lower market-specific tax rates than their foreign rivals, the above arithmetic argument is it.

Kleinbard also supports his claim that U.S. MNCs do not face a financial accounting disadvantage relative to their foreign rivals by quoting from Leslie Robinson's 2014 congressional testimony to the effect that the financial accounting literature does not show that U.S. MNCs are at a tax disadvantage[116]:

> Leslie Robinson of Dartmouth's Tuck School of Business recently summarized the academic and financial accounting literature in testimony before the Senate Finance Committee as establishing that "there is no evidence that U.S. MNCs face greater tax burdens as a consequence of how foreign profits are taxed, relative to their competitors."[117]

Starting with Kleinbard's substantive argument, whatever the merits of the arithmetic for the general proposition — that U.S. MNCs have higher ETRs on average than non-U.S. MNCs — such a general argument seems to be a flimsy foundation on which to ground a

[114] Robinson is also skeptical of using simple comparisons of global ETRs to determine whether MNCs domiciled in one country are more competitive than those domiciled in another country. According to Robinson, a more reasonable method to make those determinations is by comparing ETRs within a single jurisdiction operated by MNCs domiciled in different jurisdictions, which we have not been able to do. Robinson, *supra* note 26, at 2-3.

[115] Kleinbard, *supra* note 17, at 1059. Kleinbard illustrates his argument with a hypothetical example of a U.S. MNC and a foreign MNC that both pay tax at an overall effective rate of 25 percent. The U.S. company earns 60 percent of its income from the United States, whereas the foreign company earns 40 percent from the United States, with both companies effectively taxed at 35 percent on that income. According to Kleinbard, those assumptions imply that the U.S. MNC has an ETR of 10 percent on its non-U.S.-source income, whereas the foreign company has an ETR of 18.3 percent. He concludes that the U.S. company "completely dominates" the foreign company "along the standard 'competitiveness' yardstick." *Id.* at 1059. Of course, the calculated ETRs on non-U.S.-source income are derived from simple algebra, and the U.S. MNC has a lower ETR on non-U.S.-source income because it earns proportionally more income in the United States, which is the high-tax jurisdiction, and the companies' overall ETRs are the same. Kleinbard backs up his argument with an example, Mylan, which he introduces with the phrase, "This example is not entirely fanciful." *Id.* at 1059-1060.

[116] Robinson, *supra* note 26, at 2.

[117] Kleinbard, *supra* note 17, at 1057-1058 (quoting Robinson, *supra* note 26, at 2).

conclusion that U.S.-based MNCs have as high or higher ETRs in specific non-U.S. markets than their foreign rivals. Kleinbard also fails to establish the premises on which his mathematical argument rests. As the last section describes, the premise that U.S.-based MNCs have as low or lower companywide ETRs than their competitors is questionable. The premise that ETRs for both U.S. and non-U.S. companies are higher in the United States than they are in other jurisdictions seems reasonable, as does the premise that U.S. MNCs have proportionally larger footprints in the United States than do their rivals. However, the claim that U.S. MNCs and their foreign rivals have similar geographic footprints outside the United States is not supported and is highly questionable.[118]

Further, there is other evidence that calls into question Kleinbard's claim that U.S. MNCs have jurisdiction-specific ETRs as high as their rivals. The tendency for inversions to lower global ETRs implies that jurisdiction-specific ETRs are lowered somewhat after an inversion. Assuming then that MNCs make business and investment decisions using jurisdiction-specific ETRs, the evidence discussed in the last section showing that inversions tend to lower global ETRs suggests at the very least that inverting MNCs have lower jurisdiction-specific ETRs in some jurisdictions, although we do not know which ones. A reduction in jurisdiction-specific tax rates will improve the competitiveness of inverting companies in at least one jurisdiction (assuming that companies use market-specific ETRs to make investment decisions). Thus, Kleinbard's indirect method of establishing that U.S.-domiciled MNCs have as low or lower ETRs than their foreign rivals in specific markets comes up short. But that is not the same as saying he is wrong.

To establish — or refute — Kleinbard's claim that U.S.-based MNCs have as low or lower ETRs in foreign markets than do their non-U.S. rivals calls for direct comparisons in specific markets. We would like to be able to compare the ETRs in specific markets of U.S.-based and non-U.S.-based MNCs that compete with one another. Unfortunately, however, Kleinbard provides no comparisons nor any references to any studies comparing overall (global) ETRs of U.S.-based and foreign-based MNCs in specific national markets.

Although he does not provide evidence or refer to any studies, Kleinbard quotes and cites Robinson's testimony that "there is no evidence that U.S. MNCs face greater tax burdens as a consequence of how foreign profits are taxed, relative to their competitors."[119] Kleinbard presents Robinson's testimony as offering an affirmative conclusion: U.S. MNCs do not suffer a tax-induced disadvantage as compared with their foreign rivals. Robinson, however, offers only a negative conclusion — that there is insufficient evidence in the financial accounting literature to establish a conclusion one way or the other. Thus, to the quote above, Robinson adds, "Researchers cannot make comparisons by jurisdictions that would seem necessary to resolve the competitiveness issue."[120] Indeed, Robinson explicitly rejects Kleinbard's method of trying to derive companies' market-specific ETRs from their global ETRs:

> Comparing global ETRs will not detect violations of capital import neutrality because they, in part, reflect differences in location decisions.
>
> Since each MNC has a different geographic footprint, a comparison of ETRs within a single jurisdiction operated by MNCs resident in different countries would seem more appropriate. For instance, how does the tax burden (including both source and host country taxes) on operations in a given country compare between U.S. MNCs and non-U.S. MNCs? We do not know the answer to this question, nor is there good data to answer it. At best, we observe the source country tax, but do not observe any home country tax imposed on profits earned in a specific country.[121]

[118] Robinson, *supra* note 26, at 2-3.

[119] Kleinbard, *supra* note 17, at 1057-1058 (quoting Robinson, *supra* note 26, at 2).

[120] Robinson, *supra* note 26, at 2-3 (footnote omitted).

[121] *Id*. at 2 (footnote omitted).

As Robinson makes clear, we simply do not know what MNCs' ETRs are in specific markets, much less how they differ based on where the company is based. I am unaware of any such studies, and Robinson flatly says that as of summer 2014, there were none available.[122] Without any studies to rely on, any conclusion is shaky. The claim that U.S.-domiciled MNCs have jurisdiction-specific ETRs as high as their competitors is merely conjecture.[123] Thus, on the more sophisticated version of Kleinbard's financial accounting claim, we currently lack the data to make an informed judgment whether inversions lower market-specific ETRs in specified identified markets.

B. The Cash Flow Claim

Kleinbard not only argues that U.S.-domiciled MNCs are not at a tax-induced competitive disadvantage relative to their foreign rivals based on financial accounting conceptions of tax burdens, he further argues that U.S. MNCs are not at a disadvantage based on cash flow taxes. I now examine that claim.

Modern finance theory teaches that business and investment (sometimes called capital budgeting) decisions should be made on the basis of net present value (NPV) using after-tax cash flows, not financial accounting concepts. The NPV rule is to accept all investments with a positive NPV and to reject all investments with a negative NPV. The NPV of a project is the discounted value of the expected future net after-tax cash flows from that project. The discount rate is the weighted average cost of capital (WACC) for the project, which can differ from that of the company. The WACC is the before-tax cost of the incremental equity and the after-tax cost of the incremental debt that supports the project. Thus, the tax rate appears in both the numerator and the denominator. According to modern finance theory, the relevant tax rate is the marginal cash tax rate (often referred to simply as the MTR). That tax rate is neither an average tax rate nor a financial accounting concept. Instead, the MTR of a project is the present value of the incremental taxes to be paid if the project is undertaken, divided by the present value of the project's net cash flow. That tax rate reflects both when that cash flow is taxed and the rate at which it is taxed.

Once again, Kleinbard's claim that competitiveness arguments are baseless is a claim that U.S.-domiciled MNCs incur no costs because of the United States' worldwide tax system with deferral. That no-cost claim implies that U.S. companies pay no U.S. tax on their overseas earnings and incur no costs from deferring or avoiding U.S. taxation. Thus, the no-cost claim implies the following: (1) U.S. companies pay no explicit tax costs from repatriating cash to the United States; (2) U.S. companies pay no explicit tax costs from keeping cash abroad; (3) U.S. companies incur no explicit nontax costs from holding cash abroad; and (4) U.S. companies incur no implicit nontax costs from holding cash overseas.[124]

In contrast with Kleinbard's claim, there is good reason to believe that unconstrained U.S.-domiciled MNCs (that is, companies that do not need to repatriate overseas cash to fund U.S. investment) incur all four types of costs. First, some unconstrained companies do incur the

[122] *Id*. at 2-3.

[123] In July 2016 two researchers from Vienna University of Economics and Business, Saskia Kohlhase and Jochen Pierk, posted a paper on SSRN, the title of which suggests that they answered whether foreign subsidiaries of U.S. MNCs pay higher or lower taxes than their non-U.S. rivals in specific markets. Kohlhase and Pierk, "Why Are U.S.-Owned Foreign Subsidiaries Not Tax Aggressive?" WU International Taxation research paper series no. 2016-03 (July 2016). The authors consistently find that subsidiaries of U.S. MNCs have higher national ETRs than do subsidiaries of MNCs from countries with territorial tax systems in various European countries. However, because Kohlhase and Pierk use unconsolidated financial statements of European subsidiaries owned by foreign MNCs for 2005 through 2009, a period the authors say during which Germany had a close alignment between book and tax income, the authors' research design allows them to identify tax planning that reduces taxes but does not reduce income, such as locating production facilities in subnational states with low taxes. Unfortunately, their design does not allow them to identify income shifting through related-party debt, royalties, and aggressive transfer pricing, because that shifting reduces both taxes and income. Of course, it is such income shifting, which Kleinbard has labeled "stateless income," that is at the heart of the debate over MNCs' ETRs in specific markets.

[124] As Kleinbard recognizes, U.S.-domiciled companies that are capital constrained and thus need to repatriate foreign earnings to undertake profitable U.S. investments are taxed at full statutory rates on their overseas income. Those companies are at a tax disadvantage relative to their foreign rivals by virtue of the U.S. worldwide tax system, even though that system provides for the possibility of deferral. Those companies cannot defer repatriation indefinitely because they need access to their overseas cash to make domestic investments, so the U.S. worldwide tax puts them at a competitive disadvantage. Although there are circumstances in which it might be difficult to determine whether a company is capital constrained, Kleinbard focuses on companies that are not capital constrained and thus do not need to repatriate foreign earnings in order to make profitable U.S. investments.

explicit tax cost of repatriation at the statutory rate. Despite the potentially large U.S. tax bite, some companies repatriate earnings, which exposes them to the potential 35 percent U.S. corporate tax rate. Unconstrained major corporations with large cash holdings that have repatriated earnings in recent years include eBay and GE.[125] If it were costless to hold untaxed earnings overseas, companies that were not capital constrained would presumably never repatriate and never pay U.S. tax on their offshore earnings.

Further, the 2004-2005 tax holiday that reduced the maximum repatriation tax rate from 35 percent to 5.25 percent saw 843 U.S. MNCs repatriate in aggregate $362 billion (of which $312 billion was subject to the reduced holiday tax rate).[126] Such large and widespread repatriations are inconsistent with the notion that it is costless for U.S. MNCs to maintain foreign cash balances that would be subject to taxation upon repatriation. If it were costless for companies to keep repatriated earnings overseas, presumably they would have forgone repatriation during the holiday.[127]

Second, there is an explicit U.S. tax cost from holding cash balances in non-U.S. subsidiaries. The interest on those cash balances is subject to current U.S. taxation whether it is repatriated or held abroad in accordance with the current U.S. antiabuse regime.[128] Thus, on their foreign cash balances, U.S. MNCs earn only the after-corporate-tax rate of return, not the before-corporate-tax rate of return. In contrast, if the income were repatriated and distributed to shareholders (without corporate tax), the shareholders could invest the cash without being subject to further corporate taxation. The corporate tax paid on U.S. MNCs' overseas interest earnings is an explicit tax cost from holding cash overseas.[129]

In recent years, some U.S.-domiciled MNCs with large overseas cash balances have borrowed large sums of money and used those proceeds to pay dividends, repurchase shares, or invest in domestic operations. The best-known example is Apple, which has borrowed roughly $75 billion.[130] Because Apple can deduct its interest payments from its income, the interest the company pays on its $75 billion in debt roughly offsets the interest it earns on $75 billion of its overseas cash holdings. Apple's offset, however, is incomplete.

Congress long ago recognized that the U.S. tax law encourages U.S.-domiciled MNCs to borrow in the United States rather than abroad in order to reduce their U.S. taxable income without reducing their overall global income. Accordingly, U.S.-domiciled companies are required to apportion their borrowings between U.S. and foreign income.[131] As a result, not all interest paid on Apple's $75 billion of debt is deductible in the United States. Some of that interest is apportioned to foreign income and will generate a tax benefit only when foreign earnings are repatriated.

[125] Greg Bensinger, "EBay to Take $3 Billion Tax Charge," *The Wall Street Journal*, Apr. 29, 2014 (eBay announced that it was repatriating $9 billion, most of its overseas cash, at an expected tax cost of $3 billion); Vipal Monga, "GE Jumps on the Repatriation Bandwagon," *The Wall Street Journal*, Apr 10, 2015 (GE announced that it will repatriate $36 billion of $61 billion held overseas and pay $6 billion in taxes; the funds are to be used to help pay for dividends, share repurchases, and a share exchange from spinning off its private-label credit card business).

[126] Melissa Redmiles, "One-Time Received Dividend Deduction," 27 *SOI Bull*. 103 (2008).

[127] The economic literature on the repatriation holiday focuses on how the repatriated funds were used. *See, e.g.*, Thomas J. Brennan, "Where the Money Went: A New Understanding of the ACJA Tax Holiday," working paper (Mar. 6, 2014); Brennan, "What Happens After a Holiday? Long-Term Effects of the Repatriation Provision of the AJCA," 5 *Nw. JL. & Soc. Pol'y* 1 (2010); Jennifer L Blouin and Linda K. Krull, "Bringing It Home: A Study of the Incentives Surrounding the Repatriation of Foreign Earnings Under the American Jobs Creation Act of 2004," 47 *J. Acct Res*. 1027 (2009); and Dhammika Dhamapala, C. Fritz Foley, and Kristin J. Forbes, "Watch What I Do, Not What I Say: The Unintended Consequences of the Homeland Investment Act," 66 *J. Fin*. 753 (2011).

[128] Sections 951(a), 952(a)(2), and 954(c)(1)(A).

[129] The tax cost of earning interest on cash held offshore varies directly with interest rates.

[130] Apple's balance sheet as of September 24, 2016, available on Yahoo Finance (long-term debt of $75 billion); Tim Higgins, "Tim Cook's $181b Headache," Bloomberg, July 22, 2015.

[131] Section 864(e).

Moreover, Apple's offset is incomplete because the company holds more cash overseas than it has debt outstanding. Apple holds $180 billion in overseas cash, not $75 billion.[132] The company thus holds $105 billion in cash in its foreign subsidiaries, against which it has not borrowed. Accordingly, Apple is paying tax on the interest generated by its $105 billion of overseas cash not offset by domestic borrowings, so the company incurs an explicit tax cost from holding that cash. That, in turn, presumably means that the cash Apple holds abroad is less valuable to the company (as a U.S.-domiciled corporation) than it would be to a foreign-domiciled corporation, which could repatriate and distribute the proceeds to shareholders without incurring home-country tax.

Also, although Apple's $75 billion of borrowing is typically referred to as "arbitrage," it is an imperfect form of arbitrage. That is because the offsetting transactions are incomplete and risky. Traditional arbitrage transactions provide a profit without risk and can be unwound without cost (other than transaction costs). Unlike traditional arbitrage, Apple's arbitrage is incomplete because the company cannot deduct all of the interest it pays on its debt. Moreover, because Apple cannot unwind the transaction costlessly, its arbitrage is risky. If at some point Apple decides it wants to close out the arbitrage, it must pay off its offsetting U.S. debt. However, Apple cannot pay off its U.S. debt using its overseas funds without also paying tax upon repatriation.[133] The risk inherent in the arbitrage is underscored by Apple borrowing against only two-fifths of its offshore cash.

Third, there are explicit nontax costs from holding cash overseas. There is a widespread view that overseas cash holdings that would be subject to tax upon repatriation are valued by the market at less than their face value.[134] And companies that borrow to access that cash, because the arbitrage is imperfect, find their credit rating downgraded and hence their interest expense increased.[135]

Fourth, there is also evidence that U.S.-domiciled MNCs that hold large amounts of offshore earnings incur implicit nontax costs to avoid paying tax upon repatriation, including tax planning and structuring costs.[136] Harry Grubert and Rosanne Altshuler estimated the implicit costs of accumulating deferrals using data from the 2004-2005 repatriation tax holiday.[137] They concluded that "the marginal cost of deferral is very low immediately after the tax holiday repatriations, but after 10 years, that is, by 2015, it rises to about 7 percentage points."[138] Grubert and Altshuler further concluded that the implicit costs of deferring repatriations increase with the size of the cash balances.[139]

Another indication of the cost to companies of holding cash overseas is the effort and expense U.S.-based MNCs undertake in order to invert. Any sizeable merger and acquisition is expensive, but inversions are especially expensive. Price premiums — the excess of the merger price over the market price of the target before the transaction is announced — are often higher for inversion transactions than for other transactions.[140] Also, inverting companies are frequently downgraded by the credit reporting agencies, which results in higher borrowing costs, further increasing the cost of inverting.[141]

The discussion above looks only at the current costs of holding cash overseas. Although it can be difficult to make reliable estimates, capital budgeting is a forward-looking exercise. The NPV rule does not use current cash flows, but rather

[132] Higgins, *supra* note 130.

[133] Apple could, of course, use U.S. funds to pay off the debt without incurring repatriation taxes, but that assumes Apple has excess U.S. funds. That is uncertain, whereas the excess foreign funds are present.

[134] Foley et al., "Why Do Firms Hold So Much Cash? A Tax-Based Explanation," 86 *J. Fin. Econ*. 579 (2007); Hanlon et al., "The Effect of Repatriation Tax Costs on U.S. Multinationals," 116 *J. Fin. Econ*. 179 (2015).

[135] Robinson, *supra* note 26. *See also* Standard and Poor's Rating Services, "Ratings Direct Draft: Inversions Lower Tax Liabilities, But Also Can Impair Credit Ratings," Sept. 8, 2014 (noting that inverted companies are frequently downgraded because of their increased use of debt).

[136] Kleinbard, *supra* note 17, at 1057.

[137] Grubert and Altshuler, "Fixing the System: An Analysis of Alternative Proposals for the Reform of International Tax," 66 *Nat'l Tax J*. 671 (2013).

[138] *Id*. at 685.

[139] *Id*. at 683.

[140] Athananasiou, "Inversion Premiums Deconstructed," *Tax Notes*, Sept. 8, 2014, p. 116.

[141] S&P, *supra* note 135.

expected future cash flows. And there are good reasons to believe for U.S.-domiciled MNCs, the explicit and implicit costs of earning overseas income and holding cash abroad will increase — or at least that the managers of those companies might conclude that there is a nontrivial possibility of such an increase.

For example, in addition to the steps Treasury has taken to curb inversions, the Obama administration proposed a 19 percent minimum tax on U.S.-domiciled MNCs' overseas income without deferral, and Jacob Lew, Obama's Treasury secretary, claimed in late 2016 that there was bipartisan support in Congress for such a tax.[142] Further, President Trump as well as his Democratic opponent in the general election, Hillary Clinton, have both endorsed a minimum tax on U.S. MNCs' foreign income.[143] A minimum tax would raise taxes on overseas income of U.S.-domiciled MNCs, thereby weakening the competitiveness of U.S. MNCs relative to their foreign rivals.[144]

Moreover, managers of U.S.-domiciled MNCs might reasonably believe that it will become even more difficult for U.S. MNCs to invert and escape worldwide taxation. During the presidential campaign, Clinton released a detailed proposal designed to stop inversions.[145] Her proposal called for raising to 50 percent the foreign ownership threshold for a merger to change the legal domicile of the parent corporation. Clinton also proposed an exit tax on the untaxed overseas profits of U.S. companies acquired by foreign corporations.[146] Without being specific, Trump repeatedly said during the campaign that he would stop inversions.[147]

The significance of all this for Kleinbard's cash flow claim is that a U.S. MNC looking at the current tax situation and anticipating what is likely to happen should have no problem finding a competitiveness rationale rooted in U.S. taxation for inverting. Even if the company's managers agreed with Kleinbard that their company is not currently disadvantaged relative to its non-U.S. rivals given the current tax laws, they might still reasonably conclude that there is a plausible chance that future tax reforms (such as the elimination of deferral) would make them worse off than their non-U.S. competitors. Also, calls to tighten the anti-inversion rules even more — such as by requiring that the foreign merger partner be larger than the U.S. partner in order for the transaction to be respected as shifting domicile — are further encouraging U.S. companies to invert.[148]

The above analysis looks to the future. If we step back several years and look forward with the benefit of hindsight, we see a similar pattern. In recent years, the United States has enacted policies designed to raise the tax on income held offshore (such as the anti-hopscotch rules in the April 2016 notice) and other policies that make it more difficult for companies to invert (through a series of changes adopted beginning in 2004). Most recently, Treasury finalized regulations under section 385 that target inverting companies but make it more difficult for all companies to strip earnings out from the United States by

[142] Stephanie Soong Johnston, "Lew Says EU State Aid Issue Could Lead to 'Perfect Storm' for Tax Reform" (Oct. 7, 2016).

[143] Trump tax reform (deemed repatriation of corporate profits at a one-time tax rate of 10 percent); David Dayen, "The Huge Corporate Tax Cut Hillary Clinton Doesn't Talk About," *New Republic*, Oct. 21, 2016 (in the first presidential debate, Clinton followed Trump's endorsement of a 10 percent tax on foreign earnings, saying "I happen to support that in a way that will actually work to our benefit.").

[144] There is an uncomfortable tension between Kleinbard's support (on one hand) of proposals that would end deferral and make it more difficult for U.S. MNCs to escape from the U.S. worldwide tax system (*e.g.*, Americans for Tax Fairness, *supra* note 23, at 3) and his insistence (on the other hand) that U.S. MNCs are not at a competitive disadvantage because they are taxed no more heavily than their non-U.S. rivals. The tension arises because even if Kleinbard is correct that at the current time and on a cash basis, U.S. MNCs face taxes no higher than those faced by their foreign rivals, capital budgeting is a forward-looking exercise in which taxpayers make investment decisions today by estimating expected future cash flows, including expected future taxes. Thus, even if the current "ersatz territorial tax system" is effectively equivalent to (or even less burdensome than) actual territorial systems, a shift in the U.S. tax system toward a system that more closely resembles a traditional worldwide tax system (such as taxing overseas income at a minimum rate without deferral) would reduce returns on investments made by U.S. MNCs, thereby hampering their competitiveness. For example, if the United States were to tax the foreign income of U.S. MNCs without deferral at the statutory rate, U.S. MNCs would clearly be disadvantaged relative to their non-U.S. rivals, and thus there would be a clear forward-looking benefit to inverting: Inverting companies would escape the taxes the United States would impose on U.S.-domiciled MNCs' overseas income.

[145] Clinton Factsheets: "Ending Inversions and Investing in America." *See* Mindy Herzfeld, "Clinton's Exit Tax and a Broader Business Tax Reform Agenda," *Tax Notes*, Aug. 29, 2016, p. 1195.

[146] Thus, Clinton's proposal would seem to call for imposing an exit tax on the unrepatriated earnings of U.S. MNCs that are acquired by foreign companies. Herzfeld, *supra* note 145, at 1196.

[147] Jared Meyer, "More Economic Nonsense From Trump," *National Review*, Feb. 15, 2016.

[148] Clinton Factsheets, *supra* note 145; Herzfeld, *supra* note 145.

issuing new debt. The regulations thus give existing internal debt-intensive capital structures a big advantage over new structures. Companies that completed their inversions before April 2016, the relevant date under the regulations, have a significant edge over companies that would invert after that date.

Thus, whether using hindsight to look from the past to today, or looking forward from today into an uncertain future, there are strong, competitiveness-rooted reasons for U.S. companies to invert. Strong reasons, however, are not the same as certainty. The surprise election of Trump, whose embrace of mercantilist language calls into question long-standing policies and practices, underscores the difficulty in making definitive statements about whether U.S.-domiciled MNCs can expect to raise or lower their MTRs by inverting. That uncertainty, however, does not support Kleinbard's claim that competitiveness has nothing to do with inversions. Uncertainty can be a reason to invert rather than delay doing so. An inverted company can presumably reverse its decision and reestablish U.S. domicile; however, a company that has not inverted might find inverting more difficult in the future.

Further, when we avoid trying to predict how tax (and other policies) will evolve in the future (which is part of a complete discounted cash flow analysis) and just focus on the simpler and narrower questions at the heart of Kleinbard's cash flow claim — that the U.S. worldwide tax system imposes on U.S.-domiciled MNCs no costs of earning foreign income — we see that for the reasons given above, a U.S. MNC's expected marginal tax cost of earning income overseas will very likely be positive, although the magnitude of that cost is uncertain. The alternative hypothesis, that the cost is zero, seems unlikely in light of the above and has certainly not been established. Yet that is the position Kleinbard not only endorses but claims is supported by the evidence. Although the above arguments are detrimental to Kleinbard's claim that the U.S. tax system is an "ersatz territorial" tax system (that is, that there is no tax cost on overseas earnings), they are not dispositive of the broader claim that U.S. MNCs are at a tax disadvantage relative to their foreign rivals, because Kleinbard still has one possible escape hatch.

As Kleinbard argues, non-U.S.-domiciled MNCs can face a higher tax burden than do U.S.-domiciled MNCs on income earned outside the parent corporation's state of domicile. The idea is that non-U.S.-domiciled MNCs are subject to stricter antiabuse rules in their home country (despite being domiciled in nominally territorial states) on foreign-source income (and on domestic income shifted abroad) than are U.S.-domiciled MNCs (domiciled in an ostensibly worldwide state), so the non-U.S.-domiciled MNCs actually face higher taxes than U.S.-domiciled MNCs.

Antiabuse rules typically apply to corporations domiciled in a state, and they tax at the corporation's marginal rate the income of CFCs that is shifted or seen as problematic. Thus, although the United States has one of the highest statutory corporate tax rates among OECD countries, Kleinbard suggests that U.S. antiabuse rules are more porous and capture sufficiently less income than those of other countries, rendering the U.S. antiabuse rules less burdensome.[149]

Kleinbard makes that argument several times in his 2014 article, beginning on the second page, where he describes the environment in which U.S. MNCs operate as an "ersatz territorial environment, without any of the anti-abuse rules that a thoughtful territorial tax system *would* impose" (emphasis added).[150] And in the next paragraph, he argues that it is relatively easy for U.S. companies to aggressively move income from high-tax to low-tax jurisdictions because they are "unencumbered by any of the anti-abuse rules to which non-U.S. multinationals domiciled in jurisdictions with better designed territorial systems *might* be subject" (emphasis added).[151] The tentative language is revealing. Not only are the statements not supported by data or

[149] A similar sentiment is expressed in the letter signed by 24 tax experts. Americans for Tax Fairness, *supra* note 23, at 2 ("U.S. multinationals are unquestionably the world's leaders in global tax-avoidance strategies.").

[150] Kleinbard, *supra* note 17, at 1056.

[151] *Id*.

examples, their very language underscores the lack of evidence for Kleinbard's claim that non-U.S.-domiciled MNCs are subject to more stringent antiabuse rules.

And later in his article, Kleinbard responds directly to the argument that non-U.S. MNCs are better able to shift income around than U.S.-domiciled MNCs. His response is that the claim "is not easily demonstrated, and it ignores anti-base erosion developments like the OECD's [base erosion and profit-shifting] project or the EU's common consolidated corporate tax base."[152] To support his claim that competitiveness has nothing to do with inversions, Kleinbard has the burden of showing either that U.S.-domiciled MNCs are not taxed on foreign earnings (including U.S. earnings shifted abroad) or that non-U.S.-domiciled companies are subject to stricter antiabuse rules. His statement here does neither; it only asserts that the opposite view cannot be readily shown. As for the other developments, these reasons seem tenuous. The BEPS project, which is under the auspices of the OECD, applies to the United States as well as to the EU. And the OECD produced its final BEPS reports only in October 2015 — reports that have yet to be implemented. Also, the EU's common corporate tax base project has not yet produced an agreement, let alone been implemented.[153]

Moreover, there is good reason to believe that EU corporations are not tightly constrained by antiabuse regimes. In 2006 the Court of Justice of the European Union issued a decision that severely restricts the ability of EU member states to enact CFC rules that might otherwise restrain widespread shifting of income to low-tax jurisdictions within the EU. In its *Cadbury-Schweppes* decision,[154] the CJEU held that the United Kingdom's CFC rules violated freedom of establishment rights under the EU treaties because those rules were not limited "to wholly artificial arrangements." In 2010, in light of the CJEU's *Cadbury* decision, the European Council recommended that member states include an exception clause in their antiabuse regimes restricting their reach within the EU to only wholly artificial arrangements. Most EU member states have complied, substantially weakening antiabuse rules within the EU regarding income that is taxed in a member state. With low corporate tax rates in Luxembourg and Ireland, EU-domiciled MNCs have significant opportunities to reduce taxes by shifting income without running afoul of antiabuse rules.[155]

Ultimately, however, to answer whether U.S. MNCs or their foreign rivals are subject to stricter antiabuse regimes requires evidence. Unfortunately, quantitative evidence of the amount by which CFC legislation raises the cost of earning foreign profits for U.S.-domiciled MNCs and for non-U.S.-domiciled MNCs is lacking. However, in a 2012 working paper, Robinson and Markle develop an index of the

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[152] *Id.* at 1067. Note the shift from arguing that the U.S. tax system does not disadvantage U.S. MNCs to arguing that the converse claim — that U.S. MNCs are at a tax disadvantage — has not been established.

[153] The lack of evidence to support the claim that U.S.-domiciled MNCs are able to shift income to low-tax jurisdictions more easily and at lower cost than non-U.S.-domiciled MNCs is further underscored by Robinson's testimony, when she describes the relative costs of complying with antiabuse regimes as follows:

> It is entirely possible that, for a given profit generated in a low-tax country, a non-U.S. MNC faces a higher tax burden due to "strong" anti-abuse rules taxing those source country profits in the MNC's home country, while the U.S. firm faces indefinite deferral of home country tax under "weak" anti-abuse rules.

Robinson, *supra* note 26, at 2 n.5. And although Robinson acknowledges that is costly for U.S. companies to keep cash abroad, she describes the assumption that those costs are lower for non-U.S. MNCs than for U.S. MNCs as "not clear." *Id.* at 5 ("There is evidence supporting the notion that U.S. MNCs face non-trivial implicit costs of deferral that may put them at a competitive disadvantage, but there is no comparison of these costs to MNCs based in other countries. Competing firms operating under territorial tax systems may also bear implicit costs of avoiding home country tax through the need to navigate anti-abuse rules in the home country. The implicit cost is assumed to be low for non-U.S. MNCs, relative to U.S. MNCs. However, the validity of this assumption is not clear" (emphasis removed).).

[154] *Cadbury-Schweppes*, C-196/04 (Sept. 12, 2006).

[155] Two recent studies by German researchers examining the impact of the 2006 *Cadbury-Schweppes* decision and its aftermath on income shifting by EU-domiciled MNCs conclude that the EU's antiabuse rules are not very strict. Martin Ruf and Alfons Weichenrieder examined the impact of the *Cadbury-Schweppes* decision on the location of passive investments. They conclude that the decision has led to substantial shifting of passive investments within the EU, especially to low-taxed Ireland. They also find that much of that shifting replaced shifting to tax havens outside Europe. Ruf and Weichenrieder, "CFC Legislation, Passive Assets and the Impact of the ECJ's *Cadbury-Schweppes* Decision," WU International Taxation research paper no. 2014-02. Another group, Rainer Brautigam, Christoph Stengel, and Frank Streif, examined the effect of the CJEU's *Cadbury-Schweppes* decision on capital import and capital export neutrality. They find that the decision led to substantial declines in effective tax rates, which suggests widespread income shifting. Brautigam, Spengel, and Streif, "Decline of CFC Rules and Rise of IP Boxes: How the ECJ Affects Tax Competition and Economic Distortions in Europe," ZEW discussion paper no. 15-055 (2015).

strength of countries' CFC legislation. Their index is comparative, even if it does not translate directly into measurable costs. Robinson and Markle examined the cross-border tax systems of 28 countries. They classify 10 of them — including Austria, Belgium, India, Ireland, the Netherlands, Russia, and Switzerland — as not having CFC regimes.[156] Among the 18 countries in the sample with CFC regimes, they find that the United States is in the middle of the pack.[157] That is hardly strong evidence that U.S. MNCs are subject to laxer antiabuse rules than their rivals, and it is no support for the notion that stricter antiabuse regimes offset the positive direct and indirect tax costs U.S. companies incur on foreign earnings — costs that seem likely even if they cannot be readily quantified.

A recently published article by Markle further questions the notion that non-U.S.-based MNCs are subject to stricter antiabuse regimes than U.S.-based MNCs.[158] He looks at whether income shifting occurs more frequently when parent corporations are domiciled in jurisdictions with territorial or worldwide tax systems. His main result, which is based on data from 2004 to 2008, is that income shifting is more prevalent among corporations domiciled in territorial states than among corporations domiciled in worldwide states.[159] Markle further decomposes his results into income shifted among foreign subsidiaries and income shifted from a domestic corporation (either the parent or a subsidiary) to a foreign subsidiary. He concludes that shifting income among foreign subsidiaries is as common, regardless of where the parent is located.[160] However, shifting income out from the state of domicile is more common when the parent is domiciled in a territorial jurisdiction.[161] Thus, Markle's study, which at best (from the perspective of Kleinbard's claim that inversions do not improve competitiveness) can be read to conclude that there is no more income shifting with worldwide parents than with territorial parents, does not suggest that U.S. antiabuse laws are laxer than those of other states and can therefore make up for the higher tax and nontax costs from a worldwide tax system. Thus, although foreign antiabuse regimes might be sufficiently stricter than those to which U.S. companies are subject so as to offset the direct and indirect costs of the U.S. deferred worldwide tax system, there is still no evidence to support the conclusion that in practice the antiabuse rules of any specific jurisdiction are sufficiently stricter to offset the direct and indirect costs incurred by U.S.-domiciled MNCs.

In summary, there is little evidence whether the cost to U.S.-domiciled MNCs of worldwide taxation with deferral plus the U.S. antiabuse rules is greater than the cost to non-U.S. MNCs domiciled in territorial states of complying with their home states' antiabuse regimes. We simply lack the studies that would allow us to compare the costs of being subject to different antiabuse regimes based on the state of domicile. We therefore cannot say confidently that non-U.S. companies' costs of dealing with antiabuse rules are higher than those of their foreign rivals. However, Kleinbard does not argue that we are unsure whether the U.S. tax system disadvantages U.S.-domiciled companies relative to their foreign rivals on a cash flow basis, but rather argues that the U.S. tax system does not so disadvantage U.S.-domiciled MNCs. Given the strong evidence that U.S. companies incur costs from deferral, and the lack of evidence that those costs are offset by the costs of non-U.S.-domiciled MNCs complying with their home-country CFC regimes, Kleinbard's strong claim that competitiveness arguments for inversions are baseless is itself only conjecture and is inconsistent with the weight of evidence, which shows that for U.S.-domiciled MNCs, there are nontrivial costs of holding large amounts of untaxed cash offshore in foreign subsidiaries.

C. The Emerson 'Competitiveness Fable'

Kleinbard seeks to support his argument that U.S.-domiciled MNCs are not at a competitive disadvantage relative to non-U.S.-domiciled MNCs on either a financial accounting or cash flow

[156] Markle and Robinson, "Tax Haven Use Across International Tax Regimes," at 37, Table 2 (Nov. 2012).

[157] *Id.*; Robinson, *supra* note 26, at 6 ("the U.S. ranks right in the middle, in terms of the strength of its CFC legislation, among the 198 countries in the sample with CFC legislation").

[158] Markle, "A Comparison of the Tax-Motivated Income Shifting of Multinationals in Territorial and Worldwide Countries," 33 *Contemp. Acct Res*. 7 (2016).

[159] *Id*. at 9.

[160] *Id*.

[161] *Id*.

basis by debunking a "competitiveness fable" corporate managers tell about how the U.S. tax system disadvantages U.S. MNCs in their competition with foreign rivals. In 2006 Emerson Electric, a U.S. corporation, sought to acquire another U.S.-domiciled corporation, American Power Conversion (APC), which had more than half its earnings outside the United States. Emerson was outbid by Schneider Electric, a French corporation, which ultimately acquired APC for $6 billion, a 30 percent premium over APC's stock price and $1 billion (20 percent) more than Emerson's highest offer. According to Emerson's CFO at the time, Walter Galvin, Schneider was able to outbid Emerson for APC because Emerson had to pay U.S. taxes on Schneider's non-U.S. earnings at nearly 40 percent (including both federal and state taxes), whereas Schneider would be taxed at less than 2 percent on those same earnings.[162] In Galvin's opinion, France's territorial tax system, coupled with the U.S. worldwide tax system, made it possible for Schneider to outbid Emerson for APC. Kleinbard strongly disagrees.

Kleinbard's responses to Galvin's claim fall into four broad categories. First, Kleinbard argues that there are alternative nontax justifications for why Schneider might outbid Emerson.[163] Second, he argues that the difference in bid prices is so large that it cannot be explained by taxes.[164] Third, he contends that Emerson's competitiveness argument is misplaced because APC was a U.S. corporation at the time of its acquisition.[165] Fourth, Kleinbard wryly notes that shortly after its failure to acquire APC, Emerson was able to acquire a different (foreign) corporation.[166] I address each of these arguments in turn.

First, Kleinbard maintains that Schneider outbid Emerson for APC because Schneider had a young, ambitious president and because APC was likely a better strategic fit with Schneider than with Emerson.[167] Those are certainly plausible explanations. However, in all actual corporate acquisitions, there are likely to be nontax differences across competing bidders. The possibility of those differences alone does not undercut the claim that taxes can have an effect on which corporation acquires any particular company.

Second, Kleinbard contends that the difference between Schneider's and Emerson's global ETRs are not nearly large enough to account for the difference in bid prices. As described by Kleinbard, APC's global ETR was 26 percent in 2003, 25 percent in 2004, and 22 percent in 2003.[168] Schneider's French GAAP global ETR was "a bit higher, in the 28 to 29 percent range."[169] Throughout the same period, Emerson's companywide ETR was higher still, "close to the statutory 35 percent rate."[170] According to Kleinbard, "on its face, this 20 percent difference in the offers that the two firms made is an implausibly large premium to attribute to tax rate differentials."[171]

Fair enough. Nonetheless, the difference between Schneider's and Emerson's global ETRs potentially translates into a large difference in valuation. Assuming that both companies made their investment decisions using their global ETRs (the only tax rates Kleinbard discusses regarding the transaction), Emerson would use a 35 percent tax rate, and Schneider would use, say, a 28.5 percent rate, the midpoint between 28 and 29 percent. Thus, Schneider would expect to report to its shareholders on an after-tax financial accounting basis 71.5 percent of APC's earnings. Emerson, in contrast, would expect to report only 65 percent of APC's earnings. Thus, applying each potential acquirer's global ETR to APC's earnings, Schneider would report 6.5 cents (or 10 percent) more of after-tax earnings than would Emerson on every dollar earned by APC.[172] Assuming both companies used the same discount rate to value the same investments (a common assumption because it isolates tax effects), Schneider would place a 10 percent higher value on the same pretax

[162] Galvin, *supra* note 10, as quoted in Kleinbard, *supra* note 17, at 1061-1062.

[163] Kleinbard, *supra* note 17, at 1063-1064.

[164] *Id*. at 1063.

[165] *Id*. at 1064.

[166] *Id*. at 1065.

[167] *Id*. at 1064.

[168] *Id*. at 1063.

[169] *Id*.

[170] *Id*. at 1062.

[171] *Id*. at 1063.

[172] For every dollar earned by APC, Schneider would report after-tax earnings of 71.5 cents, whereas Emerson would report only 65 cents.

earnings than would Emerson. That difference is insufficient to account for the full difference in bid prices (20 percent), and it does not equal the statutory difference in rates (nearly 40 percent), but a 10 percent difference in valuation is certainly substantial.

Although Kleinbard might be correct that taxes cannot account for the full difference in bid prices between Schneider and Emerson, he would be wrong about the general proposition that U.S. companies are in as good a position as their foreign rivals in the competition to acquire other corporations. Thus, viewed through the lens of global ETRs, the APC example shows, if anything, that Emerson was at a large tax disadvantage relative to Schneider.

Of course, the above discussion focused exclusively on global ETRs. If we looked at Emerson's and Schneider's jurisdiction-specific ETRs or MTRs, we might reach very different results. However, we do not know what those were, and Kleinbard does not discuss the possibilities. Moreover, we do not know how Emerson and Schneider incorporated taxes into their valuation processes, so we do not know what tax rates they used to value APC.

Third, Kleinbard points out that APC was not a foreign-domiciled corporation but rather a U.S.-domiciled corporation, so Schneider, by purchasing Emerson rather than removing APC's earnings from the ambit of U.S. taxation instead further entwined itself in the U.S. tax system. Although APC's U.S. domicile complicates the argument that Emerson was at a tax disadvantage, APC's U.S. domicile alone does not rebut the claim that Schneider had a tax advantage over Emerson. For the reasons described above, APC's (future) foreign earnings and cash flow might be more valuable to Schneider than to Emerson. Also, APC's (future) U.S. earnings and cash flow might be more valuable to Schneider because it might have been better able to strip earnings out of the United States than Emerson.

Fourth and finally, Kleinbard's coup de grace is to point out that four years after Emerson's unsuccessful attempt to acquire APC, it acquired Chloride Group, a U.K. corporation, outbidding ABB, a Swiss-domiciled corporation. Kleinbard argues that Emerson's 2010 acquisition of Chloride shows that U.S.-based MNCs are not disadvantaged, because they can acquire foreign firms.[173] Of course, it is no more reasonable to conclude from Emerson's failure to acquire APC that U.S.-based MNCs are at a tax-induced competitive disadvantage than it is to conclude the opposite — that because Emerson acquired Chloride, U.S.-based MNCs are not at a disadvantage — which is precisely Kleinbard's point.

Kleinbard, however, misses an important difference (at least in Galvin's telling) between the APC and Chloride transactions. At the time they were acquired, Chloride was a much smaller company than APC. Emerson acquired Chloride for $1.5 billion, whereas Schneider acquired APC for $6 billion. According to Galvin, Emerson acquired Chloride using offshore cash. That cash, which would have been subject to tax upon repatriation, was not fully available for Emerson to use as it liked. Instead, it was locked offshore, which means that it was subject to an ongoing cost (explicit or implicit) that would not apply if the income had been repatriated. The implication is that offshore cash is a cheaper form of financing overseas acquisitions for U.S.-based MNCs, whereas new equity and U.S. cash are more expensive forms of financing. There is thus no logical inconsistency in Galvin's claim that the U.S. tax system makes it more difficult for U.S.-based MNCs to make large overseas acquisitions but easier for them to make small ones. The two arguments are the opposite sides of the same coin.

Because of deferral, the debate whether the U.S. tax system disadvantages U.S.-domiciled MNCs in foreign markets comes down to whether it is costly for U.S. MNCs to hold cash in their foreign subsidiaries. If there is no cost, there is no disadvantage, because cash held by foreign subsidiaries is as valuable as cash held by the domestic parent (and its U.S. affiliates). If, however, overseas cash is subject to explicit or implicit taxation, U.S.-domiciled MNCs are at a tax disadvantage when they are looking to invest U.S. cash overseas, because they will incur the added cost of earning overseas cash that their foreign rivals will not. In other words, parent

[173] Kleinbard, *supra* note 17, at 1064-1065.

company financing (U.S. cash or new equity of the U.S. parent) is a relatively expensive source of capital for U.S. MNCs' overseas investments because if the investment succeeds, there is an incremental cost that non-U.S. MNCs do not incur. Conversely, because the cash held by the foreign subsidiaries of U.S. MNCs is subject to explicit taxation or to the implicit cost of deferring taxation, U.S. MNCs' overseas cash provides a relatively inexpensive source of capital for acquisitions. Thus, Galvin's claims about APC and Chloride are not contradictory (although they are not established and backed up by Galvin, either), so Chloride (without more) is not the counterpoint Kleinbard takes it to be.

Viewed through the only lens into the acquisition of APC that Kleinbard provides — global ETRs — Galvin's story is broadly supported by Kleinbard's data and comments. Although Schneider's global ETR was not so much lower than Emerson's to account for the full 20 percent difference in bid prices, the difference in global ETRs could account for a 10 percent difference, half of the bid price difference. Also, from a cash flow perspective, Chloride's substantially smaller size than APC (as well as Chloride's foreign domicile) is consistent with the notion that new cash or equity is an expensive acquisition currency, whereas preexisting, untaxed offshore cash is an inexpensive currency.

D. Other Explanations for Inversions

Kleinbard rejects the idea that U.S.-domiciled MNCs invert to improve their competitiveness because, according to Kleinbard, U.S.-domiciled MNCs are not at a disadvantage relative to their foreign rivals. Instead, Kleinbard offers two alternative justifications for inversions.[174]

Kleinbard believes the principal reason why U.S. MNCs invert is that they are seeking to gain access to their large offshore stores of cash.[175] As he describes it:

> The best of the stateless income planners are drowning in low-taxed overseas cash, which today earns only negligible rates of interest. The meager earnings on the cash drag down earnings per share, while shareholders focus with laser intensity on that cash as more usefully deployed directly in their hands.
>
> It is less than a secret that firms in this position really have no intention at all of "permanently" reinvesting the cash overseas, but instead are counting the days until the money can be used to goose share prices through stock buybacks and dividends.[176]

Thus, according to Kleinbard, U.S. MNCs are engaging in inversions to put their hands on their large overseas stocks of low-taxed and untaxed cash so they can use those funds to repurchase shares and raise their stock price.

Although Kleinbard offers accessing offshore stockpiles of cash as an alternative to improving competitiveness as a justification for inversions, the two justifications are not as far apart as they might at first seem. In fact, the two justifications are closely related. The connection is perhaps easiest to see by examining the outbound argument. In the outbound argument, the claim is that companies invert because they seek to reduce the tax burden on their *future* overseas earnings; in Kleinbard's accessing cash argument, companies invert to access *prior* earnings held offshore. Thus, both arguments are predicated on the value of reaching earnings held offshore, which are worth more to the company, its managers, and investors when they can be freely accessed without additional tax cost. The difference is that Kleinbard's argument focuses on those earnings only after they have been earned. In contrast, the competitiveness argument takes a step back in time and recognizes that before those earnings are earned, they will be worth more if they can be accessed immediately or whenever desired without having to incur a repatriation tax.[177]

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[174] I consider only Kleinbard's economic justifications. Kleinbard notes that there can also be psychological motivations for undertaking a transaction such as an inversion, but he prefers to focus on the economic rationales rather than psychological motives. Kleinbard, *supra* note 17, at 1066-1067.

[175] *Id*. at 1065-1066.

[176] *Id*.

[177] The same relationship holds for the inbound argument. Kleinbard argues that U.S. MNCs strip income out of the United States and into low-tax jurisdictions and that U.S. MNCs invert to access prior earnings without additional tax. According to the inbound competitiveness argument, U.S. MNCs invert to access their future U.S. earnings more easily and cheaply.

Of course, competitiveness arguments for inversions and Kleinbard's principal reason for inversions are not in conflict. It is possible that by changing domicile, inverting companies are trying to both access past earnings with minimal tax cost and reduce the tax cost on their future earnings. Indeed, the two reasons are closely related. Both are derived from the U.S. worldwide tax system, which reduces the value to U.S.-domiciled MNCs of earnings held overseas relative to the value those earnings have to MNCs domiciled in territorial states. Because untaxed earnings held overseas are worth less to U.S.-domiciled MNCs than to MNCs domiciled in territorial jurisdictions, U.S.-domiciled MNCs have an incentive to invert: so they can realize the full value of their accumulated overseas earnings without taxation.[178] Similarly, U.S. MNCs that expect to have large overseas earnings in the future also have an incentive to invert: so they can realize the full value of their expected future earnings without taxation.

Accordingly, I do not disagree with Kleinbard that gaining access to large amounts of overseas cash is one reason why U.S. MNCs invert. However, gaining access to previously untaxed offshore cash is not the only reason why companies seek to invert. After all, not all inverting companies already hold large offshore stocks of cash, and some high-profile proposed inversions, such as Walgreen's aborted inversion, involve companies with little offshore cash.[179]

That leads to Kleinbard's second reason for why U.S. firms engage in inversions:

> The other reason for the wave of inversions relates to the same existential despair over the failure of Congress to engage with fundamental corporate tax reform, but this time the focus shifts to the tax imposed on U.S. domestic income. Many domestic-centric U.S. firms, particularly those in the services industries — say, a large chain of retail drugstores — actually pay federal corporate tax at effective rates not that far removed from the statutory rate. Companies in this situation have every reason to feel aggrieved that Congress has not addressed the high statutory rate, which burdens them disproportionately. An inversion transaction does little for those firms regarding their offshore cash, because they typically have little or none in a tax haven kitty, but the creation of an offshore parent located in a tax treaty jurisdiction does permit easy earnings stripping of the U.S. tax base on domestic operating income through newly created internal leverage, up to the ceiling set by section 163(j). But that ceiling is far too high, because it basically allows firms to strip out 50 percent of their earnings before interest, taxes, depreciation, and amortization. After depreciation and amortization reduce what remains, there are slim pickings left for the U.S. Treasury.[180]

Thus, Kleinbard argues that the second reason why U.S. MNCs are inverting is so they can shift income that would otherwise be taxed in the United States to lower-taxed jurisdictions.[181] That is not a backward-looking rationale for inversions, as was the rationale Kleinbard offered regarding foreign markets. Instead, that is a forward-looking account, which provides a rationale for companies to invert in order to reduce their effective taxes on future earnings. This second rationale is a surprising reason for inversions for Kleinbard to offer in a piece promoting the idea that tax inversions are unrelated to competitiveness. That is because that rationale is what I describe as the inbound competitiveness rationale for inversions.[182]

In summary, Kleinbard, in an article that purports to debunk the claim that U.S.-domiciled MNCs undertake inversions to improve their

[178] Indeed, the block quote in which Kleinbard puts forth the accessing cash rationale is full of language similar to the language from the cash flow argument that worldwide taxation disadvantages U.S. MNCs. Thus, Kleinbard talks of U.S. MNCs holding cash "that earns only negligible rates of interest" that "drag down earnings per share" to the detriment of shareholders who recognize that such cash could be "more usefully deployed directly in their hands." Kleinbard, *supra* note 17, at 1066.

[179] Felipe Cortes et al., "The Effect of Inversions on Corporate Governance" (Oct. 25, 2016).

[180] Kleinbard, *supra* note 17, at 1065-1066.

[181] *Id*. at 1066.

[182] Kleinbard, however, would seem to acknowledge this possibility for U.S. corporations without substantial overseas operations. Whether he also maintains that U.S.-domiciled companies can reduce their taxes on U.S. income when the company already has substantial foreign operations is not clear.

competitiveness, offers two alternative justifications to account for inversions. The opposition between his proffered rationales for inversions and the standard competitiveness arguments is not as sharp as Kleinbard apparently thinks. One of his justifications is a straightforward statement of the inbound account (from either a financial accounting or cash flow perspective), and the other is very close to the cash flow version of the outbound account. The latter differs from the outbound account in that Kleinbard considers only previously earned stocks of untaxed and undertaxed income, ignoring the value from accumulating untaxed and undertaxed income in the future.

IV. Conclusion

Kleinbard's principal thesis in his 2014 article is that inversions are in no way motivated by a desire to improve the competitiveness of U.S.-domiciled MNCs, because U.S.-domiciled MNCs are not at a tax-induced competitive disadvantage relative to their non-U.S. rivals. According to Kleinbard, the U.S. worldwide tax system does not disadvantage U.S. MNCs relative to their foreign rivals domiciled in states with territorial tax systems, and hence they cannot eliminate any tax-induced disadvantage by inverting. As described above, that claim implies that U.S.-domiciled MNCs are not disadvantaged relative to their foreign rivals from either a financial accounting perspective or a cash flow perspective in the competition to earn income in either foreign markets or the domestic market.

However, the data and studies available, either today or in 2014 when Kleinbard published his article, do not establish that U.S.-domiciled MNCs are not disadvantaged relative to their foreign rivals from either a financial accounting (global ETR) or a cash flow perspective in either foreign or domestic markets. The data are at best inconclusive. Most of the data, in fact, are consistent with and support the opposite view regarding the competitive disadvantage of U.S.-domiciled MNCs and thus the view that they can improve their competitive position by inverting. Moreover, Emerson's unsuccessful attempt to acquire APC is not a "competitiveness fable" but an illustration of the powerful impact taxes can have on competitiveness. And finally, Kleinbard's alternative justifications for inversions do not undercut the outbound and inbound competitiveness arguments but in fact support those claims.

Accordingly, despite Kleinbard's claim that competitiveness has nothing to do with inversions, improving competitiveness remains a strong reason for U.S.-domiciled companies to invert. Although improving competitiveness might not be the only reason to invert (and we do not have a good sense of the magnitude of the advantage), improving competitiveness is and remains a powerful motivation for inverting. And policies intended to curb inversions that ignore this state of affairs are likely to create tensions and produce adverse effects. ■