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The Congressional Response to Corporate Expatriations: The Tension Between Symbols and Substance in the Taxation of Multinational Corporations

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THE CONGRESSIONAL RESPONSE TO CORPORATE EXPATRIATIONS: THE TENSION BETWEEN SYMBOLS AND SUBSTANCE IN THE TAXATION OF MULTINATIONAL CORPORATIONS

Michael S. Kirsch

During the past few years, several high-profile U.S.-based multinational corporations have changed their tax residence from the United States to Bermuda or some other tax haven. They have accomplished these expatriations, and the resulting millions of dollars of annual tax savings, merely by changing the place of incorporation of their corporate parent, without the need to make any substantive changes to their business operations or their U.S.-based management structure. Congress and the media have focused significant attention on this phenomenon. Despite this attention, Congress initially enacted only a non-tax provision targeting corporate expatriations — a purported ban on expatriated companies entering into contracts with the Department of Homeland Security. This article addresses this alternative sanction, concluding that it is prototypical symbolic legislation, with no instrumental effect. The article also discusses the extent to which the initial Congressional debate over expatriations may have had indirect instrumental effects by furthering the informal enforcement of social norms. Ultimately, after almost three years of debate, Congress enacted a tax provision intended to deny the desired tax benefits to expatriating corporations. The article also addresses the substantive tax policy implications of this response, concluding that it illustrates the tenuous normative underpinnings of the place-of-incorporation rule for determining corporate residence and the need for Congress to reconsider what makes a corporation "American" in an increasingly globalized world.
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INTRODUCTION

In the past few years, several well-known U.S.-based
multinational corporations have engaged in restructurings known as "expatriations" or "inversions." Pursuant to an inversion, a corporate group changes the parent corporation's place of incorporation from a U.S. state, such as Delaware, to a foreign country, such as Bermuda or the Cayman Islands.

It is important to distinguish these corporate expatriations from related phenomena such as "runaway plants" and "outsourcing." The runaway plant phenomenon involves corporations with U.S. manufacturing operations shutting down those operations and shifting production to a foreign location. Similarly, outsourcing involves a corporation eliminating service positions in the United States and instead hiring service workers in a foreign location. In contrast to these phenomena, a corporate expatriation does not involve any immediate change in the physical location of the corporate group's management headquarters, manufacturing operations, services, or other activities. Instead, expatriation merely reflects a formal legal

The list of companies that have undergone inversions includes McDermott International, Helen of Troy, Triton Energy, Tyco International, Fruit of the Loom, Cooper Industries, and Ingersoll-Rand. Mihir A. Desai & James R. Hines, Jr., Expectations and Expatriations: Tracing the Causes and Consequences of Corporate Inversions, 55 Nat'l Tax J. 409, 418-20 (2002) (summarizing significant corporate expatriations between 1983 and 2002). At the height of the inversion trend in 2002, seven companies among the Standard & Poor's 500 had expatriated, or were in the process of expatriating. Id. at 416; see also infra note 165. For a useful summary of the history of corporate inversions, their transactional structures, and the possible government responses thereto, see Hal Hicks, Overview of Inversion Transactions: Selected Historical, Contemporary, and Transactional Perspectives, 30 Tax Notes Int'l 899 (June 2, 2003).

2 The term "expatriation" derives from the movement of the corporate parent's place of incorporation from within the United States to a foreign country. The term "inversion" refers to the flip in the corporate structure as a result of the transaction. Prior to the transaction, a U.S.-incorporated parent serves as the holding company for U.S.- and foreign-incorporated subsidiaries, whereas after the transaction a foreign-incorporated parent serves as the holding company for U.S.- and foreign-incorporated subsidiaries. This article uses the terms "inversion" and "expatriation" interchangeably.

3 A typical corporate inversion:

... is accomplished by reincorporating in an appropriate foreign location, such as Bermuda or the Cayman Islands, typically by having a firm's foreign subsidiary exchange its shares for those of the American parent company. Individual shareholders, who previously owned shares of the American parent company, will then own shares of the foreign (parent) company, which owns the American company. These transactions are commonly referred to as "inversions," since their impact is to invert the

Desai & Hines, supra note 1, at 410. The House Ways and Means Committee of the 107th Congress defined “mailbox” inversions, the most widely-reported type of inversion, as:

... occur[ing] when a U.S. company switches only its place of incorporation to a low tax foreign jurisdiction (such as Bermuda) but does not change its overall corporate structure, its operations, or the location of its employees. For all purposes, other than tax, the company continues to be and act like a U.S. company.

Ways and Means Summary of American Competitiveness and Corporate Accountability Act, TAX NOTES TODAY (July 12, 2002) (LEXIS, FEDTAX lib., TNT file, elec. cit., 2002 TNT 134-45). See also TREASURY INVERSION STUDY, supra note 1, at 1-2 (inversion transactions “all involve little or no immediate operational change .... [and are] complicated technically but virtually transparent operationally. ...”); S.B. 640, 2003 Leg., Reg. Sess. (Cal. 2003) (“[a]n expatriate company is a United States based company that has moved in name and on paper only to a tax haven country and has no substantial business activities in the country of reincorporation.”); NEW YORK STATE BAR ASSOCIATION TAX SECTION REPORT ON OUTBOUND INVERSION TRANSACTIONS (2002), available at http://www.nysba.org/content/contentgroups/Section_Information1/Tax_Section_Reports/1014report.pdf [hereinafter NY STATE BAR INVERSION REPORT]:

The inverted corporation typically is a “shell” corporation, which inverted corporation, although in substance operationally headquartered in the U.S., achieves foreign status merely by filing organizing papers in a tax haven and then typically claims “residency” in a separate U.S. tax treaty jurisdiction through what can be seen as minimal contacts with that jurisdiction.

Id. at 25. For interesting details regarding the practical aspects of incorporating in Bermuda, see DAVID CAY JOHNSTON, PERFECTLY LEGAL: THE COVERT CAMPAIGN TO RIG OUR TAX SYSTEM TO BENEFIT THE SUPER RICH — AND CHEAT EVERYBODY ELSE 232 (2003).

Some commentators have argued that in the long run a corporate group whose parent is incorporated outside the United States might be more likely to locate future investments outside the United States. See, e.g., Samuel C. Thompson, Jr., & Robert Allen Clary II, Economic Substance, Inversions, and the Bush-Kerry International Tax Reform Debate, 103 TAX NOTES 1385, 1386 (June 14, 2004) (“[a]lthough the outsourcing problem is larger than inversions, it seems clear that inversions contribute to the movement of capital and jobs offshore.”). But see DAVID L. BRUMBAUGH, CONGRESSIONAL RESEARCH SERVICE, FIRMS THAT INCORPORATE ABROAD FOR TAX PURPOSES: CORPORATE “INVERSIONS” AND “EXPATRIATION,” available at Increased Corporate Inversions Causing Tax Policy Reform Concerns, Says CRS Report, TAX NOTES TODAY (June 12, 2002) (LEXIS, FEDTAX lib., TNT file, elec. cit., 2002 TNT 113-26) [hereinafter CRS INVERSION STUDY]:

In the long run, inversions may be accompanied by some increased level of U.S. investment abroad; a firm that inverts reduces its tax burden on new
change in the country in which the parent corporation's articles of incorporation are filed.\(^4\)

Recent corporate expatriations have been driven by a desire to reduce U.S. income tax liability. The Internal Revenue Code (Code)\(^5\) imposes significant tax consequences based on a corporation's residence,\(^6\) which is determined solely by its place of incorporation.\(^7\) Accordingly, by changing the place of incorporation of the corporate parent, a multinational group might be able to save millions of dollars in U.S. taxes.\(^8\) For example, Cooper Industries anticipated a $55 foreign investment compared to domestic investment. However, any such shift may be small, and the recent corporate inversions do not appear to be accompanied by substantive shifts of economic activity from the United States to locations offshore.

As a practical matter the legal steps that must be taken in order to accomplish this ultimate result are more complicated than merely filing new articles of incorporation in a foreign jurisdiction. For additional details regarding the technical structure of corporate inversions, see TREASURY INVERSION STUDY, supra note 1, at 4–7. See also NY STATE BAR INVERSION REPORT, supra note 3, at 14–20.

The Internal Revenue Code of 1986, as amended (Code), which contains the laws imposing the federal income tax and other taxes, is codified in Title 26 of the United States Code.

The relevant Code provisions and tax consequences are discussed infra notes 19–40 and accompanying text. Technically, a corporation generally is not classified as a resident or nonresident under the Code, but instead is characterized as either "domestic" or "foreign." Cf. Treas. Reg. § 301.7701-5 (2004) (discussing the technical usage of the terms "domestic," "foreign," and "resident" in the context of Treasury Regulations). For convenience, and because this article focuses on the applicability of the residence-based theory of taxation to corporations, this article sometimes refers to the domestic or foreign characterization of a corporation as the corporation's residence.

See I.R.C. § 7701(a)(4) ("[t]he term ‘domestic’ when applied to a corporation . . . means created or organized in the United States or under the law of the United States or of any State . . .").

The anticipated tax benefits flowing from expatriations and related transactions are discussed in more detail infra notes 41–60 and accompanying text. Despite the relatively recent nature of major corporate inversions, at least some of the tax incentives underlying inversions were identified in the early days of the modern income tax. As Professors Graetz and O'Hear observed:

[As early as 1921,] businesses that derived much income from jurisdictions with low income taxes had a tax incentive to trade in their American charters, reincorporate in a foreign jurisdiction, and thereby avoid American taxes.

Even in the early days of income taxation, experience was proving that the corporate form could and would be easily manipulated in order to escape
million annual tax savings from its expatriation,\(^9\) while Ingersoll-Rand expected a $40 million savings in the first year and larger amounts thereafter.\(^10\)

As might be expected, the prospect of large multinational corporations reincorporating abroad to escape U.S. tax liability has attracted significant media and political attention. In the past three years, more than three dozen bills were introduced in Congress to address corporate expatriations,\(^11\) and numerous legislative hearings and debates occurred.\(^12\)

The expatriation phenomenon has, in effect, become a Rorschach test of international tax policy. In interpreting the causes of and appropriate responses to corporate expatriations, legislators have projected their own tax policy belief systems onto the phenomenon.

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residence-based taxation. In the 1920s, such manipulation not only circumvented the residence backstop, but also was considered a threat to American prestige and economic power; many successful American businesses abroad might ultimately be transformed into foreign enterprises. Moreover, those American businesses that remained incorporated in the United States claimed they were being handicapped in competition with foreign firms from countries that exempted all foreign source income from any domestic taxation.


See infra note 68.

For example, some legislators view expatriations in a sympathetic light, as an understandable response to an overreaching tax code, and argue that the phenomenon reflects the need to curtail drastically the scope of U.S. international taxation. Others view the U.S. international tax system as fundamentally sound, or perhaps even too limited in its scope, and characterize expatriations as unpatriotic tax avoidance by greedy corporations. The legislative proposals and debates reflect these widely varying viewpoints.

Despite the significant legislative attention given to corporate expatriations over the past few years, Congress initially refrained from enacting legislation directly addressing the tax consequences of corporate expatriations. Instead, Congress initially targeted the phenomenon through non-tax legislation. That non-tax legislation, part of the Homeland Security Act of 2002, purports to prevent expatriated corporations from entering into government contracts with the Department of Homeland Security. Thus, rather than directly addressing the tax provisions and underlying tax policies implicated by corporate expatriations, Congress initially relied on an "alternative sanction" — i.e., a mechanism outside of the traditional civil and criminal sanctions that is used to stop a perceived abuse of the tax law.

For almost two years following the enactment of this alternative sanction, Congress periodically entertained proposals aimed at the tax

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16 Several states have also enacted or proposed alternative sanctions targeting inverted corporations. See infra notes 79-81 and accompanying text. For a detailed critique of alternative sanctions in the context of individuals who surrender their citizenship for tax-avoidance purposes, see Michael S. Kirsch, Alternative Sanctions and the Federal Tax Law: Symbols, Shaming, and Social Norm Management as a Substitute for Effective Tax Policy, 89 IOWA L. REV. 863 (2004).
consequences of corporate expatriations. The House and the Senate each developed, and passed, their own respective tax-focused bills, which adopted significantly different approaches to the phenomenon. The House-favored bill would have limited certain tax benefits associated with expatriations, but in general would have continued to permit corporations to obtain significant tax benefits by expatriating. In contrast, the Senate-favored bill would have eliminated all tax benefits associated with expatriations by, in effect, disregarding the inversion transaction and continuing to treat the corporate group’s parent as a domestic corporation. Ultimately, in late 2004, Congress enacted the American Jobs Creation Act of 2004 (AJCA), which contained a tax-focused expatriation provision based largely on the Senate’s approach.

This article addresses Congress’s responses to corporate expatriations— in particular the initial alternative sanction contract ban and the more recent tax-focused legislation. Applying theories of symbolic legislation and social norms as well as an analysis of the normative tax policy arguments underlying the Congressional responses, the article concludes that these responses reflect an abdication of Congress’s responsibility to create a coherent and consistent scheme for taxing multinational corporations in an increasingly globalized economy.

Part I of the article provides background information regarding the U.S. taxation of multinational corporations and the tax consequences of corporate expatriations. Part II then provides relevant details regarding Congress’s response to the phenomenon.

Part III analyzes the Congressional response through the lens of symbolic legislation theory. The analysis focuses on the symbolic nature of the alternative sanction purporting to deny future government contracts to inverted corporations, concluding that, like most symbolic legislation, this provision has little instrumental effect. Instead, it is principally intended to allow legislators to claim public credit for having responded to a perceived problem while, at the same time, permitting them to avoid detrimental tax consequences to a politically powerful group of corporations. Part III reaches a similar conclusion with respect to the tax-focused proposal that was favored

17 The House and Senate proposals are discussed infra notes 91–95 and accompanying text.

by the House of Representatives.

Part IV considers whether, despite the lengthy delay in enacting instrumentally effective legislation, the mere fact that Congress debated the issue may have had secondary instrumental effects. In particular, it extends the expressive theory of legislation into an expressive theory of legislative debate to determine whether Congress may have influenced social norms regarding corporate expatriations indirectly.

Finally, Part V focuses on the tax policy implications of Congress's response. In particular, it addresses the expatriation provision of the AJCA. It concludes that this tax provision, by disregarding the expatriated corporation's new foreign place of incorporation, raises fundamental questions as to the central role a corporation's place of incorporation plays under current tax law. It analyzes the tenuous normative justifications for the current place-of-incorporation rule, concluding that the United States should consider alternative rules for determining a corporation's place of residence and should adopt a uniform definition applicable regardless of expatriation status.

I. BACKGROUND — OVERVIEW OF RELEVANT U.S. TAX LAW

A. U.S. Taxation of Multinational Corporations

Two fundamental principles underlie the U.S. taxation of corporations in an international context. First, the United States exercises broad taxing jurisdiction over corporations that are considered domestic residents. Unlike some countries, which generally utilize a “territorial” tax system by taxing corporations only on income that arises within that country, the United States taxes

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19 The following discussion provides only a general overview of U.S. international taxation designed to put the corporate expatriation phenomenon in context.

20 For example, Germany, the Netherlands, Switzerland, and France impose a form of territoriality, whereby resident corporations “can in some circumstances invest in foreign subsidiaries, pay tax in the country in which they make their investment, and pay no (or very little) tax when the earnings from abroad are paid back to the home country.” NY STATE BAR INVERSION REPORT, supra note 3, at 9 (footnote omitted).

21 A territorial system also is referred to as an “exemption” system, because the country exempts income arising outside of its borders. As a practical matter, even those countries that purport to have territorial systems often impose tax on certain types of foreign income, such as passive income earned by their residents. See NY
domestic corporations on their worldwide income, regardless of where the income arises. To the extent a foreign country in which the income arises also taxes the same income, the United States allows the domestic corporation to claim a foreign tax credit to alleviate the potential for double taxation.\textsuperscript{22} This broad taxation of domestic corporations is often referred to as worldwide "residence"-based taxation because it focuses on the relationship between the corporate taxpayer and the United States rather than focusing on the source of the income.

Under a residence-based system it is, of course, important to distinguish between corporations that are U.S. residents and those that are not.\textsuperscript{23} The United States utilizes a place-of-incorporation rule for determining whether a corporation is domestic or foreign.\textsuperscript{24} Thus, a corporation is considered a domestic corporation taxable on its worldwide income if it is organized under the laws of one of the U.S. states.\textsuperscript{25} In contrast, several of the United States's major trading

\textsuperscript{22} See I.R.C. §§ 901-905.

\textsuperscript{23} Professor Graetz has recognized the conceptual difficulty of determining a corporation's residence, observing that "in the case of corporations, the idea of residence is largely an effort to put flesh into fiction, to find economic and political substance in a world occupied by legal niceties. It is no accident that we call corporations doing business around the world 'multinationals.'" Graetz, \textit{supra} note 12, at 320.

\textsuperscript{24} I.R.C. § 7701(a)(4) ("[t]he term 'domestic' when applied to a corporation . . . means created or organized in the United States or under the law of the United States or of any State . . ."). As summarized in a Senate Finance Committee Report:

[The] place of incorporation determines whether a corporation is treated as domestic or foreign for purposes of U.S. tax law, irrespective of other factors that might be thought to bear on a corporation's "nationality," such as the location of the corporation's management activities, employees, business assets, operations, or revenue sources, the exchanges on which the corporation's stock is traded, or the residence of the corporation's managers and shareholders.

\textsuperscript{25} For this purpose, the District of Columbia is treated as a state. I.R.C.
partners that impose worldwide residence taxation utilize standards other than place of incorporation for determining corporate residence.\textsuperscript{26}

In contrast to its broad taxation of domestic corporations, the United States taxes foreign corporations — i.e., corporations incorporated under the laws of a foreign country\textsuperscript{27} — only on income connected to U.S. business operations\textsuperscript{28} and certain nonbusiness income from U.S. sources.\textsuperscript{29} Accordingly, a foreign corporation generally is not subject to U.S. income tax on income that arises outside the United States.

The second fundamental principle underlying the U.S. taxation of corporations in an international context is that the United States generally treats a corporation as a separate taxpayer, distinct from its shareholders. For example, if a parent corporation owns all the outstanding stock of a subsidiary corporation, each corporation generally will be treated as a distinct taxpayer, taxable only on the income that corporation itself earns.\textsuperscript{30}

\textsuperscript{26} Many countries that have adopted worldwide residence-based taxation utilize a standard other than place of incorporation for determining corporate residence, including the location of management, the residence of majority shareholders, or the principal place of business. \textit{See infra} note 243; \textit{see also} JOSEPH ISENBERGH, \textit{INTERNATIONAL TAXATION: U.S. TAXATION OF FOREIGN PERSONS AND FOREIGN INCOME \S 4.4 (3d ed. 2003); DEP'T OF TREASURY, U.S. MODEL INCOME TAX CONVENTION OF SEPT. 20, 1996, art. 4(1), available at http://www.treas.gov/offices/tax-policy/library/model996.pdf [hereinafter U.S. MODEL TAX CONVENTION] (contemplating that a foreign country might determine corporate residence based on “place of management... or any other criterion of a similar nature”). It is possible that a corporation would be treated as a resident of both the United States under the place-of-incorporation rule and another country under that country’s fact-dependent residence rule. \textit{Cf. I.R.C.} \S 1503(d) (preventing double-deduction of losses for dual resident corporations); U.S. MODEL TAX CONVENTION, \textit{supra}, art. 4(3) (providing tiebreaker rules for determining treaty residence of a corporation that is treated as a domestic resident under each country’s laws). In the context of eligibility for tax treaty benefits, the United States has been willing to look to factors other than place of incorporation to determine a corporation’s residence. \textit{See infra} notes 313–320 and accompanying text (discussing the limitation on benefits provision of the recent U.S.-Netherlands tax treaty protocol).

\textsuperscript{27} I.R.C. \S 7701(a)(5).

\textsuperscript{28} I.R.C. \S 882.

\textsuperscript{29} I.R.C. \S 881.

\textsuperscript{30} In the wholly domestic context, affiliated groups of corporations may elect to be treated as a single, consolidated taxpayer. \textit{See} I.R.C. \S\S 1501–1504 and the regulations thereunder.
In the absence of special rules, this separate taxpayer treatment might significantly undermine the residence-based taxation principle. For example, a domestic corporation seeking to earn income from foreign sources could establish a wholly owned subsidiary incorporated in a foreign country and have that foreign subsidiary engage in the foreign income-producing activity. To the extent that the foreign subsidiary is respected as a separate entity, the United States would not currently tax the domestic parent corporation on the income earned by its foreign subsidiary. Moreover, the United States would not tax the foreign subsidiary on the foreign income earned by the subsidiary because, as discussed above, the United States only taxes certain U.S.-related income of a foreign corporation. Eventually, when the foreign subsidiary distributes its earnings to the domestic parent as a dividend, the United States would be able to impose tax because the domestic corporation, which is taxable on its worldwide income, would have received dividend income. However, the timing of that dividend distribution is within the control of the domestic parent corporation.

In effect, by interposing the foreign corporation and delaying the distribution of the foreign corporation’s earnings, the domestic corporation could defer the U.S. taxation of those earnings. If the distributions were delayed long enough, this deferral of U.S. taxation would approximate a permanent exclusion of the foreign income from U.S. taxation. Accordingly, despite the general standard of worldwide taxation applied to domestic corporations, in the absence of special rules, well-advised domestic corporations effectively could exempt significant amounts of foreign income from the U.S. tax base by utilizing foreign subsidiaries.

In order to lessen this ability of domestic corporations to defer U.S. taxation on foreign income through the use of foreign subsidiaries, Congress has enacted several special “anti-deferral” regimes. The most significant of these regimes, particularly with

31 See I.R.C. § 301.
32 See J. Clifton Fleming, Jr., et al., Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income, 5 FLA. TAX REV. 299, 339-40 (2001). As those authors observed, “deferral can be regarded as an indirect, elective method for well-advised U.S. residents to achieve an exemption-like treatment for their foreign-source income.” Id. at 340 (footnote omitted). See also Reuven S. Avi-Yonah, Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State, 113 HARV. L. REV. 1573, 1593 n.70 (2000) (“[D]evelopment is equivalent to exemption of the yield on the amount deferred. Thus, the income earned on foreign source profits of U.S. multinationals becomes exempt from U.S. tax.”) (citations omitted).
respect to corporate expatriations, is the "Subpart F" regime. In effect, the Subpart F regime cuts back on the separate taxpayer treatment generally afforded to corporations by requiring a domestic corporate parent to include certain income of the foreign subsidiary in its own current income. In particular, if the domestic corporation owns a threshold amount of the foreign corporation's stock and the foreign corporation constitutes a "controlled foreign corporation," then the domestic corporation is required to include currently as its own income certain types of foreign income earned by the foreign corporation even though the foreign corporation has not yet distributed those amounts to the domestic corporation as a dividend.

The domestic corporation in the simple fact pattern discussed above, by owning all the stock of a foreign subsidiary, would be subject to the Subpart F regime. However, the regime does not completely eliminate the treatment of the foreign subsidiary as a separate taxpayer. Rather, the Subpart F regime requires the domestic parent to include in its income only certain types of income (Subpart F income) earned by the foreign subsidiary. Accordingly,

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33 See I.R.C. §§ 951–964. The Subpart F regime derives its name from its structural location within the Code (Subpart F of Part III of Subchapter N of Chapter 1 of Subtitle A of the Code).

34 The domestic corporation is treated as a "United States shareholder" of the foreign corporation and therefore potentially subject to a Subpart F inclusion, if it owns (directly, indirectly, or constructively) "10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation." I.R.C. § 951(b).

35 The foreign corporation is a "controlled foreign corporation" if more than fifty percent of the voting power or value of its stock is owned (directly, indirectly, or constructively) by "United States shareholders." I.R.C. § 957(a). As discussed supra note 34, the term "United States shareholder" includes domestic corporations that own at least ten percent of the foreign corporation’s stock.

36 The United States is not alone in establishing anti-deferral regimes. According to the International Fiscal Association, nineteen other developed countries have anti-deferral rules that resemble the U.S. regimes in their broad outlines. Lee A. Sheppard, Preventing Corporate Inversions, Part 3, 95 TAX NOTES 1864, 1865–66 (June 24, 2002).

37 The domestic corporation meets the definition of "United States shareholder" (because it owns at least ten percent of the stock of the foreign corporation) and the foreign subsidiary meets the definition of "controlled foreign corporation" (because more than fifty percent of its stock is owned by a United States shareholder).

the domestic parent is still able to utilize the benefits of deferral with respect to income earned by the foreign subsidiary that is not Subpart F income.

In very broad terms, the types of income earned by the controlled foreign corporation that are considered Subpart F income, and that must therefore be included in the domestic parent's income, include highly mobile passive income, such as interest, dividends, and royalties, and certain business income that does not have sufficient connection to the foreign country in which the foreign subsidiary is incorporated. The types of income that are not considered Subpart F income, and that therefore can continue to receive the benefits of deferral when earned through a foreign subsidiary, include active business income with a sufficient connection to the foreign country in which the foreign subsidiary is incorporated.

B. Tax Consequences of Corporate Expatriations

1. Anticipated Future Tax Benefits to Corporation

The recent wave of corporate expatriations was motivated by anticipated reductions in U.S. income tax liability. These tax savings

\footnote{See I.R.C. §§ 952–954 (defining Subpart F income and components thereof).}

\footnote{See, e.g., I.R.C. § 954(d)(1), (e)(1) (defining foreign base company sales income and foreign base company services income components of Subpart F income).}

The line between Subpart F income, for which the benefits of deferral are eliminated, and non-Subpart F income, which continues to receive the benefits of deferral, does not necessarily reflect a clean, policy-driven divide. Rather, it reflects political compromises that occurred in 1962, at the time of the enactment of Subpart F, and subsequently between those who wanted to fully eliminate the benefits of deferral (i.e., to disregard the separate taxpayer status of foreign subsidiaries) and those who wanted to continue to allow deferral for all income earned by foreign subsidiaries (i.e., to respect the separate taxpayer status of foreign subsidiaries). See Treasury Subpart F Study, supra note 38, at 12–22. The recent spate of corporate expatriations has further fueled this ongoing debate.

\footnote{See supra notes 9–10 and accompanying text (giving examples of anticipated tax savings from corporate inversions by Cooper Industries and Ingersoll-Rand). See also Unofficial Transcript of W & M Hearing on Corporate Inversions, Tax Notes Today (June 12, 2002) (LEXIS, FEDTAX lib., TNT file, elec. cit., 2002 TNT 113-32) (providing testimony of Acting Assistant Secretary of the Treasury Pamela Olson that the “key reasons cited” for inversion transactions are the “substantial reductions in overall corporate taxes”); NY State Bar Inversion Report, supra note 3, at 8 (“A review of public securities filings shows that U.S. corporations are implementing (or at least considering implementing) inversion transactions primarily to save taxes.”) (footnote omitted).}
generally reflected reductions in the U.S. tax on both the foreign income of the corporate group and the U.S.-source income of the corporate group. The following discussion addresses the anticipated tax savings prior to the enactment of the American Jobs Creation Act of 2004.

a. Reduction of U.S. Tax on Foreign Income

The anticipated tax savings with respect to foreign income directly followed from the interaction of the residence-based taxation system and the Subpart F regime summarized in the prior section. As an example, consider a corporate group whose publicly-traded parent is incorporated in the United States and has many subsidiaries incorporated in both the United States and in foreign countries. The corporate parent, as well as each of the U.S.-incorporated subsidiaries, would be treated as domestic taxpayers, and would be taxable on their own worldwide income. Moreover, the corporate parent would be taxable on the foreign income of the foreign subsidiaries to the extent that the income is Subpart F income. In contrast, if the corporate parent of that group were incorporated outside the United States, the Subpart F regime would not apply with respect to foreign subsidiaries of the group (because the ultimate shareholder of the subsidiaries would be foreign, not domestic). Thus, by undergoing an inversion and substituting a foreign-incorporated parent for the U.S.-incorporated parent, the group could avoid future application of the Subpart F regime and ensure that the United States would not impose a corporate-level tax on the foreign income earned by the foreign subsidiaries of the group.

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42 For additional discussion of the tax savings underlying corporate expatriations, see S. REP. NO. 108-192, at 136-41 (2003); TREASURY INVERSION STUDY, supra note 1, at 11-15; NY STATE BAR INVERSION REPORT, supra note 3, at 8-12.

43 This occurs because the corporate parent, as a domestic corporation owning all the stock of the foreign subsidiary, is a “United States shareholder” of a “controlled foreign corporation.” See supra notes 33-36 and accompanying text.

44 In addition, the United States would not tax the foreign income earned by the foreign corporate parent itself. To the extent the group has subsidiaries incorporated in the United States, the United States would continue to tax those domestic subsidiaries on their worldwide income. Presumably, the group could structure its operations so that most of the group’s foreign income is earned by the foreign subsidiaries rather than the domestic subsidiaries.

45 In particular, it would eliminate the U.S. tax on foreign Subpart F income, described supra notes 39-40 and accompanying text, which would have been taxable.
Because inversions attempt, at least in part, to eliminate tax on the corporate group's foreign income, the Treasury Department has referred to the transactions as "self-help territoriality." Several commentators have defended this self-help use of corporate inversions to reduce the U.S. taxation on the group's foreign income, arguing that it is a necessary response by U.S. multinationals who must compete in the global economy against corporations whose home countries utilize a more limited territorial system. Others have strongly criticized this argument as being overly simplistic and misleading.

b. Reduction of U.S. Tax on U.S. Income

In addition to seeking a reduction of U.S. tax on foreign income, corporations expatriated in an attempt to reduce U.S. tax on their

had the corporate parent remained domestic.

46 TREASURY INVERSION STUDY, supra note 1, at 29; see also Unofficial Transcript of Hearing on Corporate Inversions, TAX NOTES TODAY (July 1, 2002) (LEXIS, FEDTAX lib., TNT file, elec. cit., 2002 TNT 126-67) (relating the statement of Rep. McCrery, Chair of the Select Revenue Measures Subcomm. of the Ways & Means Comm., that "... the inverted company generally structures its affairs so as to avoid United States tax on its global income, thereby getting around our worldwide tax system. This has sometimes been referred to as 'self-help' territoriality."); Samuel C. Thompson, Jr., Section 367: A "Wimp" for Inversions and a "Bully" for Real Cross-Border Acquisitions, 94 TAX NOTES 1505, 1507 (March 18, 2002) ("The effect of the pure inversion and related transactions is to achieve de facto territorial taxation, which exempts all foreign income from taxation until repatriated."). The self-help territoriality obtained through an inversion transaction would provide even more relief than would be provided through a de jure territorial system. According to the Treasury Inversion Study:

One difference is in the treatment of any passive income earned abroad. The territorial tax systems of most of our trading partners include rules imposing tax on passive income earned from foreign sources. Where the foreign parent of an inverted company is located in a no-tax country, passive income earned abroad may not be subject to tax anywhere.

TREASURY INVERSION STUDY, supra note 1, at 29 n.50. See also NY STATE BAR INVERSION REPORT, supra note 3, at 22 & n.47 ("[M]ost so-called territorial systems do not provide a blanket exemption that is as favorable as the intended tax treatment of the inverted company," particularly with respect to passive income.).

47 See infra notes 82-85 and accompanying text. See also NY STATE BAR INVERSION REPORT, supra note 3, at 22 ("This aspect of inversions [eliminating U.S. taxation on foreign income] has many defenders, who point out that many other jurisdictions have territorial systems that eliminate home country tax on much (or even all) foreign source income.").

48 See infra notes 86-89 and accompanying text.
U.S. income. Indeed, this goal may have been even more important than the anticipated post-inversion reduction in taxes on foreign income.49

Following the inversion, only the U.S. subsidiaries of the corporate group generally would be subject to significant U.S. income taxation.50 The corporate group could then engage in various transactions to reduce the taxable income of those U.S. subsidiaries. For example, a subsidiary could be structured to owe significant indebtedness to the foreign parent. The large interest payments from the U.S. subsidiary to the foreign corporation would be deductible in calculating the subsidiary's taxable income, thereby reducing its tax liability.51 Similar opportunities for reducing a domestic subsidiary's

49 See TREASURY INVERSION STUDY, supra note 1, at 22 ("[N]otwithstanding the longer-term competitive benefits related to the tax treatment of future foreign operations or foreign acquisitions, the decision to enter into the inversion may be dependent in many cases upon the immediate expected reduction in U.S. tax on income from U.S. operations."). See also Lee A. Sheppard, Turbo-Charged Income Stripping, TAX NOTES TODAY (Dec. 6, 2002) (LEXIS, FEDTAX lib., TNT file, elec. cit., 2002 TNT 235-4) ("In its inversion report, the Treasury recognized that what really gets the inverting CFO's attention is the immediate potential for stripping income out of the United States. Tax savings on foreign income are a future benefit.").

50 The new foreign parent and the foreign subsidiaries generally would not have significant amounts of income connected with a U.S. business or arising from U.S. sources. See supra notes 27-29 (discussing taxation of foreign corporations). Although the foreign parent would generally be subject to a thirty percent withholding tax with respect to any dividends paid to it by the U.S. subsidiary, see I.R.C. § 881(a)(1), inversions often are structured so that such dividends are eligible for a significantly reduced withholding rate under a tax treaty. See TREASURY INVERSION STUDY, supra note 1, at 12-13, n.27 (describing the use of the U.S.-Barbados tax treaty to secure a reduced five percent U.S. withholding tax on dividends paid by the U.S. subsidiary to the new post-inversion foreign parent); William G. Gale, Notes on Corporate Inversions, Export Subsidies, and the Taxation of Foreign-Source Income, 27 TAX NOTES INT'L 1495, 1502 (Sept. 23, 2002) (describing the importance of tax treaties in enabling the inversion structure to reduce taxation on U.S. income).

51 As the Treasury Department observed:

One of the simplest ways for a foreign-based company to reduce the U.S. tax on income from U.S. operations is through deductions for interest payments on intercompany debt.... The U.S. subsidiary can be loaded up with a disproportionate amount of debt for earnings stripping purposes through the mere issuance of an intercompany note. Thus, the desired earnings stripping, and U.S. tax reduction, can be accomplished without any real movement of assets or change in operations.

TREASURY INVERSION STUDY, supra note 1, at 21. Senator Grassley described this
U.S. income exist through the use of structures involving manipulation of royalties, management fees, administrative fees, and transfer prices.\textsuperscript{52} Because these approaches enable the domestic subsidiary to shift taxable income away from the domestic subsidiaries that otherwise would be taxed on it, the phenomenon is often referred to as "earnings stripping."\textsuperscript{53}

The Code contains several provisions that purport to limit a corporate group's ability to shift income away from domestic subsidiaries using these techniques.\textsuperscript{54} For example, section 163(j) aims to limit "interest stripping" by limiting the extent to which a corporation that is excessively leveraged with debt can deduct interest payments to related corporations.\textsuperscript{55} Similarly, section 482 and the extensive regulations thereunder attempt to prevent corporations under common control from charging each other non-arms-length prices in an attempt to shift income improperly within the group.\textsuperscript{56} However, there is general consensus that these provisions did not significantly reduce the potential opportunities for reducing U.S. tax on U.S. income following an inversion.\textsuperscript{57}

Unlike the reduction of tax on foreign income resulting from

\textsuperscript{52} See NY STATE BAR INVERSION REPORT, \textit{supra} note 3, at 23 & n.50.

\textsuperscript{53} See TREASURY INVERSION STUDY, \textit{supra} note 1, at 21.

\textsuperscript{54} These provisions are not specific to corporate groups that have undergone inversions, as they apply generally to any relevant payments between related corporations.

\textsuperscript{55} I.R.C. § 163(j).

\textsuperscript{56} I.R.C. § 482.

\textsuperscript{57} See TREASURY INVERSION STUDY, \textit{supra} note 1, at 20–26. The Treasury Department acknowledged the limitations of section 163(j) when it observed "[t]he prevalent use of foreign related-party debt in inversion transactions is evidence that these rules should be revisited." \textit{Id.} at 22.
inversions, which at least has some defenders, this use of corporate inversions to reduce U.S. tax on U.S. income has been uniformly condemned. Even those who defend, or at least express some sympathy for, corporations inverting to reduce U.S. tax on foreign income, tend to criticize the use of inversions to reduce tax on income arising in the United States.

2. Immediate Tax Consequences to Corporation and Shareholders

The anticipated tax benefits for an expatriating corporation did not come without a potential tax cost. In particular, a corporate inversion could generate immediate tax consequences to both the corporation and also to its shareholders.

At the shareholder level, Code section 367 and the Treasury Regulations thereunder could require the shareholders of the domestic parent corporation to recognize gain at the time of the inversion, particularly if the inversion is structured as a stock transaction (i.e., the shareholders exchange their stock in the old domestic parent for stock in the newly formed foreign parent). In effect, the shareholder would be treated as if she sold the stock of the

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58 See supra note 47 and accompanying text.

59 The New York State Bar Report observed that “[t]he earnings stripping aspect of inversions has few defenders from a policy perspective.” NY STATE BAR INVERSION REPORT, supra note 3, at 24; see also Martin A. Sullivan, Congress’s Inversion Odyssey: Oh the Places You’ll Go, 96 TAX NOTES 9, 11 (July 1, 2002) (“[I]nversions are about tax relief for foreign- and U.S.-source income.... They provide an off-shore platform for aggressive tax avoidance that borders on evasion.”). While the Treasury study criticizes this aspect of inversions, it tempers its criticism of inversions by noting that the opportunities for earnings stripping are not limited to corporate groups that have undergone corporate inversions. See TREASURY INVERSION STUDY, supra note 1, at 22.

60 See, e.g., TREASURY INVERSION STUDY, supra note 1, at 22; Cym H. Lowell, Inversion Transactions: Solutions to Exacerbate Planning Hurdles?, J. INT’L TAX’N, Oct. 2002, at 31 (sympathizing with the use of inversions in order to prevent U.S.-based companies from being placed at a competitive disadvantage with respect to their foreign income, but noting that “careful attention should be focused on ensuring that an inversion transaction... cannot be used to reduce inappropriately the U.S. tax on income from U.S. operations”).

61 For a more detailed summary of the relevant pre-AJCA tax consequences to shareholders and the corporation as a result of the inversion, see TREASURY INVERSION STUDY, supra note 1, at 7-11. For a thorough analysis of the pre-AJCA tax consequences to various forms of inversion transaction structures, see Thompson, supra note 46.

old corporation, with the recognized gain equal to the excess of the fair market value of the stock over the shareholder's adjusted basis in the stock.\textsuperscript{63}

At the corporation level, Code section 367 and the Treasury Regulations thereunder could require the old domestic parent corporation to recognize gain at the time of the inversion, particularly if the inversion is structured as an asset transaction (i.e., a transfer of the corporate group assets from the old corporation to the newly formed foreign corporation). Under this transaction, the domestic corporation would recognize gain as if all its assets had been sold for fair market value at the time of the transaction.\textsuperscript{64} The corporation might be able to offset some of the tax on this gain by applying a foreign tax credit or net operating losses, thereby reducing the tax cost of the transaction.\textsuperscript{65}

As a practical matter, this potential for tax consequences at the shareholder and corporation level did not dissuade numerous corporations from expatriating in the first few years of this decade. This lack of deterrent effect has been attributed to several factors. For example, the fall in the stock market from its historic highs in the late 1990s made the potential section 367 shareholder and corporate taxable gain significantly smaller.\textsuperscript{66} The tax impact was further

\textsuperscript{63} Treas. Reg. § 1.367(a)-1T 3(a), (c) (2005). There are significant complexities and exceptions to this general rule that are not relevant to the discussion in this article.

\textsuperscript{64} See I.R.C. § 367(a)(1), (5). See generally TREASURY INVERSION STUDY, supra note 1, at 9 (discussing exceptions to this gain recognition requirement); Thompson, supra note 46, at 1546-48 (arguing that section 367 should be revised to make it a more effective deterrent to corporate inversions).

\textsuperscript{65} See I.R.C. § 902. See also H.R. REP. NO. 108-548, pt. 1, at 244 (2004); Thompson & Clary, supra note 3, at 1387 (illustrating applicability of foreign tax credit to reduce tax on gain in Cooper Industries inversion).

\textsuperscript{66} Because the shareholder's gain is based, in part, on the fair market value of the stock at the time of the transaction, the depressed value of the stock would limit the amount of gain recognition. Indeed, if the fair market value of the stock had fallen below the shareholder's adjusted basis (generally, her original cost), the shareholder would not recognize any gain from the inversion. See generally TREASURY INVERSION STUDY, supra note 1, at 17-18; NY STATE BAR INVERSION REPORT, supra note 3, at 12-13; Avi-Yonah, supra note 24, at 1794-95; Thompson, supra note 46, at 1546 ("[W]ith the recent decline in the stock market, many companies could apparently enter into inversion transactions without causing their shareholders to realize substantial gains.... This may be one of the reasons that Cooper Industries has proposed its inversion transaction at this time."); cf. Elizabeth Chorvat, You Can't Take It With You: Behavioral Finance and Corporate Expatriations, 37 U.C. DAVIS L. REV. 453, 505-09 (2003) (proposing a Code
reduced to the extent that the corporation's shareholders were tax-exempt institutions or foreign taxpayers, for which the requirement of gain recognition had no practical effect.  

II. THE CONGRESSIONAL RESPONSE TO CORPORATE EXPATRIATIONS

The corporate expatriation phenomenon occupied Congress's attention for almost three years. During that period, more than thirty bills were introduced targeting corporations that engage in inversion transactions. However, despite the strong legislative spotlight

amendment to make gain dependent on the stock's value during a two-year window, rather than on the value on the date of the transaction, thereby reducing the incentive to expatriate during a downturn in the market).

67 NY STATE BAR INVERSION REPORT, supra note 3, at 13.

focused on inversions, Congress initially enacted only one provision specifically targeting corporate expatriates. That law, rather than focusing on tax consequences, instead addresses an area far removed from tax policy — the ability of the expatriated corporation to enter into government contracts with the Department of Homeland Security. As noted above, this purported contract ban is an example of Congress's recent attempt to impose non-tax “alternative sanctions” in an effort to address perceived abuses of the tax laws. Only after an additional two years of debate did Congress enact legislation targeting the tax consequences of corporate expatriation in late 2004.

The following subparts first explain the Homeland Security alternative sanction, and then summarize the legislative proposals and recently enacted legislation that focus on changing the tax consequences to expatriating corporations.

A. Alternative Sanctions — Restrictions on Future Government Contracts

In November 2002 Congress passed, and President Bush signed,
the Homeland Security Act of 2002, establishing the Department of Homeland Security. Section 835 of that Act contained the alternative sanction addressing corporate expatriations. That section provides, in general, that “[t]he Secretary [of Homeland Security] may not enter into any contract with a foreign incorporated entity which is treated as an inverted domestic corporation.”

As originally enacted, this alternative sanction contained important exceptions. The exceptions provided:

The Secretary [of Homeland Security] shall waive [the ban] with respect to any specific contract if the Secretary determines that the waiver is required in the interest of homeland security, or to prevent the loss of any jobs in the United States or prevent the Government from incurring any additional costs that otherwise would not occur.

Critics quickly noted that these exceptions eviscerated the statutory ban. In particular, by providing an exception for any contract that imposes “any additional costs that otherwise would not occur,” the provision continued to allow a foreign corporate parent to enter into a contract if it was the low bidder. Several months later, in response to these charges, Congress amended the alternative sanction by eliminating the exceptions concerning loss of jobs or imposing additional costs on the government. Accordingly, only the “in the interest of homeland security” exception remains. Despite this

75 Id. § 835(d), 116 Stat. at 2229.
76 See infra notes 117–118 and accompanying text.
77 See Homeland Security Act Amendments of 2003, Pub. L. No. 108-7, § 101(2), 117 Stat. 526, 528 (2003). That amendment provides that all of the language in section 835(d) of the Homeland Security Act following the words “homeland security” is deleted, thereby deleting the contract ban’s exception for contracts that may cause the loss of jobs or that may impose additional costs on the government. Cf. text accompanying supra note 75 (citing the text prior to the amendment). Following this amendment, section 835(d) of the Homeland Security Act provides that “[t]he Secretary [of Homeland Security] shall waive subsection (a) with respect to any specific contract if the Secretary determines that the waiver is required in the interest of homeland security.” 6 U.S.C.A. § 395(d) (West Supp. 2004).
amendment, the current provision still has only limited instrumental impact. The significant instrumental shortcomings of the provision are discussed below in the context of symbolic legislation theory.⁷⁸

Although this article focuses on the congressional response to corporate expatriations, it is interesting to note that several states have also enacted alternative sanctions targeting inverted corporations. For example, in 2003 California enacted a law providing, in general, that "a state agency may not enter into any contract with an expatriate corporation or its subsidiaries."⁷⁹ Similarly, North Carolina enacted a provision prohibiting state contracts for goods or services with corporations or their affiliates that incorporate in certain specified tax haven countries after 2001 and the stock of which is principally traded in the United States.⁸⁰ Legislators in several other states have proposed similar bills."⁸¹

⁷⁸ See infra notes 101-134 and accompanying text.
⁷⁹ California Taxpayer and Shareholder Protection Act of 2003, CAL. PUB. CONT. CODE § 10286.1(a) (West 2004). Unlike the federal contract ban on Homeland Security contracts, the California contract ban extends its reach to subsidiaries of the foreign parent corporation. The California statute contains several exceptions, including a provision allowing

[t]he chief executive officer of a state agency [to] waive the prohibition . . . if the executive officer . . . has made a written finding that the contract is necessary to meet a compelling public interest, . . . [such as] ensuring the provision of essential services, ensuring the public health and safety, or an emergency. . . .

Id. § 10286.1(c).
B. Proposals to Modify the Tax Laws

In addition to its enactment of the Homeland Security Act's non-tax alternative sanction, Congress also debated proposals and considered numerous bills that would alter the tax treatment of inverted corporations. After nearly three years, Congress ultimately enacted a tax-focused provision in late 2004.

The tax-focused proposals regarding corporate expatriation fell into two broad categories: (a) broad suggestions that the entire U.S. tax regime applicable to international transactions be overhauled, and (b) narrower proposals specifically targeted at the post-expatriation tax consequences applicable to corporate groups that engage in inversion transactions.

1. Broad Proposals to Overhaul Entire International Tax Regime

With respect to the first category, critics of the federal tax system argue that corporate expatriations are merely a symptom of much broader problems underlying the manner in which the United States taxes income earned in an international context. In particular, it is argued that the worldwide residence-based income taxation of corporations hampers the competitiveness of U.S.-based multinational corporations in an ever more globalized world, thereby forcing corporations to expatriate in order to remain competitive. For example, Bill Thomas, the chairman of the House Ways and Means Committee, observed with respect to corporate inversions:

I'm less inclined to say "you can't do it" than I am to treat it
as a symptom, examine the underlying disease — and it’s the tax code and [its] failure to be even minimally useful to these folk — and deal with the fact that the U.S. is out of sync with the rest of the world[.] . . . We are not well equipped to deal with trade in the 21st century; we have to change our tax code.\textsuperscript{82}

Similarly, the Bush Administration, as evidenced by the Treasury Inversion Study,\textsuperscript{83} views the corporate inversion phenomenon as evidence of a need to reexamine the tax code to make it more favorable for U.S.-based companies competing in an international marketplace.\textsuperscript{84} Similar sentiments were expressed in congressional proposals, primarily by House Republicans, to address corporate


\textsuperscript{83} \textit{TREASURY INVERSION STUDY}, \textit{supra} note 1.

\textsuperscript{84} \textit{See} \textit{TREASURY INVERSION STUDY}, \textit{supra} note 1, at 2 (in addressing corporate inversions, “[w]e also must work to address the U.S. tax disadvantages that are caused for U.S.-based companies that do business abroad relative to their counterparts in our major trading partners.”). The study also states that

[b]oth the recent inversion activity and the increase in foreign acquisitions of U.S. multinationals are evidence that the competitive disadvantage caused by our international tax rules is a serious issue with significant consequences for U.S. business and the U.S. economy. A comprehensive reexamination of the U.S. international tax rules is needed.

\textit{Id.} at 29. In a statement accompanying the study, then-Secretary of the Treasury Paul O’Neill stated:

[I]f the tax code disadvantages U.S. companies competing in the global marketplace, then we should address the anti-competitive provisions of the [C]ode. I don’t think anyone wants to wake up one morning to find every U.S. company headquartered offshore because our tax code drove them away and no one did anything about it.

expatriations.\textsuperscript{85}

In response, numerous other commentators argue that the focus on the expatriation phenomenon as a reason to move from a residence-based system to a territorial system is merely a "red herring,"\textsuperscript{86} or an excuse to "change the subject" away from the earnings stripping that primarily is driving the expatriations.\textsuperscript{87} These

\textsuperscript{85} The House Ways and Means Committee report accompanying the original House-passed version of the American Jobs Creation Act of 2004, H.R. 4520, 108th Cong. (2004), states "[t]he Committee believes that corporate inversion transactions are a symptom of larger problems with our current uncompetitive system for taxing U.S.-based global businesses and are also indicative of the unfair advantages that our tax laws convey to foreign ownership." H.R. REP. No. 108-548, pt. 1, at 242–46 (2004). See infra note 93 (discussing House Bill 4520). See also H.R. 1531, 108th Cong. § 402(b) (2003); H.R. 1308, 108th Cong. § 103(b) (2003) (legislative proposals expressing the "sense of Congress that passage of legislation to fix the underlying problems with our tax laws is essential and should occur as soon as possible, so United States corporations will not face the current pressures to engage in inversion transactions").

Those arguing for a broad-based overhaul of the U.S. international tax regime advocate various solutions. For example, some suggest that the United States abandon the worldwide taxation of the business income of its residents and instead adopt a territorial approach to taxation. See, e.g., Herman B. Bouma, Corporate Expatriations: If There's a Problem, It's 'Place of Incorporation' Rule, DAILY TAX REP. (BNA), Nov. 22, 2002, at J-1 (concluding that a territoriality system is the best approach for taxing international business income, because under such a system there generally would be no need for a determination of a corporation's residence). Bouma, in noting that some kind of anti-abuse rules might be necessary to ensure taxation of passive income not connected with business activity in any country, implicitly acknowledges that his proposal might need a definition of corporate residence for some limited circumstances. See id. Numerous commentators have argued in favor of moving the U.S. tax system away from a worldwide residence system for corporations and toward a territorial system even outside of the corporate inversion debate. See, e.g., Graetz, supra note 12, at 320–23. Others argue that more drastic reforms are necessary, such as the implementation of a value added tax in lieu of an income tax on international income. See, e.g., James H. Ditkoff, The Real Solution to Corporate Expatriations: A Territorial VAT, DAILY TAX REP. (BNA), Jan. 9, 2003, at J-1; see also Chris Edwards, Cato Policy Analysis Addresses Corporate Tax 'Distortions', TAX NOTES TODAY (Aug. 14, 2003) (LEXIS, FEDTAX lib., TNT file, elec. cit., 2003 TNT 158-23) (arguing that "U.S. firms would not be pursuing inversions unless there was something seriously wrong with the U.S. tax system," and that the corporate income tax should be replaced with a cash-flow tax).

\textsuperscript{86} Avi-Yonah, supra note 24, at 1795 ("I would like to emphasize that in the inversion context the competitiveness issue is the reddest of red herrings — a completely irrelevant line of argument.").

\textsuperscript{87} Sheppard, supra note 49 (arguing that the principal reason for inversions is the ability to reduce U.S. taxes on domestic income through earnings stripping, and that
commentators defend the importance of retaining residence-based worldwide taxation as the general rule for corporations. Indeed, some commentators argue that the worldwide residence-based taxation regime should be strengthened by the expansion of the anti-deferral regimes, such as Subpart F, so that U.S. corporations cannot avoid current taxation on their active business income through the use of foreign subsidiaries.

Because the arguments in favor of and against the broad overhaul of the U.S. international tax system have been discussed in detail elsewhere, this article does not purport to revisit them. Rather, this article assumes that the United States will retain the broad contours of its existing system for taxing corporations in an international setting. Of more interest for purposes of this article are those tax proposals, including the tax provision ultimately enacted, that purport to target the inversion phenomenon without changing the general residence-based income tax regime applicable to corporations. Those proposals are summarized in the following section.

the Treasury Inversion Study’s suggestion regarding the tax system is an attempt to “change the subject”). Similarly, another commentator observed that the “bluster about big-picture concepts of territoriality and tax reform” is “just a sideshow,” Sullivan, supra note 59, at 9–10, and that

the biggest problem with the assertion of the close relationship between territoriality and inversions is that territoriality is about tax relief for foreign-source income while inversions are about tax relief for foreign- and U.S.-source income. Inversions are more than self-help territoriality. They provide an off-shore platform for aggressive tax avoidance that borders on evasion.

Id. at 11; see also Thompson & Clary, supra note 3, at 1388 (criticizing the Treasury Department’s assertion that corporate inversions are evidence of the need to reconsider the existing tax regime in order to maintain U.S. corporations’ international competitiveness).


89 See Fleming et al., supra note 32, at 350–54.

90 That is, the worldwide taxation of corporations considered to be domestic residents, along with a foreign tax credit to prevent double taxation and some type of anti-deferral regime, such as Subpart F, that backstops worldwide taxation with respect to certain income earned through foreign subsidiaries. See supra Part I.A.
2. Narrow Proposals Targeted at Inversion Transactions

As noted above, legislators introduced more than thirty bills addressing corporate expatriations. The large majority of these proposals targeted the specific tax consequences that flow from corporate expatriations. From these bills, two leading proposals emerged: (i) a proposal passed by the Senate that would have treated the new foreign corporate parent as a domestic corporation following a corporate inversion, and (ii) a proposal passed by the House that would have modified specific provisions of the tax code that affect the tax consequences of certain inversion transactions, but would have respected the new post-inversion parent corporation as a foreign

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91 See supra note 68.


The Senate-passed proposal was introduced by Senator Charles Grassley, Chairman of the Senate Finance Committee, and co-sponsored by Senator Max Baucus, ranking minority leader of the Committee. The bill would have added a new Code section 7874, which would have provided that "[i]f a foreign incorporated entity is treated as an inverted domestic corporation, then, notwithstanding section 7701(a)(4), such entity shall be treated for purposes of this title as a domestic corporation." S. 1637, § 441(a). A foreign corporation was to be treated as an inverted domestic corporation if (i) the inversion transaction was completed after March 20, 2002, (ii) there was at least 80 percent continuity of ownership in the post-inversion foreign corporation by the stockholders of the pre-inversion domestic corporation, and (iii) the corporation's expanded affiliated group did not have substantial business activities, relative to its worldwide activities, in the new country of incorporation. Id. In this regard, the Senate bill is similar to the Reversing the Expatriation of Profits Offshore (REPO) Act, S. 2119, 107th Cong. § 2 (2002), co-sponsored by Senators Grassley and Baucus during the 107th Congress, and to S. 2050, 107th Cong. (2002). For analysis of the inversion provisions of the earlier REPO Act, see NY STATE BAR INVERSION REPORT, supra note 3, at 48-59.

While the domestic taint of the Senate bill would have applied only to inversions occurring after March 20, 2002, the bill also would have imposed lesser tax consequences with respect to inversions occurring after December 31, 1996, and before March 20, 2002, which are similar to the proposed rules regarding inversion gain contemplated by House Bill 4520, discussed infra note 93. See S. 1637, § 441(a) (adding Code section 7874(b)-(d)).
corporation under general Code definitions.93

The Senate bill, by continuing to treat the post-expatriation foreign-incorporated parent as a domestic corporation, would have overridden the place-of-incorporation rule in the case of inversion transactions. In so doing, it would have effectively shut down future inversions by removing the potential tax benefits — i.e., the ability to escape the Subpart F regime for income earned through foreign subsidiaries and the ability to shift some U.S. income out of the U.S. tax base.94

Although the House provisions might have reduced some tax benefits associated with inversion transactions, the expatriated company still would have been able to obtain the benefits of avoiding the Subpart F regime on future foreign income, as it could have under then-existing law. Accordingly, the House proposal would have had less of an impact on companies contemplating expatriation than the Senate proposal would have had.95

C. Enactment of New Tax Provision

As part of the American Jobs Creation Act of 2004 (AJCA),

93 H.R. 4520, § 601(a) (as passed by the House on June 17, 2004). The bill passed the House by a 251-178 margin. 150 CONG. REC. H4433 (daily ed. June 16, 2004) (roll no. 259). Representative Bill Thomas, Chairman of the House Ways and Means Committee, introduced the bill. The bill would have added a new Code section 7874(a) limiting the ability of the former domestic parent corporation to utilize tax attributes, such as net operating losses or foreign tax credits, to reduce the tax owed on any gain recognized in an inversion transaction occurring after March 4, 2003. In addition, the bill would have imposed an excise tax on certain stock options held by executives of expatriating corporations. See H.R. 4520, § 602(a). The bill also requires the Treasury Department to conduct several studies with respect to corporate expatriations, including studies on the effects of the transfer pricing rules, tax treaties, and the U.S. income tax provisions generally. See H.R. 4520, § 606.

94 The potential tax benefits arising from expatriations under current law are discussed supra notes 41–60.

95 As Thompson and Clary observed:

[The Senate] approach would effectively bring an end to inversions. . . .

[The House proposal] contains a much weaker anti-inversion provision than the one in the JOBS Act. [The House proposal] contains a provision that would not permit net operating losses and other tax attributes to offset corporate-level gain realized by the inverted corporation. Because a corporation can control the amount of corporate-level gain it recognizes in an inversion, this provision is not likely to be effective in stopping inversions.

Thompson & Clary, supra note 3, at 1386.
Congress ultimately adopted a tax-focused provision based on the Senate approach. In particular, the AJCA provision treats the post-expatriation foreign-incorporated parent as a domestic corporation, thereby overriding the place-of-incorporation rule in the case of inversion transactions. This continued domestic taint removes the

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96 Pub. L. No. 108-357, § 801(a), 118 Stat. at 1562 (2004). The Act added new Code section 7874(b), which provides:

(b) INVERTED CORPORATIONS TREATED AS DOMESTIC CORPORATIONS. — Notwithstanding section 7701(a)(4), a foreign corporation shall be treated for purposes of this title as a domestic corporation if such corporation would be a surrogate foreign corporation if subsection (a)(2) were applied by substituting “80 percent” for “60 percent”.

Pub. L. No. 108-357, § 801(a), 118 Stat. at 1563 (2004). The foregoing provision cross-references the definition of “surrogate foreign corporation” in new Code section 7874(a)(2)(B), which provides in relevant part as follows:

(B) SURROGATE FOREIGN CORPORATION. — A foreign corporation shall be treated as a surrogate foreign corporation if, pursuant to a plan (or a series of related transactions) —

(i) the entity completes after March 4, 2003, the direct or indirect acquisition of substantially all of the properties held directly or indirectly by a domestic corporation . . . ,

(ii) after the acquisition at least 60 percent of the stock (by vote or value) of the entity is held —

(I) in the case of an acquisition with respect to a domestic corporation, by former shareholders of the domestic corporation

by reason of holding stock in the domestic corporation, . . .

(iii) after the acquisition the expanded affiliated group which includes the entity does not have substantial business activities in the foreign country in which, or under the law of which, the entity is created or organized, when compared to the total business activities of such expanded affiliated group.


97 This domestic taint generally applies only with respect to an inversion completed after March 4, 2003. See I.R.C. § 7874(a)(2)(B)(i), (b) (as added by Pub. L. No. 108-357, § 801(a), 118 Stat. at 1563). In contrast, the Senate proposal would have applied the domestic taint to inversions completed after March 20, 2002. See H.R. REP. No. 108-755, at 453 (2004). Also, this domestic taint applies only if there is at least eighty percent continuity of ownership in the post-inversion foreign corporation by the stockholders of the pre-inversion domestic corporation. See I.R.C. § 7874(a)(2)(B)(ii), (b) (as added by Pub. L. No. 108-357, § 801(a), 118 Stat. at 1563). If there is less than eighty percent continuity of ownership, but at least sixty percent continuity, lesser tax consequences apply. See I.R.C. § 7874(a) (as added by Pub. L. No. 108-357, § 801(a), 118 Stat. at 1562–63). These consequences are similar to the House-passed proposal, which would have limited the ability of the former domestic parent corporation to utilize tax attributes, such as net operating losses or
potential tax benefits otherwise available if the corporate parent were treated as a foreign corporation.

III. SYMBOLIC ASPECTS OF CONGRESS’S RESPONSE TO CORPORATE EXPATRIATIONS

A. Symbolic Legislation — In General

Congress’s initial legislative response to corporate expatriates — the alternative sanction barring contracts with the Department of Homeland Security — is best understood through the lens of symbolic legislation theory. In addition, this theory sheds light on the tax-focused proposal that was favored by the House of Representatives.

According to this theory, “symbolic legislation serves the needs of the public by indicating that Congress is ‘doing something’ about a perceived problem and, accordingly, serves the needs of its legislative supporters by making them appear effective and enhancing their chances for reelection.” Murray Edelman is credited with laying the foundation for the modern study of symbolic legislation. The author previously summarized Edelman’s theory as follows:

Under Edelman’s view, for most individuals politics is “a series of pictures in the mind, placed there by television news,

foreign tax credits, to reduce the tax owed on any gain recognized in an inversion transaction. See supra note 92.

The AJCA also imposes an excise tax on certain stock options held by certain insiders in expatriated corporations, which is based on similar provisions that previously were included in the House and Senate bills. See Pub. L. No. 108-357, § 802, 118 Stat. at 1566. In addition, the legislation requires the Treasury Department to prepare a study, no later than December 31, 2006, analyzing the effectiveness of the AJCA provisions with respect to corporate inversions. Id. § 806(c), 118 Stat. at 1575.

Kirsch, supra note 16, at 921 (footnote omitted). As Daniel Shaviro observed, “proposing and enacting legislation is a means of symbolic communication with members of the general public, of causing them to like a politician without the inconvenience (and possible political inconsequence) of actually having to benefit them tangibly. Thus, without regard to its actual effects, legislation can promote reelection.” Daniel Shaviro, Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s, 139 U. PA. L. REV. 1, 8–9 (1990) (footnote omitted).

Murray Edelman, The Symbolic Uses of Politics (1964); see also Charles D. Elder & Roger W. Cobb, The Political Uses of Symbols 1 (1983). For the author’s detailed application of the theory of symbolic politics in the context of Congress’s response to U.S. citizens renouncing their citizenship to avoid taxes, see Kirsch, supra note 16, at 921–30. For an extensive list of research applying symbolic politics theory to federal tax legislation and other areas, see id. at 921 n.255.
newspapers, magazines, and discussions,” constituting a “passing parade of abstract symbols.” As a result, “most citizens have only a foggy knowledge of public affairs though often an intensely felt one.” This observation may be particularly true in the context of tax legislation, where the details are often mired in the densely worded, definition-laden, exception-filled language of the Code. In this context, according to Edelman’s theory, the principal function of much legislation, as well as other forms of political participation, is to provide symbolic reassurance to the public, while only a small group of interested, involved persons generally receives any tangible benefit from the legislation.\(^\text{100}\)

Subpart B explores the implications of this theory in the context of the Homeland Security contract ban alternative sanction. Subpart C applies a similar analysis to the House’s proposed tax legislation addressing corporate expatriations.

\section*{B. Alternative Sanctions as Symbolic Political Response}

In 2002, during the second session of the 107th Congress, Congress spent considerable time focusing on the perceived problem of corporate expatriations, holding several hearings\(^\text{101}\) and entertaining numerous bills.\(^\text{102}\) This Congressional attention coincided with extensive coverage of the topic in the popular press.\(^\text{103}\) Much of the

\begin{itemize}
\item \(^\text{100}\) Kirsch, supra note 16, at 921–22 (footnotes omitted).
\item \(^\text{101}\) See supra note 12.
\item \(^\text{102}\) See supra note 68 (listing tax proposals addressing corporate inversions, including more than ten bills introduced during the 107th Congress).
\item \(^\text{103}\) The following is a limited sample of the many newspaper and magazine articles and editorials that addressed this topic during 2002: Editorial, Inversion Subversion, WASH. POST, June 9, 2002, at B6; Molly Ivins, Commentary, GOP Gifts: Payback Not Patriotism, CHI. TRI., Nov. 28, 2002, at N21 (“The polite term for these corporate tax-dodgers is ‘corporate inversion’ or ‘corporate expatriates,’ but they are tax cheats, pure and simple.”); David Cay Johnston, Vote on an Offshore Tax Plan is Roiling a Company Town, N.Y. TIMES, May 9, 2002, at A1 (discussing proposed inversion by Stanley Works); David Cay Johnston, U.S. Corporations are Using Bermuda to Slash Tax Bills, N.Y. TIMES, Feb. 18, 2002, at A1; Alison Mitchell, Companies Use Ex-Lawmakers in Fight on Offshore Tax Break, N.Y. TIMES, Aug. 10, 2002, at A1; Allan Sloan, The Tax-Free Bermuda Getaway, NEWSWEEK (U.S. ed.), Apr. 15, 2002, at 41; Jonathan Weisman, Patriotism Raining on Tax Paradise: Lawmakers are Chafing at Firms that Exist Offshore Only on Paper, WASH. POST, Aug. 21, 2002, at E1. In addition, the topic was discussed on numerous television programs during 2002. See, e.g., Nightline: Nightline Matter of Trust: Profits or
media attention and legislative debates centered on the symbolic aspects of the phenomenon. For example, critics of inversions characterized the corporations as Benedict Arnolds,\(^{104}\) traitors,\(^{105}\) tax dodgers,\(^{106}\) tax cheats,\(^{107}\) and participants in a Bermuda beach party.\(^{108}\) The names of several bills introduced by critics of inversions — including the No Tax Breaks for Corporations Renouncing America Act, the Uncle Sam Wants You Act, and the Corporate Patriot Enforcement Act\(^{109}\) — as well as the September 11, 2001, retroactive effective date used for several of the bills,\(^{110}\) reflected this symbolic

\(^{104}\) See, e.g., \(149\) \textsc{Cong. Rec.} \textsc{S}109 (daily ed. Jan. 9, 2003) (comments of Sen. Harkin); \textit{Hearing on Corporate Inversions, Before the Subcomm. on Select Revenue Measures of the House Ways and Means Comm.,} \(107\)th Cong. \textsc{107-75} (2002), available at \textsc{LEXIS}, \textsc{ALLNWS} lib., \textsc{FEDNEW} file (statement of Rep. McNulty, Member, House Subcomm. on Select Revenue Measures); \textit{Crossfire: Rumsfeld Turns Up Heat in Afghanistan; Does President Deserve Month-Long Vacation?} (CNN television broadcast, Aug. 2, 2002 (transcript no. 080200CN.V20)) (statement of Paul Begala).

\(^{105}\) A popular website criticizing corporate inversions is http://www.corporatetraitors.com (last visited Jan. 12, 2005).

\(^{106}\) Ivins, \textit{supra} note 103, at N21; Sloan, \textit{supra} note 103, at 41.

\(^{107}\) Ivins, \textit{supra} note 103, at N21.

\(^{108}\) Sloan, \textit{supra} note 103, at 41.

\(^{109}\) \textit{See supra} note 68.

\(^{110}\) See, e.g., \textit{Uncle Sam Wants You Act} of 2002, H.R. 4756, \(107\)th Cong. \textsection 2(b) (2002); \textit{Save America’s Jobs Act} of 2002, H.R. 3922, \(107\)th Cong. \textsection 2(c) (2002); \textit{Corporate Patriot Enforcement Act} of 2002, H.R. 3884, \(107\)th Cong. \textsection 2(b) (2002). The relationship between corporate expatriation and September 11 is a recurring theme in the symbolic rhetoric. For example, Rep. Richard Neal observed:
atmosphere. In contrast, supporters of the corporations argued that the corporations were being forced to expatriate by an overly broad and complex tax Code, favorably comparing a corporation's actions against unfair taxes to "rumrunners of Prohibition days" and the nation's founding fathers.

Despite the spotlight focused on corporate expatriations, as the 107th Congress approached its adjournment Congress had not yet enacted legislation directly targeting the phenomenon. Finally, on the last day of the session, the alternative sanction purporting to ban expatriated corporations from entering into contracts with the Department of Homeland Security was approved by Congress and sent to the President for signature as part of the Homeland Security Act. However, just hours before the legislation was approved by

> [T]he same company whose jackhammers carved Mount Rushmore [Ingersoll-Rand] paid $28,000 to rent a mailbox in Bermuda in order to avoid a $40 million tax bill from Uncle Sam. The board of directors of that company voted less than a month after the tragic attacks of September 11th to renounce [the company's] U.S. citizenship.


See supra notes 82–89 and accompanying text.

David Greising, Investors Pay for Tax Runners' Fun in the Sun, CHI. TRI., Aug. 9, 2002, at 3-1.

Crossfire: Rumsfeld Turns Up Heat in Afghanistan; Does President Deserve Month-Long Vacation? (CNN television broadcast, Aug. 2, 2002 (transcript no. 080200CN.V20)) (statement of Joe Matthews); see also Herman B. Bouma, Corporations that Reincorporate Abroad are Not Traitors or Tax Cheats, DAILY TAX REP. (BNA), Oct. 16, 2002, at J-1 (arguing that "[c]ompanies who reincorporate abroad are in fact playing by the rules.... [i]t is wrong to refer to these corporations as traitors and tax cheats."). An official of Cooper Industries, which underwent an inversion transaction in 2002, observed while speaking at a tax conference: "[q]uite frankly,.... the charges of any kind of patriotism [issues] leveled at inverted companies, I found to be offensive.... The real reason for inversions... is that the U.S. tax system is out of sync with its trading partners." Cathy Phillips, Congress "Certain" to Revisit Corporate Inversion Imbroglio, Angus Says, TAX NOTES TODAY (Dec. 16, 2002) (LEXIS, FEDTAX lib., TNT file, elec. cit., 2002 TNT 241-8).

As noted supra note 69, inverted corporations were tangentially addressed in the Sarbanes-Oxley Act of 2002.

Congress,\textsuperscript{116} language was inserted that significantly undermined any instrumental effect the alternative sanction might have had. Specifically, a statutory exception was inserted allowing a waiver of the contract ban to “prevent the Government from incurring any additional costs that otherwise would not occur.”\textsuperscript{117} Thus, as a practical matter, despite the purported contract ban, a corporate expatriate could enter into Homeland Security contracts as long as it was the low bidder.\textsuperscript{118}

This purported ban on Homeland Security contracts was prototypical symbolic legislation. It enabled its supporters to claim credit for some legislation that purported to address a perceived problem, thereby satisfying the general public’s demand for action.\textsuperscript{119} At the same time, consistent with Edelman’s theory, it ensured that the interested, involved group that would actually be affected by the legislation — in this case, corporations that have engaged in an inversion transaction — received their desired result. In particular, given that some legislation was to be enacted, the best outcome for


\textsuperscript{118} See Snowe, supra note 116 (“[T]he legislation as enacted would have required federal contracts to be awarded on the basis of the lowest bid, or if job losses could follow, regardless of where a company was incorporated.”). For contemporary criticisms of the instrumental effectiveness of the provision, see Ivins, supra note 103, at N21 (the exceptions make the statute a “toothless provision that affects no company”); Daniel J. Mitchell, Commentary, Competitive Bidding Benefits, WASH. TIMES, Nov. 21, 2002, at A21 (the exceptions “almost completely emasculated” the provision); Maj. Thomas Modeszto, ed., Contract and Fiscal Law Developments of 2002 — The Year in Review, 2003 ARMY LAW. 1, 254 (2003) (because of these exceptions, “[t]he provision is not as stringent as originally proposed”).

the targeted group of expatriate corporations was a provision that had little, if any, practical effect on their ability to enter into government contracts. As one reporter observed during the course of the Congressional debates over the contract ban provision in 2002, "[r]ecognizing that there may be no way to stop Congress from taking high-profile action on the politically potent issue this year, the businesses are looking for ways to limit the damage."\(^{120}\)

Several months after the enactment of this alternative sanction, Congress revisited the provision in response to complaints by some lawmakers regarding its ineffectiveness.\(^{121}\) In February 2003, Congress amended the alternative sanction by eliminating the exceptions concerning loss of jobs or imposing additional costs on the government.\(^{122}\) Accordingly, only the "in the interest of homeland security" exception remains.

Despite this amendment, the current provision has only limited practical impact. The alternative sanction prohibits the Department of Homeland Security from entering into a contract with a "foreign incorporated entity"\(^{123}\) that is treated as an "inverted domestic

\(^{120}\) Julie Hirschfeld Davis, Big Guns Hired to Fight Tax Reforms; Firms Enlist Ex-Lawmakers to Limit Expected Changes to Offshore Finance Breaks, BALT. SUN, Aug. 9, 2002, at 1A. See generally infra note 134 (describing lobbying efforts surrounding anti-inversion legislation).

\(^{121}\) Indeed, at the time of the original enactment of the Homeland Security Act, the Republican leadership promised several swing voters that three "‘egregious’ special interest provisions," including the broad exceptions to the federal contract provision, would be revisited. See Snowe, supra note 116. As summarized in the tax press:

House members scaled back the language last week, making it ineffective, by adding a waiver to the compromise package just before members voted on final passage....

Senate Minority Leader Trent Lott, R-Miss., agreed to settle the disputed new language in the next Congress. He accommodated concerns by promising to take up the corporate expatriate provision (along with two other nontax items) on the first appropriations bill to be considered in January.


\(^{123}\) A "foreign incorporated entity" is "any entity which is, or but for subsection (b) would be, treated as a foreign corporation for purposes of the Internal Revenue
corporation." As those terms are defined in the statute, the ban generally extends only to the new foreign parent arising from the inversion transaction. It does not apply to any domestic subsidiaries that are part of the inverted group. Thus, following the inversion, the corporate group can continue to enter into Homeland Security contracts through the group's domestic subsidiaries. As Representative Richard Neal complained, the provision "bans only contract applications from the foreign parent, leaving unaffected the U.S. subsidiaries, where U.S. federal contracts are normally managed."

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Section 835 of the Homeland Security Act of 2002 provides in relevant part:

(a) IN GENERAL. — The Secretary may not enter into any contract with a foreign incorporated entity which is treated as an inverted domestic corporation under subsection (b).

(b) INVERTED DOMESTIC CORPORATION. — For purposes of this section, a foreign incorporated entity shall be treated as an inverted domestic corporation if, pursuant to a plan (or a series of related transactions) —

1. the entity completes after the date of enactment of this Act, the direct or indirect acquisition of substantially all of the properties held directly or indirectly by a domestic corporation or substantially all of the properties constituting a trade or business of a domestic partnership;
2. after the acquisition at least 80 percent of the stock (by vote or value) of the entity is held —
   (A) in the case of an acquisition with respect to a domestic corporation, by former shareholders of the domestic corporation by reason of holding stock in the domestic corporation; . . . . [and]
3. the expanded affiliated group which after the acquisition includes the entity does not have substantial business activities in the foreign country in which or under the law of which the entity is created or organized when compared to the total business activities of such expanded affiliated group.


Neal, supra note 119; see also David Cay Johnston, Key Company Assets Moving Offshore, N.Y. Times, Nov. 22, 2002, at C3 (the provision "allows [inverted] companies to win government contracts if the work is done by an American subsidiary"). As a further limitation, the contract ban applies only to contracts entered into by the Department of Homeland Security. It does not apply to contracts entered into by other government departments or agencies. Cf. Patriotic Purchasing
The instrumental ineffectiveness of the contract ban was recently demonstrated in a high-profile contract awarded by the Department of Homeland Security. In May 2004, Accenture LLP, a domestic subsidiary of Accenture Ltd., a Bermuda company, was awarded the $10 billion prime contract by the Department of Homeland Security to develop and implement the new U.S.-VISIT system. This system, which is intended to "help strengthen security at America's borders and modernize the border management process," involves the deployment of "end-to-end management and sharing of data on foreign nationals covering their interactions with federal officials before they enter, when they enter, while they are in the United States, and when they exit." Although the foreign parent, Accenture Ltd., is a Bermuda company that is the successor to a former U.S.-based entity (Arthur Andersen), the contract ban in the Homeland Security Act did not bar the award.

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Act of 2002, H.R. 4831, 107th Cong. § 2 (2002) (legislative proposal that would have prevented award of any federal contract to an expatriated corporation, although the ban would have applied only to the foreign corporate parent of the group).

126 See ACCENTURE LTD., SEC FORM 10-K (2003), at 12, 85–86 (describing Bermuda registration of Accenture Ltd. and its subsidiary structure).


128 Id.

129 Id.

130 See ACCENTURE LTD., supra note 126, at 85–86 (describing organization's history).

131 As discussed supra notes 123–125 and accompanying text, the statutory ban does not apply to domestic affiliates of a foreign parent. Also, Accenture's move to Bermuda occurred in 2001, whereas the statutory contract ban applies only to corporations that engage in an inversion after the November 25, 2002, enactment date of the Homeland Security Act. See Homeland Security Act of 2002, Pub. L. No. 107-296, § 835(b)(1), 116 Stat. 2135, 2228 (2002) (codified as amended at 6 U.S.C. 395). It should also be noted that representatives of Accenture LLP have argued that the Accenture group, although headquartered in Bermuda as of 2001, was not, as a technical matter, formed pursuant to a corporate inversion. According to a recent press release:

It is important to remember that the global Accenture organization has never been a U.S.-based or U.S.-operated organization and has never operated under a U.S. parent corporation. Despite what critics say, Accenture did not undertake what is called a "U.S. corporate inversion."

Thus, even the 2003 amendment to the Homeland Security contract ban provision, which purported to eliminate significant exceptions to the ban, itself has the markings of symbolic legislation. Supporters of the amendment are able to claim that they have taken additional steps to combat the perceived problem of corporate inversions. In so doing, they would be acting in accordance with Edelman's theory that the enactment of some legislation, regardless of its effectiveness, may be enough to satisfy the public that the perceived problem of corporate expatriation was addressed.\footnote{See Kirsch, supra note 16, at 926.}

The amendment is also consistent with the second aspect of Edelman's theory — "that a small group of interested, well-organized persons receive tangible benefits while the public receives only symbolic reassurance."\footnote{Id. (footnote omitted). In this regard, the Congressional response is consistent with recent interest group models. As Professor Sara Sun Beale observed in the criminal law context, "[i]nterest group models provide an explanation for the phenomenon described by Edelman, in which politicians deliver legislation conferring tangible benefits on powerful interest groups, while they placate the general public with legislation or administrative action that provides only empty symbolic gestures." Sara Sun Beale, Federalizing Hate Crimes: Symbolic Politics, Expressive Law, or Tool for Criminal Enforcement?, 80 B.U. L. REV. 1227, 1249 (2000).}

In this situation, the expatriate corporate
groups undertook well-organized, well-funded lobbying pressure on legislators. By limiting the instrumental effectiveness of the amendment, Congress enabled these expatriate corporations to continue to enter into lucrative government contracts, despite the purported denial of those contracts under the Homeland Security Act and the 2003 amendment.

Thus, Congress's initial legislative enactment targeting corporate expatriates — which was the only legislative response for nearly three years — is best understood through the lens of Edelman's symbolic legislation theory, rather than as a substantive response to a perceived exploitation of the tax code.

134 For a detailed description of the high-profile lobbyists hired to combat anti-inversion legislation, see Davis, supra note 120. According to that article:

To lead the effort, the companies have assembled a formidable display of political muscle — among them, former Senate Majority Leader Dole, a Kansas Republican; former House Ways and Means Committee Chairman Bill Archer, a Texas Republican; former Sen. Dennis DeConcini, an Arizona Democrat; and Kenneth M. Duberstein, a former Reagan White House chief of staff.

According to lobbying records, Dole is registered on behalf of Tyco, Duberstein and DeConcini are working for Accenture, and Archer is signed up on behalf of energy companies Weatherford International Inc., which reincorporated in Bermuda in June, and Noble Drilling Services Inc., which did so in the Cayman Islands in May.

companies that have moved offshore... have turned... to veterans of the Washington establishment, who can use their friendships and political influence to open doors that might otherwise be slammed in what has become a decisively anti-corporate environment on Capitol Hill.

Id. See also Martin A. Sullivan, The Real K Street: Tax Lobbyists Prosper from ETI Legislation, 101 TAX NOTES 189, 191–95 (Oct. 13, 2003) (listing amounts paid to top four tax lobbying firms with respect to various tax legislation, including inversion bills.). For a detailed description of the lobbying conducted by one company with respect to proposed anti-inversion legislation, see Hamilton, supra note 131 (describing Accenture’s expenditure of approximately $1 million in six months on a “battalion of lobbyists,” including several “heavy hitters, “ to lobby “the Senate, the House, the Treasury Department, the U.S. Trade Representative, the Office of Management and Budget, and the Executive Office of the President” against various anti-inversion proposals); see also Ackman, supra note 131 (in defeating more stringent proposals that would have banned future government contracts, “Accenture and its lobbyists — who are based in Washington, D.C., not Bermuda — won the day then, and they seem confident they’ll win again.”).
C. House Proposal as Symbolic Political Response

Symbolic legislation theory not only explains the alternative sanctions that Congress has enacted in response to corporate expatriations, but also is relevant in understanding the leading tax-focused proposal favored by the House of Representatives. As discussed supra, the House favored a bill that would have altered two tax consequences flowing from corporate inversion. The bill would have (i) limited the ability of the former domestic parent corporation to utilize tax attributes, such as net operating losses or foreign tax credits, to reduce the tax owed on any gain recognized in an inversion transaction occurring after March 4, 2003, and (ii) imposed an excise tax on certain stock options held by executives of expatriating corporations.

As with the debate leading to the passage of the Homeland Security alternative sanction, supporters of the House bill argued that it would address a perceived problem. However, supporters of this provision defined the perceived problem more narrowly than did the supporters of the alternative sanction contract ban. As discussed supra, these supporters asserted that "corporate inversion transactions are a symptom of larger problems with our current uncompetitive system for taxing U.S.-based global businesses and are also indicative of the unfair advantages that our tax laws convey to foreign ownership." Accordingly, they were less willing to define corporate inversions as necessarily bad and to invoke rhetoric challenging the patriotism of the expatriating corporations.

Nonetheless, apparently recognizing the need to be seen as doing something about inversions, the House Report accompanying the House proposal claimed that the bill "contains provisions to remove the incentives for entering into inversion transactions." Accordingly, at least to some extent, the House proposal can be viewed as satisfying the public's desire to "do something" about a perceived problem in accordance with Edelman's theory. This conclusion is further supported by Edelman's observation that the public generally has only a vague understanding of the intricacies of

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135 See supra notes 93 and 95 and accompanying text.
137 Id. § 602(a).
138 See supra notes 46-47 & 82-85 and accompanying text.
139 H. R. REP. NO. 108-548, pt. 1, at 244.
140 Id.
legislation.\textsuperscript{141} Thus, even if the subtleties of the House Republicans’ arguments regarding the anticompetitive aspects of the current tax system were lost on the general public, the proponents of the bill could claim that they were “doing something” about corporate expatriations.

In addition to providing the public with some assurance that something was being done to address a perceived problem, the House proposal can be viewed as conforming with the second aspect of Edelman’s theory: it ensured that the interested, involved group that would actually be affected by the legislation — in this case, corporations that have engaged in an inversion transaction — received their desired result. In particular, given that some legislation was to be proposed, the best outcome for the targeted group of expatriate corporations would be a provision with little, if any, practical adverse effect on their ability to expatriate.

As noted above,\textsuperscript{142} several commentators pointed out the instrumental ineffectiveness of the House proposal. For example, the principal proposal to limit the use of tax attributes to offset inversion gain may have had only limited effects, due to a corporation’s ability to control the amount of gain recognized in an inversion transaction.\textsuperscript{143}

Perhaps of even greater relevance, a provision that might actually have had a significant adverse impact on expatriating corporations was dropped prior to passage of the House proposal, due to significant opposition from business interests. That provision, which had been a part of earlier bills sponsored by Chairman Thomas,\textsuperscript{144} would have tightened Code section 163(j) to make it more difficult for certain U.S. subsidiaries to deduct interest payments made to related foreign parties. As discussed supra, such earnings stripping techniques provide opportunities for post-inversion groups to reduce the U.S. income tax on their U.S. income, so a provision limiting this technique

\textsuperscript{141} See supra note 100 and accompanying text. As the author previously noted, “[t]his observation may be particularly true in the context of tax legislation, where the details are often mired in the densely worded, definition-laden, exception-filled language of the Code.” Kirsch, supra note 16, at 922.

\textsuperscript{142} See supra note 95.

\textsuperscript{143} Thompson & Clary, supra note 3, at 1386.

might have reduced the incentive for expatriating. Multinational corporations had been lobbying extensively against the inclusion of the proposed tightening of Code section 163(j), and that lobbying ultimately convinced Chairman Thomas to drop that provision from the House proposal, leaving only the relatively benign provisions limiting the use of tax attributes to offset inversion gain and modifying the treatment of stock options held by executives of the inverted corporation. The extent to which the proposal's instrumental

145 See H.R. REP. NO. 108-393, at 158–61 (2003) ("[T]he ability of foreign-based companies to strip earnings out of the United States through the use of related-party interest payments provides the 'juice,' or immediate financial incentive, for a company to invert...."). Foreign companies that have not undergone expatriations can also use the interest stripping technique. Id. at 158. The provision would not, however, have eliminated other potential methods by which inverted corporations, and foreign corporations generally, may be able to engage in earnings stripping. See Sullivan, supra note 59, at 12–13 (observing that, even if Code section 163(j) is amended to limit earnings stripping through related company interest payments, other techniques involving royalty payments and tax treaties will still be available).

146 Alison Bennett, Extraterritorial Income Earnings Stripping Dropped to Win Progress On Export Tax Repeal Measure, Thomas Says, DAILY TAX REP. (BNA), June 8, 2004, at G-6, available at LEXIS, 109 DTR G-6 (Chairman Thomas “said he decided to drop controversial earnings-stripping language from [the bill] simply so the bill could move as time grows short on the legislative calendar.”).

147 See supra note 93 and accompanying text. The excise tax imposed on stock options held by executives of the inverted corporation may have the same limited effect as the excise tax imposed on “golden parachute” payments received by executives following a takeover of a corporation. See I.R.C. § 4999 (imposing a twenty percent excise tax on excess parachute payments). Over time, senior executives of most major corporations have negotiated for gross ups in their compensation packages so that the corporation will ultimately pay the excise tax resulting from a golden parachute payment. See Ryan Miske, Note, Can't Cap Corporate Greed: Unintended Consequences of Trying to Control Executive Compensation Through the Tax Code, 88 MINN. L. REV. 1673, 1681–83 (2004) (citing recent surveys illustrating the extensive use of gross ups).

The House proposal also included a mandate requiring the Treasury Department to conduct several studies with respect to corporate expatriations, including studies on the effects of the transfer pricing rules, tax treaties, and the U.S. income tax provisions generally. See American Jobs Creation Act of 2004, H.R. 4520, 108th Cong. § 606 (2004). Given that the Treasury Department and the Joint Committee on Taxation had already issued studies on corporate expatriation, see supra notes 1 & 12, and that Congress had held numerous hearings on the issue, see supra note 12, it is not clear what additional information, if any, these studies would have provided to Congress. In particular, given that the mandated report on expatriations would not be due until December 31, 2005, which is half a decade after Congress first became interested in this issue, and three and one-half years after Treasury issued its initial inversion report, the House proposal’s requirement of
effectiveness was undercut at the behest of interested corporate stakeholders, consistent with Edelman's theory, is illustrated by a quotation from a representative of a corporate lobbying group following the removal of the section 163(j) provision from the House proposal: "[w]e're thrilled with the apparent decision to take the earnings-stripping language out of the bill," and following the provision's removal "we expect to be lobbying in support of the [revised] version of the bill as hard as we can."\textsuperscript{148}

Thus, the House proposal to address corporate inversions had the hallmarks of symbolic legislation as described by Edelman's theory. It would have allowed supporters to claim to the public that the purported problem of corporate expatriations was being addressed, while the small group of interested taxpayers — the relevant multinational corporations — would receive the tangible result they desired (\textit{i.e.}, a provision with limited adverse tax effects).

\textbf{IV. SOCIAL NORM-RELATED ASPECTS OF CONGRESS'S RESPONSE}

\textit{A. Social Norms and Corporations — In General}

As the preceding part illustrates, for several years Congress postponed enacting legislation with significant instrumental effects on corporate expatriations. Nonetheless, the absence of such legislation does not necessarily mean that Congress's actions did not affect the corporate inversion trend. Indeed, the mere fact that Congress addressed the issue, thereby raising its public profile, had an impact on corporations contemplating inversions. This part briefly analyzes this secondary effect of Congressional action.

In considering whether to expatriate, a corporation obviously considers the anticipated tax benefits and costs.\textsuperscript{149} As discussed above,

\begin{quote}
Treasury studies itself has the earmarks of symbolic legislation — provisions that give the public the appearance that something is being done about a problem, but that do not adversely affect the specific taxpayers involved.
\end{quote}

\textsuperscript{148} Bennett, \textit{supra} note 146 (statement of Todd Malan, executive director of the Organization for International Investment). According to Bennett, "[s]takeholders... said they were delighted by the decision to drop language from H.R. 4520 that would have limited earnings-stripping deductions under Section 163(j)." \textit{Id}.

\textsuperscript{149} For a detailed analysis of the importance of anticipated tax benefits and costs in the expatriation decision, see Desai & Hines, \textit{supra} note 1, at 416, 421. The corporation also considers legally circumscribed benefits and costs in non-tax areas. For example, the change of the corporate parent's place of incorporation might have effects on shareholder rights and other important considerations. \textit{See infra} notes 255–
Congress initially did not enact any provisions that would directly influence this calculation. In addition to the tax benefits and costs, the expatriation decision might be influenced by a less tangible consideration — nonlegally enforceable rules and standards, sometimes referred to as social norms.

An extensive body of literature recognizes that actors are influenced not only by legal rules, but also by social norms. Much of

Desai and Hines identify three principal tax considerations that drive the expatriation decision:

(i) the tax consequences that arise from no longer being subject to rules arising from the U.S. treatment of foreign source income, (ii) the tax consequences that arise from triggering capital gains at the firm level or shareholder level, and (iii) the tax consequences that arise from enhanced opportunities to relocate profits worldwide in a tax-advantaged way after an expatriation.

Desai & Hines, supra note 1, at 416, 421 (footnote omitted). The House proposal to limit the use of tax attributes to offset the tax on inversion gain, if enacted, would have affected the second factor identified by Desai and Hines. However, as explained supra notes 142–143 and accompanying text, the practical effect would have been small. While earlier proposals to modify Code section 163(j) to limit earnings stripping might have had a significant impact on the third factor identified by Desai and Hines, that provision was dropped from the House proposal. See supra notes 144–148 and accompanying text.

This article utilizes the “nonlegally enforceable rules and standards” interpretation of social norms set out by Rock and Wachter in order to emphasize the self-governing aspect of social norms and to distinguish the concept from legally enforceable rules and standards. See Edward B. Rock & Michael L. Wachter, Norms & Corporate Law: Introduction, 149 U. PA. L. REV. 1607, 1612–13 (2001); Edward B. Rock & Michael L. Wachter, Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation, 149 U. PA. L. REV. 1619, 1641 (2001); see also Marcel Kahan, The Limited Significance of Norms for Corporate Governance, 149 U. PA. L. REV. 1869, 1870–71 (2001) (summarizing the various formulations of the definition of “social norms” in legal literature and criticizing the lack of an agreed-upon definition, but observing that “Rock and Walter deserve applause for using the precise (if inelegant) acronym of NLERS to denote their concept of norms”) (footnotes omitted); see generally Kirsch, supra note 16, at 913 n.219 (citing legal and non-legal scholarship on social norms).

See generally Ann E. Carlson, Recycling Norms, 89 CAL. L. REV. 1231, 1239–41 (2001) (summarizing the various theories regarding the mechanisms by which social norms influence a target’s behavior); Kirsch, supra note 16, at 914 n.221 (comparing Richard McAdams’s esteem-driven model, in which individuals’ desire for respect or prestige drives norm creation, and Eric Posner’s signaling model, in which “in a world of private information, an individual behaves in certain ways and punishes those who do not behave in that way, in order to signal to others that she is a ‘good’ type with whom others might want to engage in future cooperative
this social norms literature focuses on the extent to which social norms affect the behavior of individuals. However, some recent scholarship addresses the effect of social norms on corporations.

According to the social norms literature, norms "influence[] an actor's preferences either directly, through internalization, or indirectly through the imposition of second-order social sanctions such as shaming or ostracism." To the extent a corporate inversion violates social norms, the impact might be felt at two separate levels.

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153 Early studies addressing the importance of social norms to individual conduct include ROBERT C. ELICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES (1991); Robert C. Ellickson, Of Coase and Cattle: Dispute Resolution Among Neighbors in Shasta County, 38 STAN. L. REV. 623 (1986) (addressing importance of social norms, rather than legal rules, for rural landowners settling disputes involving trespassing livestock); Lisa Bernstein, Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry, 21 J. LEGAL STUD. 115 (1992) (addressing importance of social norms in diamond industry). See also Kirsch, supra note 16, at 913–21 (noting the ineffectiveness of Congress's attempts to alter social norms to prevent individuals from surrendering their U.S. citizenship to avoid taxes). Professor McAdams has cited additional studies on the role of social norms in

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154 For example, the University of Pennsylvania Law Review recently published several articles on the topic as part of a Symposium on Norms and Corporate Law. See Symposium, Norms & Corporate Law, 149 U. PA. L. REV. 1607 (2001). Even within the context of the corporation, much norm analysis focuses on the behavior of individuals. See, e.g., Margaret M. Blair & Lynn A. Stout, Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law, 149 U. PA. L. REV. 1735, 1737 (2001) (focusing on importance of trust and trustworthiness in discouraging "corporate participants from stealing, shirking their duties, or otherwise mistreating each other"); Robert Cooter & Melvin A. Eisenberg, Fairness, Character, and Efficiency in Firms, 149 U. PA. L. REV. 1717, 1726 (2001) ("Our main concern is with good agent character, by which we mean the disposition of an agent of a firm to adhere to the firm's normative standards, reflexively or on the basis of commitment even when against interest.") (emphasis in original).


156 For a detailed analysis of the enforcement of social norms in the context of corporations, see David A. Skeel, Jr., Shaming in Corporate Law, 149 U. PA. L. REV.
First, it could impact at a personal level the directors or corporate officers involved in the expatriation decision, either through an internalized sense of the incorrectness of expatriation, or through fear of sanctions, such as shaming or ostracism. With respect to the latter, commentators have recognized the importance of communities in defining and enforcing social norms.\footnote{See Kirsch, supra note 16, at 919–20.} Corporate directors and officers are members of communities, and to the extent their actions in supporting an expatriation were viewed as violating a community’s social norms, they might be subject to sanction by that community.\footnote{Indeed, these individuals are members of several potentially relevant communities. To the extent a director or officer resides in the same local community as the corporate headquarters, the social norms of that local community might be relevant. \textit{Cf.} David Cay Johnston, \textit{Vote on an Offshore Tax Plan Is Roiling a Company Town}, \textit{N.Y. Times}, May 9, 2002, at A1 (describing the hostility of residents of New Britain, Connecticut, the headquarters of Stanley Works, toward CEO John Trani in the context of Stanley Works’ contemplated inversion in 2002). Moreover, to the extent the directors or officers interact with leaders of other large corporations across the country, the social norms of that community are also relevant. See Skeel, supra note 156, at 1812 ("[C]orporate directors are enmeshed in communities in which reputation does indeed matter. The directors of large U.S. corporations are, in the words of one shareholder activist, ‘the most reputationally sensitive people in the world.’") (footnote omitted).}

Second, it could impact the corporation at the corporate level. A corporation, as an entity, cannot internalize a norm in the way an individual can. However, a corporation could be the target of second order sanctions to the extent social norms disfavored a corporate parent changing its place of incorporation in pursuit of tax savings. For example, the firm might experience a backlash from U.S. customers and a possible reduction in revenue.\footnote{158 \textit{See} Skeel, supra note 156, at 1812 ("[C]orporate directors are enmeshed in communities in which reputation does indeed matter. The directors of large U.S. corporations are, in the words of one shareholder activist, ‘the most reputationally sensitive people in the world.’") (footnote omitted).} This potential decrease in revenue might, in turn, lower the value of the

\footnote{In this sense, an expatriation in violation of existing social norms could be viewed as analogous to a corporation engaging in other behavior that violates social norms. For example, a U.S. clothing retailer that purchases its apparel from factories in developing countries that employ child laborers might experience a public backlash and a potential earnings loss. See, e.g., Cynthia A. Williams, \textit{The Securities and Exchange Commission and Corporate Social Transparency}, 112 \textit{HARV. L. REV.} 1197, 1285–87 (1999) (discussing the adverse public reactions to Wal-Mart’s Kathie Lee Gifford clothing line and to Nike in response to disclosures of unfavorable labor conditions at their overseas factories).}
corporation’s stock. Concern over these potential sanctions against the corporation could induce the directors or shareholders to oppose inversion proposals even if the social norms do not influence these individuals at a personal level.

B. The Stanley Works Example

Prior to the announcement of the proposed inversion by Stanley Works in February 2002 and the congressional focus on expatriations soon thereafter, there was reason to believe that social norms would not significantly constrain the corporate expatriation trend. With respect to the pre-February 2002 expatriations, it is

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161 An anticipated decrease in future revenue would be only one factor that would affect the stock price of an expatriating corporation. Other important factors would include the anticipated future tax savings to the corporation following the inversion and the anticipated immediate tax cost arising from the inversion transaction. For a detailed analysis of the effect of these latter factors on the stock price of an inverting corporation, see Desai & Hines, supra note 1, at 416-22. Cf. John C. Coffee, Jr., Do Norms Matter? A Cross-Country Evaluation, 149 U. Pa. L. Rev. 2151, 2152 (2001) (“[C]ompliance with nonlegally enforceable social norms can significantly affect market value and ... innovative legal engineering designed to develop credible signals of such compliance may be one of the most important services that corporate attorneys can perform for their clients.”).

162 Stanley Works announced its proposed inversion on February 8, 2002. See STANLEY WORKS, SEC SCHEDULE 14A (Feb. 8, 2002).

163 See supra notes 12 & 68 (citing Congressional hearings in 2002 and numerous bills introduced in 2002). The first of the inversion-targeted bills cited supra note 68 was introduced on March 6, 2002. See H.R. 3857, 107th Cong. (2002). The Treasury Department also focused significant attention on inversions in the first half of 2002. See, e.g., TREASURY INVERSION STUDY, supra note 1; Alison Bennett, Treasury Close to Issuing Preliminary Study On Corporate Inversions, Angus Tells ABA, DAILY TAX REP. (BNA), May 13, 2002 at G-10, available at LEXIS, 92 DTR G-10 (statement of Treasury International Tax Counsel Barbara Angus that the increasing size, scope, and frequency of inversions is “certainly a source for concern and further examination”).

164 The possibility that relevant social norms might have changed as a result of Congress's involvement with corporate expatriations is discussed infra Part IV.C.2.

165 Significant inversions announced prior to February 2002 include:

<table>
<thead>
<tr>
<th>Company</th>
<th>Industry</th>
<th>Announcement Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Triton Energy</td>
<td>Oil &amp; gas</td>
<td>February 8, 1996</td>
</tr>
<tr>
<td>Tyco</td>
<td>Electric components, security &amp; fire protection, healthcare, financial services</td>
<td>March 17, 1997</td>
</tr>
<tr>
<td>Fruit of the Loom</td>
<td>Apparel</td>
<td>February 11, 1998</td>
</tr>
</tbody>
</table>
difficult to measure precisely the effect of social norms at the corporate director level. However, given that several corporations undertook expatriations during that period, it is reasonable to assume that the individual directors of those corporations did not fear significant informal sanctions from peers within their community, and did not feel internalized constraints against approving the inversion. Indeed, within certain industries — such as the oil and gas industry — the significant number of inversions provides strong evidence that directors within some industries felt no such constraints imposed by their community.  

Similarly, at the corporate level, the early adopters apparently assumed that there would be no significant public backlash against the company. This assumption is borne out by an economic study showing that share prices of these corporations rose by an average of 1.7 percent immediately following the expatriation announcements.  

<table>
<thead>
<tr>
<th>Company</th>
<th>Industry</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transocean</td>
<td>Offshore drilling</td>
<td>March 15, 1999</td>
</tr>
<tr>
<td>Everest Reinsurance</td>
<td>Insurance</td>
<td>September 17, 1999</td>
</tr>
<tr>
<td>Foster Wheeler</td>
<td>Engineering, consulting, and equipment manufacturing for power industry</td>
<td>November 29, 2000</td>
</tr>
<tr>
<td>Cooper Industries</td>
<td>Electrical products, tools, hardware, metal support products</td>
<td>June 11, 2001</td>
</tr>
<tr>
<td>Global Marine</td>
<td>Offshore drilling</td>
<td>September 4, 2001</td>
</tr>
<tr>
<td>Ingersoll Rand</td>
<td>Industrial &amp; construction equipment, refrigeration, locks &amp; security</td>
<td>October 16, 2001</td>
</tr>
<tr>
<td>Nabors Industries</td>
<td>Land &amp; offshore drilling</td>
<td>January 2, 2002</td>
</tr>
<tr>
<td>Noble Drilling</td>
<td>Deepwater drilling</td>
<td>January 31, 2002</td>
</tr>
</tbody>
</table>

See Desai & Hines, supra note 1, at 418–20, tbl.1.

As discussed supra notes 155–158, compliance with social norms can come from either an internalization of the norm, a fear of sanctions from the community for violating the norm, or both. While the directors of the first few corporations to expatriate might have feared that their actions violated the social norms of their community, once several corporations successfully inverted with no adverse consequences to their directors, directors of other companies considering expatriating probably had less concern about this issue.

As noted supra note 165, a significant percentage of the large inversions announced prior to 2002 involved participants connected to the oil and gas industry (Triton Energy, Transocean, Global Marine, Nabors Industries, Noble Drilling).

See Desai & Hines, supra note 1, at 430. This increase in share price does not necessarily indicate that the market anticipated no adverse revenue effect from the expatriation. However, to the extent any adverse revenue effect was anticipated, it
Indeed, a leading commentator, citing the early inversions, observed that "after Tyco, it became clear that share prices do not drop as a result of reincorporation — on the contrary, recently inverting companies have seen their share prices rise in reaction to the expected tax savings. Thus... there seems to be no market downside to inversions."169

While it is possible that the lack of significant adverse reaction against the early corporate expatriation reflected a lack of norm violation, it is also possible that the expatriations violated then-existing social norms170 but the public was largely unaware of the transactions. Scholars have recognized that public awareness of the potentially transgressing behavior is a necessary prerequisite for the informal enforcement of social norms.171 After all, if a community is not aware that a person engaged in disfavored conduct, those members will not be able to impose informal sanctions, such as boycotts or other public campaigns, against the transgressor. In the context of corporate expatriations, even if significant segments of the population would have viewed the early tax-motivated inversions as violating acceptable norms, a lack of information might have prevented the public from being able to impose informal sanctions against the corporations. Although corporations publicly disclose details of inversion transactions in their Securities and Exchange Commission filings,172 it seems safe to assume that the general public

would have been outweighed by the expected net tax savings (after considering the immediate tax costs associated with the transaction).

169 Avi-Yonah, supra note 24, at 1794.

170 The potential social norms that might have been violated are discussed infra notes 208–212.

171 See Toni M. Massaro, Shame, Culture, and American Criminal Law, 89 Mich. L. Rev. 1880, 1917 (1991) (noting that "audience awareness" is one of the conditions necessary for effective shaming); Dan M. Kahan & Eric A. Posner, Shaming White Collar Criminals: A Proposal for Reform of the Federal Sentencing Guidelines, 42 J.L. & Econ. 365, 371 (1999) (in the case of effective shaming, "everyone knows or can easily discover that the offender is a bad type.").

172 For examples of Securities and Exchange Commission disclosures by firms inverting in the late 1990s, see FRUIT OF THE LOOM, INC., SEC FORM 8-K (Feb. 11, 1998) (announcing approval by Fruit of the Loom directors of a Cayman Islands-based inversion transaction in order "to avail itself of certain business, tax and financing advantages that are not available in the United States," particularly because, unlike the United States, "the Cayman Islands generally imposes no corporate income taxes on foreign income."); TRITON ENERGY CORP., SEC SCHEDULE 14A (Feb. 23, 1996) (announcing proposal by Triton Energy directors of a Cayman Islands-based inversion transaction in order "to avail ourselves of certain business, tax and financing advantages compared to those that would be available to
does not regularly consult these filings. Moreover, the general press paid little attention to the pre-2002 inversion transactions.

Circumstances changed significantly in February 2002. On February 8, Stanley Works announced that its directors had approved an inversion transaction to reorganize the company under a Bermuda parent corporation, subject to a shareholder vote. Stanley Works was incorporated in Connecticut in 1852, and has its principal executive offices in New Britain, Connecticut. The company is a worldwide producer of tools and door products for professional, industrial and consumer use, and is the best-selling hand-tool manufacturer in the United States.

us if the parent were a United States corporation. The creation of a Cayman Islands parent corporation will minimize corporate income taxes because the Cayman Islands generally imposes no corporate income taxes on foreign income.

Cf. Kirsch, supra note 16, at 908 & n.199 ("[I]t seems safe to assume that the overwhelming majority of Americans do not regularly read the Federal Register," and therefore the publication therein of the names of individuals who surrendered citizenship will have little effect in triggering potential norm-based shaming sanctions.).

For example, during the twelve months following Fruit of the Loom's February 1998 expatriation announcement, only a half-dozen articles in major market newspapers mentioned the transaction, and most of these references consisted of brief factual statements in the context of other business news. See Diary, Plain Dealer (Cleveland, OH), Feb. 12, 1998, at 1C (one paragraph reference to transaction announcement); Financial Desk, L.A. Times, Feb. 12, 1998, at D3 (one paragraph reference to transaction announcement); Fruit of Loom 4th-Quarter Charges Result in Loss, Chi. Sun-Times, Feb. 13, 1998, at 58 (one sentence reference to inversion plan in context of article announcing earnings results); Fruit of the Loom Posts 4th-Quarter Loss, Com. Appeal (Memphis, TN), Feb. 13, 1998, at B5 (one sentence reference to inversion plan in context of article announcing earnings results); Heather Pauly, Fruit of Loom Seeks Cayman Islands Tax Deal, Chi. Sun-Times, Feb. 12, 1998, at 56 (short article announcing proposed transaction and paraphrasing company's press release describing anticipated tax benefits); The Ticker, Midwest Briefs, Chi. Trib., Nov. 13, 1998, at N2 (one paragraph statement announcing shareholder approval of the transaction). Given the fact that Fruit of the Loom, an apparel maker that sold underwear and other items under its own name, was a well-known company, it is reasonable to anticipate that the public might have focused on the Fruit of the Loom transaction, had the public been aware of it and had the public perceived it as violating social norms.

See Stanley Works, SEC Schedule 14A (Feb. 8, 2002). For additional details regarding the Stanley Works expatriation proposal saga, see Johnston, supra note 3, at 237-47.


Id.

See Matthew Lubanko, Stanley's Brand Tarnished?; Experts: Over Long Haul,
Shortly after this announcement, the media and Congress began focusing on the corporate expatriation trend. In May 2002, after significant press attention, Stanley Works shareholders narrowly approved the proposed inversion, but the following day Stanley Works announced that a new shareholder vote would be held due to confusion surrounding the initial shareholder vote. Because of the extensive press and Congressional focus on the proposed Stanley Works transaction, in part because Stanley Works' tools and garage door openers made it a familiar household name, Stanley Works soon became the “poster child” for the corporate inversion trend.

Consumers Aren’t Likely to Hammer Toolmaker, HARTFORD COURANT, Aug. 3, 2002, at E1 (stating that as of 2000, Stanley Works held twenty-six percent of the U.S. hand-tools market, nearly double its nearest rival.).

In particular, in February 2002, the New York Times ran a front page article on the corporate expatriation “megatrend,” naming several large corporations that had undertaken, or were planning, one of these “paper transaction[s].” David Cay Johnston, U.S. Corporations are Using Bermuda to Slash Tax Bills, N.Y. TIMES, Feb. 18, 2002, at A1; see also Daniel Mitchell, Commentary, Europe’s Tax Hit on America, WASH. TIMES, Jan. 24, 2002, at A16 (mentioning Accenture, Ingersoll-Rand, Tyco, and Fruit of the Loom expatriations, but defending them as understandable attempts to escape a “punitive” American tax system).

Stanley Works, SEC FORM 425 (May 13, 2002) (“Although the company believes that the shareowner vote was fair and appropriate, it acknowledges concerns raised at yesterday’s shareowners meeting that some people may have been confused about 401K plan voting procedures.”); see also David Cay Johnston, Stanley Voids Bermuda Vote and Promises to Try Again, N.Y. TIMES, May 11, 2002, at C1 (noting that Stanley Works’ decision to invalidate the initial shareholder vote was influenced by a lawsuit by Connecticut Attorney General Richard Blumenthal alleging that Stanley Works had used deception to win shareholder approval).

In the months following the voided shareholder vote, numerous public protests were held against the company, and hundreds of newspaper articles, editorials, and letters to the editor criticized Stanley Works for its proposed transaction. Finally, in August 2002, after enduring this bad publicity for several months, the Stanley Works board of directors voted to cancel the proposed inversion transaction. The company did not directly cite the bad publicity as a reason for canceling the proposed transaction. Rather, "the company cited the growing prospect of comprehensive tax legislation.... Most positively, Congress has started down a path to deliver comprehensive tax reform that would eliminate the inequities of U.S. international taxation and thereby accomplish Stanley's original and continuing goal." Connecticut Attorney General Richard Blumenthal that "Stanley Works became the poster child, in part, because of the way that it sought to do this [expatriation]"); Stacey Stowe, Stanley Works Decides to Stay Put After All, N.Y. TIMES, Aug. 4, 2002, at CN5 (statement of John Sweeney, president of the A.F.L.-C.I.O., describing Stanley Works as the "poster child for corporate greed"); see also Anthony C. Infanti, Eyes Wide Shut: Surveying Erosion in the Professionalism of the Tax Bar, 22 VA. TAX REV. 589, 595 (2003) (subsequent law review article referring to Stanley Works as "the poster child for the debate over corporate inversions") (footnotes omitted). See, e.g., Thomas Bieluczyk & William Weir, Stanley Drops Bermuda Plan; Board, Under Pressure, Decides Not to Reincorporate to Save Taxes, HARTFORD COURANT, Aug. 2, 2002, at A1 (describing protest, attended by John J. Sweeney, the national AFL-CIO president, at which "several hundred demonstrators convened in New Britain next to a giant, inflatable rat holding a Bermuda flag"); William M. Welch, Offshore Tax Shelters Under Fire, USA TODAY, July 31, 2002, at 3B ("Stanley's decision touched off a storm of protest."); Ben White, Labor Demands Corporate Reform, WASH. POST, July 31, 2002, at E1 (citing protest in New Britain, Connecticut, the location of Stanley Works' corporate headquarters); David Cay Johnston, Pressure on Companies Using Tax Dodge, N.Y. TIMES, July 27, 2002, at C3 (citing protests). These protests were principally led by labor unions opposed to the inversion. A search in the LEXIS "news" library, "allnws" file, revealed approximately 360 documents during the relevant period mentioning the company's proposed Bermuda transaction, the large majority of which were themselves critical of the transaction or described criticism by others. See STANLEY WORKS, SEC FORM 8-K (Aug. 2, 2002). Id. The only reference in the press release to the outside pressures being imposed on the company was the statement by the Chairman and Chief Executive Officer that [w]e have been asked by the Congressional leadership on both sides of the aisle to support their efforts toward rectifying this situation by enacting legislation that will create a level playing field for companies incorporated in the U.S. We have honored their request, and the ball is now in their
To some extent, Stanley's decision to abandon its expatriation appears to stem not from informal social norm enforcement, but from concern about legal-based instrumental factors. For example, according to the previously cited press release, members of Congress offered Stanley directors assurances that legislation providing tax relief for domestic manufacturers might be forthcoming. Furthermore, by the time of the August 2002 abandonment, numerous tax-focused bills had been introduced in Congress that might have eliminated many of the tax benefits Stanley sought by expatriating. For example, the Grassley-Baucus REPO Act proposal in the Senate, had it been enacted as proposed, would have continued to treat the post-expatriation Stanley corporate parent as a domestic parent. Also, in August 2002, Congress was actively considering the Homeland Security provision that would have banned corporate expatriates from future Homeland Security contracts. In addition, the Connecticut attorney general had sued Stanley Works to prevent the company from completing its plans.

Nonetheless, there also appear to have been some aspects of nonlegal social norms enforcement in play. Despite the official press release's focus on the legislative assurances received by Stanley as an inducement to abandon its plans, press reports at the time were more forthcoming about the role that outside public pressure, spearheaded

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187 See generally supra note 68.
188 See supra note 92.
189 The REPO Act is discussed supra note 92. Because the Stanley Works inversion had not been completed by March 20, 2002, the REPO Act would have applied to it. See S. 2119, 107th Cong. § 2(a) (2002). Although the tax legislation ultimately enacted in 2004 contains a domestic taint provision similar to that in the REPO Act, it applies only to inversions completed after March 4, 2003. See supra note 97.
190 See David Cay Johnston, Musical Chairs on Tax Havens: Now It's Ireland, N.Y. TIMES, Aug. 3, 2002, at C1 (noting effect of potential government contract ban on Stanley's decision). As discussed supra notes 114–125 and accompanying text, the alternative sanction purporting to ban future Homeland Security contracts was subsequently enacted in an instrumentally ineffective form.
191 See Virginia Groark, Stanley Works is Staying, and a Tax Issue Remains, Too, N.Y. TIMES, Aug. 11, 2002, at CN1; Noam Scheiber, State Attorneys General as Corporate Cops, N.Y. TIMES, Dec. 15, 2002, § 6 (Magazine), at 126 (“Connecticut's attorney general, Richard Blumenthal, waged his own battle to keep the New Britain-based Stanley Works from reincorporating in Bermuda.”).
by labor unions and politicians, played on the company.\textsuperscript{192} In particular, the public press highlighted the potential effect that the inversion might have had on Stanley's sales in the United States. As one contemporary newspaper article observed, "The question is whether all this ill will [arising from the planned expatriation] is headed out to the Home Depot in Peoria."\textsuperscript{193} Another article on the same topic observed that "[t]he typical Stanley customer is an American male, age 25 to 54. Often, he is a tradesman who belongs to a union. And union members generally know which companies are perceived as friendly to American workers and American causes."\textsuperscript{194}

To the extent the Stanley Works decision to cancel the planned transaction resulted from concerns about this type of public backlash, it represents an example of the ability of social norms to influence an actor's behavior.\textsuperscript{195}

\textsuperscript{192} See, e.g., Bieluczyk & Weir, supra note 183, at A1 (citing the "months of pummeling from state officials, national lawmakers of both parties, New Britain leaders, Stanley employees and top union leaders").


\textsuperscript{194} Lubanko, supra note 178.

\textsuperscript{195} As discussed supra notes 155–161 and accompanying text, social norms can influence a corporation's actions not only through concern about potential sanctions, such as boycotts, against a violator, but also at the personal director's level due to a director's internalized sense of the incorrectness of expatriation, or through fear of sanctions, such as shaming or ostracism, from the director's peers. It appears unlikely that this latter effect played a significant role in compelling the Stanley directors to cancel the planned inversion. For example, it is unlikely that within the broad community of directors of large publicly-held corporations the initial decision to undertake the inversion was viewed as a violation of acceptable norms, particularly because numerous other public companies had recently undergone such transactions. While the residents of New Britain, Connecticut, where Stanley Works has its corporate headquarters, were hostile to the planned transaction, see Johnston, supra note 158, it is unlikely that the Stanley directors, particularly the outside directors who had little regular contact with New Britain, would have internalized the norms of that community or felt significant concern about shaming or other informal sanctions of that community. See generally notes 157–158 and accompanying text (discussing role of communities in social norm enforcement).

However, John Trani, the President and CEO of Stanley Works, did acknowledge that he and other directors of the company did feel at least some personal pressure regarding the issue, though not enough to influence their decision. When asked by a reporter "How is the mood of Stanley executives?", Trani replied:

No one likes to be vilified in the press. We're all human beings. On the other hand, you have to do what you believe is right. A CEO likes to be popular, but respect is mandatory. Respect only comes when people you lead believe what you're doing and saying is right.
The concern about public backlash may have been significantly greater for Stanley Works than for corporations that had expatriated previously. Whereas Stanley sold retail products to the public under its own name, most of the other expatriating corporations had little direct public contact. Accordingly, the public was less likely to pay attention to those other companies’ inversion transactions and, even had the public been aware of them, the lack of a public consumer base would have lessened the opportunities for the public to boycott or otherwise impose sanctions on those other companies.

In this regard, concern about social norm compliance has the potential to create a de facto two-tiered corporate residence regime. U.S.-based multinationals with little direct public contact could expatriate and become foreign corporations for U.S. tax purposes, while U.S.-based multinationals with significant public contact might feel pressure to retain their U.S. incorporations, thereby remaining domestic corporations.

C. The Role of Congress

As discussed previously, beginning in 2002 Congress entertained numerous legislative proposals, held several hearings, and passed the Homeland Security alternative sanction purporting to ban contracts with expatriated corporations. Although the alternative sanction legislation that Congress enacted had no direct instrumental effect,


196 See supra note 165 (listing and describing companies that announced expatriations prior to February 2002). See also JOHNSTON, supra note 3, at 237:

Most of the companies that made the Bermuda move had little contact with consumers because they sold to other businesses. They had much less to worry about . . . than . . . Stanley, whose profits depended not just on the quality of its tools, but on the positive attitude consumers had toward the company.”

Id.; Johnston, supra note 179, at A12 (quoting a tax expert's observation that some companies had turned down expatriation proposals because of concerns about the public reaction, and that “[t]he companies most willing to [expatriate] are not household names, but Stanley Works is verging on a household name.”). Although the 1998 Fruit of the Loom expatriation involved a well-known brand with sales to the public, that transaction received little press attention and, accordingly, was not subject to any significant public backlash. See supra notes 170–174 and accompanying text (discussing importance of information in the context of social norm enforcement).

197 The instrumental ineffectiveness of the alternative sanction ban on Homeland Security contracts is discussed supra Part III.B. As discussed supra notes 188–191 and
it is important to consider whether Congress's initial actions might have had some indirect effect on expatriations in the context of social norms. This subpart considers two possible effects in this regard. First, Congress's activity in 2002 might have played an informational role, helping to provide information about expatriation activities that generally would not have come to the public's attention. The public then could have used this information to sanction informally corporations or their directors for violating an already existing social norm against corporate expatriation (if, indeed, such a norm existed). Section 1 of this subpart concludes that the Congressional focus on expatriations served this informational role, at least to some extent.

Second, the Congressional activity might have had an "expressive" effect, altering the then-existing social norms regarding corporate expatriations. After briefly examining the legal literature's theories regarding expressive legislation, section 2 of this subpart extends these theories to address the expressive effects of legislative debate and concludes that Congress's actions had, at most, only a small amount of expressive effect.

1. Information-Providing Effect

As discussed in the prior subpart, prior to February 2002, there was reason to believe that social norms would not significantly constrain the corporate expatriation trend. In this context, it is possible that Congress, merely by publicly discussing the names of companies that engaged in inversion transactions, might have had some social norm-related impact. Regardless of whether the legislators viewed the corporations as violating social norms, the publicity surrounding the legislative proposals and hearings helped furnish information to the public about affected corporations so that members of the public who perceived the transactions as violating social norms might have been able to act on that information.

Just prior to Congress's heavy focus on corporate expatriations,
the general press had begun to place a spotlight on the phenomenon.\textsuperscript{200} Indeed, it is reasonable to assume that the media's attention to the issue made various legislators aware of the potential political benefits of focusing on the issue.\textsuperscript{201} However, it is also clear that once anti-inversion bills were introduced in Congress and hearings were scheduled, press coverage increased significantly.\textsuperscript{202}

Thus, Congress's focus on the inversion phenomenon in 2002 appears to have been part of a snowballing effect — by focusing on the phenomenon as a result of early press coverage, Congress produced additional press coverage, which in turn heightened the political importance of the issue in Congress, ensuring additional Congressional attention and further press coverage. In the end, this heightened publicity increased the likelihood that members of the

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\textsuperscript{200} As noted supra note 179, media attention to expatriations was precipitated by a February 2002 New York Times front page article on the corporate expatriation "megatrend," which named several large corporations that had undertaken, or were planning, one of these "paper transaction[s]." Johnston, supra note 179.

\textsuperscript{201} For example, when interviewed for the February 2002 New York Times front-page article that helped focus attention on the inversion phenomenon, "Senator Charles E. Grassley of Iowa, the ranking Republican on the Senate Finance Committee, expressed alarm. 'There is no business reason for doing this, other than to escape U.S. taxation. I believe the Finance Committee needs to investigate this activity.'" Johnston, supra note 179, at A12; see also Rob Hotakainen, \textit{Wellstone Bill Aims to Close Offshore Tax Loophole}, \textit{STAR TRIB.} (Minneapolis, MN), Mar. 8, 2002, at 3D (implying that the February 2002 New York Times article spurred Sen. Paul Wellstone to introduce an anti-inversion bill in March 2002). Some prescient legislators, however, had mentioned the issue previously. See \textit{Unofficial Transcript of Finance Committee Hearings on Tax Shelters}, \textit{TAX NOTES TODAY} (Mar. 16, 2000) (LEXIS, FEDTAX lib., TNT file, elec. cit., 2000 TNT 52-28) (Sen. Daniel Patrick Moynihan asking witnesses "[s]hould we be concerned about this, and if so, what should we do about it? Are we entering an era of, my goodness, corporate expatriation?"); \textit{Remarks by Rep. Bill Archer to the National Italian American Foundation}, (Oct. 15, 1999), available at LEXIS, ALLNWS lib., FEDNEW file ("Go to Bermuda, go to Aruba, go to the Cayman Islands — see the thousands of American corporations that have fled this country for only one reason, and that is because of our tax code. They'll all come back home" if the income tax is abolished and replaced by a sales tax.).

\textsuperscript{202} Starting on March 6, 2002, and throughout the remainder of that year, approximately one dozen legislative proposals targeting expatriation were introduced. See supra note 68. Also, during 2002, numerous committee and subcommittee hearings were held in both the Senate and House. In contrast to the dearth of articles focusing on the inversion phenomenon prior to March 2002, dozens of newspaper articles and radio and television broadcasts were dedicated to the inversion phenomenon from April 2002 onward. See supra note 103 (citing some of these articles and broadcasts).
public would become aware of the fact that certain corporations had engaged in an inversion transaction, or planned to do so. In turn, this increased the possibility that the public might informally sanction those corporations, to the extent the transactions were viewed as violating then-existing social norms.

It is difficult to quantify the extent, if any, to which the public imposed informal sanctions for violations of already-existing norms, utilizing the factual information that Congress helped provide. While some corporations — particularly Stanley Works\(^{203}\) — apparently changed their behavior at least in part because of the public reaction to a planned inversion, it is not clear whether the public was enforcing previously existing norms against expatriation, utilizing Congress as merely a source of factual information about the companies engaged in the activity, or whether Congress's actions themselves altered the then-existing norms. This latter possibility is discussed in the following subpart.

2. Expressive Norm-Altering Effect

The prior section treated social norms as an exogenous variable, implicitly assuming that Congress, while possibly providing information to the public, was not itself influencing the public's view of whether corporate expatriations violate social norms. However, social norms are not static. Numerous commentators have studied the mechanisms by which norms arise and change over time.\(^{204}\) Of particular relevance for this discussion, there is general agreement that legislation enacted by Congress can have an expressive effect that changes social norms and thereby alters an actor's behavior, apart from any direct instrumental aspects of that legislation.\(^{205}\) There is

\(^{203}\) The Stanley Works saga was discussed in detail supra Part IV.B.

\(^{204}\) For example, under Richard McAdams's esteem-based theory of norm development, a norm may arise for some behavior X if:

(1) there is a consensus about the positive or negative esteem worthiness of engaging in X (that is, either most individuals in the relevant population grant, or most withhold, esteem from those who engage in X); (2) there is some risk that others will detect whether one engages in X; and (3) the existence of this consensus and risk of detection is well-known within the relevant population.

McAdams, supra note 153, at 358 (footnotes omitted).

\(^{205}\) For a summary and comparison of the competing theories of expressive legislation, see Scott, supra note 155, at 1623-26 (acknowledging the explanatory power of expressive theories of law in particular contexts, but questioning their usefulness as general, predictive, testable theories).
disagreement, however, as to the precise mechanism by which this “expressive” function of legislation works and how effective it is. For example, as previously summarized by the author:

[U]nder Richard McAdams's esteem-based theory of norm development, the enactment of legislation plays an important role in publicizing to the community that a consensus on desired (or undesired) behavior exists. Once individuals become aware of this consensus, they are more likely to perceive that an esteem gain is available by complying with it. Thus, under McAdams's theory, the enactment of legislation can provide “the jolt necessary to create a new norm, or strengthen an old one.”

Cass Sunstein also advocates a role for expressive legislation in norm management. He recognizes the collective action problem that faces agents who seek to alter norms and views politicians as potential norm entrepreneurs who are in a position to overcome this collective action problem, alerting the public to the existence of a shared complaint and suggesting a collective solution. Under certain circumstances, the enactment of legislation may lower the cost to individuals of expressing the new norms, resulting in a norm bandwagon that encourages an ever-increasing number of people to reject a previously popular norm. Eventually, a tipping point is reached, where the new norm becomes generally accepted and adherence to the old norm produces social disapproval.206

The relevant question is to what extent, if any, do these theories apply to Congress's response to corporate expatriations? That is, to what extent might Congress's actions have altered social norms that existed prior to Congress's focus on expatriations, rather than merely highlighting factual information about inversion transactions to enable enforcement of existing norms?

In order to analyze the extent to which Congress's actions fulfilled this expressive role altering social norms, it is important to consider the state of social norms regarding corporate expatriations at the

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outset of the recent inversion trend. Prior to the late 1990s, few large publicly-held corporations underwent corporate inversions. Accordingly, the corporations that were the early adopters of this strategy faced an important uncertainty — i.e., to what extent would the corporate expatriation be viewed as violating social norms.

Several social norms could have been viewed as having relevance with respect to a corporate group changing the place of incorporation of its corporate parent in order to reduce taxes. For example, given the high profile accorded tax reduction by newly-elected President Bush in 2001, these transactions could have been viewed as legitimate steps to ameliorate excessive U.S. taxation. Also, to the extent the inversions were undertaken in order to "level the playing field" between U.S.-based multinationals and foreign-based multinationals, they could have been viewed as consistent with general norms involving fair play. On the other hand, norms of fair play might have dictated that a U.S.-based corporation not engage in tax-cutting maneuvers unavailable to U.S.-based individuals. Similarly, even if the corporation complied with all its tax obligations arising from the inversion transaction, it could have been viewed as violating general norms of tax compliance to the extent it was reducing its tax obligations in a manner not available to the general public. The public might have been particularly predisposed to this perception in light of the high profile corporate scandals involving Enron, WorldCom, and others, which were unfolding at approximately the same time as the inversion trend. In addition, particularly after

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207 See supra note 1 (discussing the eleven-year gap between the first and second modern corporate inversions, and the increasing trend starting in the late 1990s).

208 For an analogous discussion of the relevant social norms in the case of an individual surrendering U.S. citizenship to reduce taxes, see Kirsch, supra note 16, at 913–21.

209 Cf supra note 186 (quoting Stanley Works executive's desire for a "level playing field" between companies incorporated in the United States and those incorporated elsewhere).

210 As the author observed in the related context of individuals surrendering citizenship to avoid future tax obligations:

In a technical sense, an individual who surrenders citizenship to avoid taxes would not be violating this [tax compliance] norm as long as he complies with the [existing relevant tax laws]. Nonetheless, some individuals might perceive tax-motivated expatriation as cheating in violation of this norm, even if all applicable tax code provisions are complied with, because it involves a reduction in taxes in a manner not available to most individuals. Kirsch, supra note 16, at 917–18 (footnotes omitted).

211 See Weisman, supra note 103, at E2 (relating statement by Rep. James H.
September 11, 2001, inversion transactions could have been viewed as unpatriotic behavior by ungrateful corporations that owed much of their original success to the United States.\footnote{212}

As discussed in the previous subpart,\footnote{213} corporate inversions prior to 2002 faced little public attention and little adverse reaction. This lack of significant backlash against these early inversions potentially had important implications for future inversions. Once several large publicly traded corporations expatriated without significant adverse consequences to their directors or to the corporations' revenue, directors of other corporations might have sensed that they would not suffer informal sanctions at the personal level from their communities, and their firms would not suffer informal sanctions from the public for expatriating. As one researcher observed, "firms may have been reluctant to incorporate abroad for fear of public relations damage. Once several firms undertook reorganizations, the damage potential may have been perceived to have fallen, and other firms followed."\footnote{214}

Maloney that "[w]hether it's Enron abusing partnership rules, WorldCom abusing expensing rules or Stanley Works abusing the tax code, the public sees corporate abuse.").\footnote{212}

According to a prominent tax specialist who advised some companies regarding expatriations, "companies are understandably reluctant to do something like this because it will not necessarily be properly construed in the marketplace. It may be seen as not patriotic and in the wake of Sept. 11, that is not a good posture for a company." David Cay Johnston, \textit{U.S. Corporations are Using Bermuda to Slash Tax Bills}, \textsc{N.Y. Times}, Feb. 18, 2002, at A12 (statement of Robert Willens, described as a "tax expert at Lehman Brothers").\footnote{213}

\textit{See supra} notes 162-174 and accompanying text.\footnote{214}

\textit{CRS Inversion Study, supra} note 3. A similar observation regarding the uncertain public reaction surrounding the early inversions was made by Professor Reuven Avi-Yonah in testimony before a Senate Appropriations subcommittee in 2002:

Until Tyco inverted successfully in 1997, investment bankers generally assumed that a U.S. company would pay an unacceptable price in its share value if it reincorporated in Bermuda. \ldots The presumed drop in share value related to corporate governance concerns and to reputational issues. But after Tyco, it became clear that share prices do not drop as a result of reincorporation — on the contrary, recently inverting companies have seen their share prices rise in reaction to the expected tax savings. Thus, despite the recent troubles of Tyco and Global Crossing, there seems to be no market downside to inversions.

\textit{Law Professor Testimony on Corporate Inversions, Tax Notes Today (Oct. 17, 2002)} (LEXIS, FEDTAX lib., TNT file, elec. cit., 2002 TNT 201-20). \textit{See also} \textit{Johnston, supra} note 3, at 237 (observing that "[i]f a company that was a household name could make the move \ldots it meant — as Grassley said — Katie, bar the door.").
Indeed, once a significant number of firms in a particular industry expatriate, the directors of the remaining U.S.-incorporated groups might feel compelled to initiate inversions in order to remain competitive.\footnote{For example, Stanley Works chairman and chief executive John Trani observed, "[n]ot only are we disadvantaged against our foreign competitors, but two of our major U.S. competitors, Cooper Industries and Ingersoll-Rand Company have a significant advantage over Stanley Works because they have already reincorporated." \textit{STANLEY WORKS}, SEC FORM 8-K (Aug. 2, 2002), Exhibit 20(i); see also Weisman, \textit{supra} note 103, at E2 (statement of Sen. Charles E. Grassley, then the ranking Republican on the Senate Finance Committee, that "[s]ome companies are willing to stay and pay. Other companies dash and stash the cash. And that makes the former into a sucker."). This pressure to follow an industry trend might apply not only at the corporate level, but might also be felt personally at the director level. As discussed \textit{supra} note 158, directors themselves may feel pressure to comply with social norms of their peer communities, including the community of corporate directors and executives within their industry.}

This shift toward acceptability within the relevant executive community is analogous to the norm shift that occurred among professionals in the 1970s with respect to hostile takeovers. As described by Melvin Eisenberg, until the mid-1970s, "the social norms of the business, financial, and legal establishment were strongly opposed to hostile takeovers," and most "establishment" corporations, commercial banks, investment bankers, and lawyers, would not participate in hostile takeovers.\footnote{Melvin A. Eisenberg, \textit{Corporate Law and Social Norms}, 99 COLUM. L. REV. 1253, 1288 (1999).} However, the norm quickly shifted in 1974 when International Nickel made a hostile takeover bid for ESB, a battery company, and "a premier investment bank, Morgan Stanley, decided to break ranks and assist [International Nickel's] hostile bid."\footnote{Id. at 1288-89.} Eisenberg summarizes the effect on social norms, observing that "[o]nce Morgan Stanley flipped, the old, inefficient social norm crumbled.... Once Morgan Stanley sanctioned hostile takeovers, competitors jumped in.\footnote{Id. at 1290 (quoting RON CHERNOW, THE HOUSE OF MORGAN 601(1990)); see also Skeel, \textit{supra} note 156, at 1828: Prior to the takeover boom, a strong norm prohibited Wall Street banks from financing or advising hostile takeover bidders. In the small, close-knit community of Wall Street financiers, a bank that violated that norm would be shamed by its peers.... [However,] the norm collapsed once Morgan Stanley broke ranks by agreeing to participate in a hostile bid for [International Nickel].... \textit{Id.} at 1828 (footnotes omitted).}"

\footnote{Id. at 1290 (quoting RON CHERNOW, THE HOUSE OF MORGAN 601(1990)); see also Skeel, \textit{supra} note 156, at 1828: Prior to the takeover boom, a strong norm prohibited Wall Street banks from financing or advising hostile takeover bidders. In the small, close-knit community of Wall Street financiers, a bank that violated that norm would be shamed by its peers.... [However,] the norm collapsed once Morgan Stanley broke ranks by agreeing to participate in a hostile bid for [International Nickel].... \textit{Id.} at 1828 (footnotes omitted).}
At the corporation's level, there are several possible explanations for the early lack of public resistance to expatriations. As discussed in the preceding subpart, it is possible that social norms might have dictated an unfavorable public attitude to expatriating corporations, but the public was not aware of the early transactions. A related possibility is that social norms might have disfavored expatriation, but the public was not in a position to impose meaningful nonlegal sanctions, such as boycotts, against transgressors. This explanation might make sense in the case of corporations with little public interaction, such as drilling companies and industrial manufacturers, but it would not explain the lack of public sanction of well-known retail companies, such as Fruit of the Loom. A third possibility is that then-existing social norms might not have viewed corporate expatriation as "bad" behavior.

Had the inversion trend continued without significant public attention, it is possible that at some point informal sanctions would have become ineffective, even if the public (once informed of the trend) viewed expatriations as inappropriate. In particular, if significant percentages of the market leaders in various industries had already undergone expatriations by the time the public became aware of the phenomenon, it is unlikely that public sanctions, such as boycotts, would have much affect, even if the collective action problems described by Sunstein could have been overcome. At that

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219 See supra notes 170–174 and accompanying text.

220 By the nature of their industries, Triton Energy, Transocean, Foster Wheeler, Global Marine, Nabors Industries, and Noble Drilling, among other expatriating companies, would have little interaction with the public. See supra note 165.

221 See supra note 196. Sunstein's model might suggest that even if the public had been aware of Fruit of the Loom's expatriation, and even if a significant portion of the public disfavored the transaction, collective action problems might have prevented the public from imposing meaningful sanctions against the company. See Sunstein, Social Norms and Social Roles, supra note 206, at 911. Others who have focused on the importance of collective action problems in norm development are Lawrence Lessig, The Regulation of Social Meaning, 62 U. CHI. L. REV. 943, 993–1016 (1995), and Robert Cooter, Expressive Law and Economics, 27 J. LEGAL STUD. 585 (1998).

222 Assume, for example, that most of Fruit of the Loom's competitors in the apparel industry had also expatriated by the time the public became aware of the disfavored phenomenon. Even if the expatriations were viewed as violating social norms, it is unlikely that the public could successfully boycott all of the major manufacturers in the apparel industry. Also, at the personal director level, once a sufficient number of firms in the industry expatriated, directors would no longer fear sanctions from within their community. See supra notes 206–208 and accompanying text.
point, even if the public initially would have reacted unfavorably to an isolated expatriation, the public probably would have accepted the new reality once a significant number of U.S.-based multinational corporations had moved their parents’ place of incorporation abroad.

However, as discussed previously, the corporate inversion trend did not continue to stay “below the public radar” long enough to allow significant expatriation across large numbers of industries, and thus the state of affairs described in the prior paragraph was not reached. Sparked by media reports, Congress focused significant attention on the phenomenon beginning in 2002.223

As noted above, the literature addressing the expressive function of law focuses on the norm-shaping effects of legislation actually enacted by Congress.224 Under this focus, Congress’s initial response appears to have had little expressive effect on the social norms surrounding corporate expatriation. As previously discussed, despite focusing on the expatriation issue throughout much of 2002, Congress did not actually pass legislation — the Homeland Security contract ban — until late in the year.225 However, the informal social disapproval of corporate expatriations — particularly as evidenced by the reaction to the Stanley Works proposal226 — took place before Congress finally enacted the Homeland Security alternative sanction in late November 2002. Thus, social norms opposed to corporate expatriations appear to have been in place before Congress finally enacted legislation purporting to condemn corporate inversions.

It is possible, however, that a slightly modified version of the theories on expressive legislation might have been in effect. In particular, rather than focusing on the expressive effect of statutes enacted by Congress, it is possible that the legislative debate itself had an expressive effect on social norms,227 even before Congress actually enacted legislation at the end of 2002.

It is possible to fit this modified theory — which I will refer to as

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223 See supra note 68 (listing proposed legislation targeting inversion transactions).
224 See supra notes 205–206 and accompanying text.
225 The Homeland Security Act was approved by the Senate on November 19, cleared the House of Representatives on November 22, and signed by the President on November 25, 2002. See supra note 115.
226 The possible effect of social norms on the Stanley Works proposal is discussed supra notes 192–196 and accompanying text.
227 Again, as mentioned before, this theory focuses on whether Congress’s activities actually helped change then-existing social norms, rather than merely providing information by which the public could act on then-existing social norms.
the theory of expressive legislative debate — into the framework of the expressive theory of legislation set out by McAdams, Sunstein, and others. For example, extending McAdams's theory of expressive legislation, if the legislative debates and hearings reflected that a clear consensus on desired (or undesired) behavior existed, it is possible that members of the public would receive the jolt they needed to perceive an esteem gain by complying with the reflected norm. For example, if the legislative debates and hearings made clear that there was widespread disapproval of expatriations, members of the public might be more willing to comply with informal sanctions, such as boycotts, of violators. Similarly, extending Sunstein's theory of expressive legislation, if the legislative debates and hearings reflected a clear consensus against expatriation, the debates might help overcome collective action problems and encourage members of the public to join a norm bandwagon enforcing informal sanctions against corporate violators.

It appears that this theory of expressive legislative debate had, at most, only limited applicability with respect to the corporate expatriation trend. One limitation of the theory is that the public might pay little attention to the details of ongoing debate in Congress. More importantly, even if the public were aware of the debates, the debates and related political pronouncements did not produce a clear consensus as to the acceptability (or lack thereof) of corporate expatriations. A significant number of legislators — primarily House Democrats and Senate leaders of both parties — publicly expressed their views that corporate expatriations were inappropriate and should be stopped. In contrast, several leading

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228 It is conceivable that legislative debate on a topic could reflect a clear consensus among legislators, even though Congress has not yet been able to enact the underlying legislation. For example, unrelated procedural obstacles may have prevented the legislation from being considered, or the issue on which there is consensus might be part of a larger legislative package upon which disagreement still exists.

229 This factor is similar to the earlier observation that the public is unlikely to read SEC filings on a regular basis. See supra note 173 and accompanying text.

230 For example, the Washington Post quoted Sen. Charles Grassley, the ranking Republican on the Senate Finance Committee, as stating “[t]he companies are right from the standpoint that they're not doing anything illegal, but I take a position that it is immoral and unethical. . . . Some companies are willing to stay and pay. Other companies dash and stash the cash. And that makes the former into a sucker.” Weisman, supra note 103, at E2. These legislators' views were also conveyed in regional newspapers. See, e.g., Dan Rather, Patriotism vs. Profit, THE TIMES UNION (Albany, NY), July 14, 2003, at A6 (statement by Senator Grassley that “[i]t's
legislators — primarily House Republicans — defended corporate expatriations as legitimate responses to an overburdensome tax code.\textsuperscript{211} To the extent the public perceived this lack of agreement regarding the merits of corporate expatriation, the legislative debates would not have an expressive effect in altering or confirming social norms regarding this issue.\textsuperscript{232}

It is possible, however, that the public perceived a legislative consensus against corporate expatriations despite statements by some legislators defending corporate expatriations. In particular, some legislators who viewed the inversion trend primarily as a legitimate response to an overburdensome tax code nonetheless made some public statements critical of expatriating corporations. For example, Chairman Thomas "told reporters that he might draft a three-month moratorium to send a signal to firms that are currently considering setting up parent corporations abroad."\textsuperscript{233} To the extent the public outrageous... that some companies are willing to leave their country during a war and a recession just to save some taxes."); Associated Press, Senate Panel OKs Charitable-Giving Tax Break, \textit{Deseret News} (Salt Lake City, UT), June 19, 2002, at A9 (statement by then-Senate Finance Committee Chairman Max Baucus that the then-current tax code inappropriately "let[s] a corporation, with nothing more than a file folder or post office box in a tax haven country, escape millions in U.S. taxes... "). For similar statements in the Congressional Record by Senators Baucus and Grassley, see 148 CONG. REC. S10,576 (daily ed. Oct. 16, 2002) (statement of Sen. Charles Grassley arguing for a ban of federal contracts for corporate expatriates, on the grounds that "[y]ou would think that the 'greed-grab' of corporate inversions would satisfy most companies, but unfortunately it is not enough... . Imagine the nerve. They create phony foreign headquarters to escape taxes and then use other peoples' taxes to turn a profit. That's really something, something that needs to be stopped."); 148 CONG. REC. S2594 (daily ed. April 11, 2002) (similar statement from Sen. Max Baucus).

\textsuperscript{231} For example, USA Today disseminated then-House Majority Leader Dick Armey's observation that "penalizing businesses for minimizing their tax burden by legally moving offshore 'is akin to punishing a taxpayer for choosing to itemize instead of taking the standard deduction.'" Welch, \textit{supra} note 183. A New York Times article observed that "[t]he chief tax writer in Congress, Representative Bill Thomas... reiterated his view that American tax law was forcing corporations to acquire an offshore mailbox, [saying] 'We need to do the rest of the job by passing legislation that removes incentives for companies to acquire an offshore address.'" Johnston, \textit{supra} note 190, at C3.

\textsuperscript{232} Indeed, given the disagreement reflected in much legislative debate in a broad range of areas, it is likely that legislative debate will rarely have expressive effect.

\textsuperscript{233} Sue Kirchoff, \textit{Bush Backs Tax-Haven Moratorium}, \textit{Boston Globe}, June 7, 2002, at D1, D8. There is a potential relationship between the potential expressive effect of the legislative debates and the symbolic legislation theory discussed \textit{supra} Part III. In the context of symbolic politics, to the extent Rep. Thomas and others
viewed these statements as reflecting at least a baseline sentiment that corporate inversions were "bad" (even if they were understandable responses to a problematic tax code), the legislative debate surrounding expatriations might have had at least some minimal expressive effect in solidifying social norms against the transactions, even before any expatriation-targeted legislation was enacted.

In summary, Congress's initial response to the wave of corporate expatriations appears to have played only a limited role in the social norms context. By giving significant attention to the issue, Congress served an indirect informational role, furnishing information about expatriating corporations so that members of the public who perceived the transactions as violating social norms might have been able to act on that information. However, Congress's actions appear to have had little expressive effect in altering social norms. In particular, the alternative sanction legislation Congress passed in late 2002 had little expressive effect because, by that time, there already appeared to have been a significant public consensus against expatriations. At most, the legislative debate and hearings on the issue might have had some small expressive effect to the extent the public perceived a limited consensus among legislators that expatriations were "bad."

V. TAX POLICY IMPLICATIONS OF CONGRESS'S RESPONSE

A. Tension Between New Tax Provision and Place-of-Incorporation Rule

Thus far, the article has focused on two aspects of the Congressional responses to corporate expatriations — the enacted alternative sanction purporting to ban Homeland Security contracts and the House-passed proposal modifying certain tax provisions. Part III concluded that these two responses are best understood as symbolic legislation that purports to do something about a perceived problem, but that has (or would have had, in the case of the House proposal that was not enacted into law) little direct instrumental effect. As discussed in Part IV, at most these responses and the debate surrounding them might have had limited impact on shaping who generally defend expatriations believe that social norms already disfavor expatriations, they might make limited statements criticizing expatriations in order to create the appearance that they are addressing a perceived problem. In the context of the expressive effect of legislative debate, once they make such statements they might contribute to the solidification of social norms against corporate expatriations.
the social norms, thereby indirectly affecting corporate expatriations.

In contrast to these limited impacts on corporate expatriations, the ultimate Congressional response — the AJCA tax legislation passed in 2004, based on the Senate-passed tax proposal — undoubtedly has a direct instrumental effect on corporate expatriations. As discussed previously, the AJCA provision treats the new foreign parent arising from the inversion transaction as a domestic corporation for U.S. income tax purposes. As a result of this domestic taint, the two principal tax benefits of an inversion transaction — avoidance of the Subpart F regime with respect to certain income earned by foreign subsidiaries and the ability to use earnings stripping techniques to reduce U.S. tax on income arising in the United States — are no longer available to an expatriating corporation.

A corporate inversion involving the transfer of substantially all of the properties of a domestic corporation to a foreign corporation after March 4, 2003, is subject to the new provision if two factual tests are satisfied:

Indeed, even before the enactment of the AJCA, the mere possibility that the Senate-preferred approach might be enacted may have created an interrorem effect on corporations that otherwise might have undertaken an inversion transaction. The Senate-passed provision would have applied to inversions completed after March 20, 2002. S. 1637, 108th Cong. § 441(a) (2004) (proposed I.R.C. section 7874(a)(2)(A)). This date was carried over from the Reversing the Expatriation of Profits Offshore (REPO) Act, which had been favorably reported by the Senate Finance Committee in the 107th Congress and which also was sponsored by Senators Baucus and Grassley. See S. 2119, 107th Cong. § 2(a) (2002) (proposed I.R.C. section 7874(a)(2)(A)). Any corporation considering expatriation after March 20, 2002 would have had to consider the possibility that the desired tax benefits would be lost if the Senate proposal eventually were enacted. As discussed above, the version ultimately enacted in the AJCA adopted March 4, 2003 as the operative date. See supra notes 96–97 and accompanying text.

This discussion focuses on the provisions applicable when there is at least eighty percent continuity of ownership in the post-inversion foreign corporation by the stockholders of the pre-inversion domestic corporation. See supra note 97. In the case of corporate expatriations where there was less than eighty percent, but at least sixty percent, continuity of ownership, the AJCA adopted the approach favored by the House, which merely limits the ability of the expatriating corporation to utilize various tax attributes to offset gains from the inversion, but respects the resulting corporation as a foreign corporation. See supra note 97.

These two tax goals of corporate inversions are discussed in detail supra notes 43–60 and accompanying text.

The AJCA provision also addresses partnership inversions. See Pub. L. No.
(i) after the transaction, at least eighty percent of the stock of the foreign corporation is held by former shareholders of the domestic corporation (the ownership continuity test),\(^{239}\), and

(ii) neither the foreign corporation nor its corporate group has substantial business activities in the foreign country under whose laws the foreign corporation is organized (the no substantial business activity test).\(^{240}\)

Accordingly, if these tests are satisfied, the post-inversion corporate parent is treated as a domestic corporation for U.S. tax purposes, even though it is incorporated in a foreign country, such as Bermuda, rather than the United States.

This newly enacted provision addressing corporate inversions constitutes a significant departure from the long-standing place-of-incorporation rule for determining corporate residence. The place-of-incorporation rule, which has been the jurisdictional touchstone for corporate taxation since the early days of the modern income tax,\(^{241}\), looks solely to the jurisdiction in which the corporation is incorporated: corporations incorporated under the laws of one of the U.S. states are domestic, while those incorporated under the laws of a foreign country are foreign.\(^{242}\) Factual inquiries, such as the identity and residence of the corporation's shareholders, the location of the corporation's management, or the place where the corporation conducts its business activities,\(^{243}\) are ignored under the place-of-incorporation rule.

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108-357, § 801(a), 118 Stat. at 1562 (2004). This article, however, focuses only on the implications of the proposal with respect to the taxation of multinational corporations.

\(^{239}\) I.R.C. § 7874(a)(2)(B), (b) (as passed in Pub. L. No. 108-357, § 801(a), 118 Stat. at 1563 (2004)).

\(^{240}\) I.R.C. § 7874(a)(2), (b) (as passed in Pub. L. No. 108-357, § 801(a), 118 Stat. at 1563 (2004)). These requirements are discussed in detail supra notes 96–97 and accompanying text.

\(^{241}\) See Graetz & O'Hear, supra note 8, at 1060.

\(^{242}\) I.R.C. § 7701(a)(4), (5). See also supra notes 24–25 and accompanying text.

\(^{243}\) In contrast to the U.S. tax code's focus on place of incorporation, other countries often base corporate residence on fact-specific inquiries, focusing on "some economic or commercial connection such as the place of management, principal business location, or less frequently, residence of shareholders." HUGH J. AULT ET AL., COMPARATIVE INCOME TAXATION: A STRUCTURAL ANALYSIS 371 (1st ed. 1997). More recently, some countries have combined the place-of-incorporation test and the fact-specific tests, "treating a corporation as resident if either test is satisfied." Id. at 371–73 (explaining the use of combined tests by the United Kingdom, Canada, Australia, Germany, and the Netherlands).
incorporation test.\textsuperscript{244}

Even after enactment of the AJCA provision, the place-of-incorporation rule remains the general rule for determining corporate residence, applicable to the vast majority of corporations. The legislation's special domestic taint rule applies only in the case of inverting corporations that run afoul of the ownership continuity and no substantial business activity tests. In effect, the tax code now has a two-tiered test for determining corporate residence: the place-of-incorporation rule for most corporations, and the domestic taint rule for certain corporate inversions.

The normative justifications offered for this two-tiered approach cast significant doubt on the continuing viability of the general place-of-incorporation rule. In particular, the very reasons given by the Senate Finance Committee Report for supporting the special rule for inversions lead to the logical conclusion that the place-of-incorporation rule should be reconsidered and, perhaps, abandoned. In effect, the arguments supporting the special rule for inversions are the tax policy equivalent of declaring that the Emperor (in this case, the long-standing place-of-incorporation rule) has no clothes.\textsuperscript{245}

According to the Senate Finance Committee Report accompanying the Senate-passed proposal (upon which the AJCA provision was based), the reason for enacting a special residence test

\textsuperscript{244} See supra note 25. Factual inquiries have some tangential relevance under current law, particularly in determining the source of an income item paid by a corporation to another taxpayer. The rules for determining the source of income—which rules are relevant in determining the scope of taxation if the recipient of the income is a foreign taxpayer and the availability of a foreign tax credit if the recipient of the income is a domestic taxpayer—sometimes depend on the residence of the corporation paying the item (as determined under the place-of-incorporation rule). For example, interest paid by a domestic corporation generally is treated as domestic source, see I.R.C. § 861(a)(1), and dividends paid by a domestic corporation generally are treated as domestic source, see I.R.C. § 861(a)(2)(A), whereas interest paid by a foreign corporation generally is treated as foreign source, see I.R.C. § 862(a)(1), and dividends paid by a foreign corporation generally are treated as foreign source, see I.R.C. § 862(a)(2). However, if a domestic corporation receives at least eighty percent of its gross income from the active conduct of a foreign business, the interest it pays is treated, at least in part, as foreign income. See I.R.C. § 861(a)(1)(A), (c). Similarly, if a foreign corporation receives at least twenty-five percent of its gross income from the conduct of a U.S. business, a portion of the dividends it pays are treated as domestic income. See I.R.C. § 861(a)(2)(B). Cf Joseph L. Andrus, Determining the Source of Income in a Changing World, 75 TAXES 839, 841–54 (1997) (discussing the role of residence in determining the source of income).

\textsuperscript{245} Cf HANS CHRISTIAN ANDERSEN, The Emperor's New Clothes, in STORIES FOR THE HOUSEHOLD 56 (Porter and Coates 1877).
for inversion transactions is that these transactions, by changing the place of the parent’s incorporation, generally result in only

a minimal presence in a foreign country of incorporation. . . . In particular, these transactions permit corporations and other entities to continue to conduct business in the same manner as they did prior to the inversion, but with the result that the inverted entity avoids U.S. tax on foreign operations and may engage in earnings-stripping techniques to avoid U.S. tax on domestic operations. The Committee believes that certain inversion transactions . . . have little or no non-tax effect or purpose and should be disregarded for U.S. tax purposes.246

Statements by the supporters of the recently-enacted AJCA provision further reflect this view that a change in place of incorporation is a mere paperwork formality, devoid of any substance. For example, on a nationally syndicated television show, Senator Grassley summarized an inversion transaction as follows: “Go down there [Bermuda], set up a file cabinet with a sheet of paper in it.”247 Also, the late Senator Paul Wellstone, who had sponsored legislation similar to the Senate proposal,248 argued that

a number of prominent U.S. corporations, using creative

246 S. REP. NO. 108-192, at 142 (2003). Similarly, the California legislature, in passing the California Taxpayer and Shareholder Protection Act, discussed supra note 79, made a finding that “[a]n expatriate company is a United States based company that has moved in name and on paper only to a tax haven country and has no substantial business activities in the country of reincorporation.” S.B. 640, 2003 Leg., Reg. Sess. (Cal. 2003).


248 See S. 2050, 107th Cong. § 1(a) (2002). The Wellstone proposal, like the recently-enacted AJCA provision, would have treated a post-inversion foreign-incorporated parent as a domestic corporation for tax purposes. Unlike the AJCA provision, the Wellstone proposal would have required this domestic taint if there was at least fifty percent (rather than eighty percent) continuity of ownership, without regard to whether substantial business was conducted by the foreign corporation in its country of incorporation, and without regard to the date of the inversion transaction (i.e., even if the transaction occurred on or before March 4, 2003). Id.
paperwork, have transformed themselves into Bermuda corporations in order to avoid paying their share of U.S. taxes. These new Bermuda companies are basically shell corporations. They have no staff, no offices, no business activity in Bermuda. This exists for the sole purposes of shielding income from the IRS.  

This lack of confidence in the tax code's general focus on place of incorporation is furthered by the "no substantial business activity" test of the legislation. By calling off the special domestic taint if the post-inversion corporate parent conducts substantial business activities in the country in which it is incorporated, the provision implies that the location of a corporation's business activities may be a more legitimate determinant of residence than is the place of incorporation. Indeed, a bill introduced by Senator Evan Bayh, which would have imposed a domestic taint on expatriated corporations in a manner similar to the AJCA provision, went so far as to use the defined term "nominally foreign corporation" to refer to the post-inversion parent.

If, as the supporters of the new provision imply, a change in the corporate parent's place of incorporation is mere "paperwork" involving a new "sheet of paper," the logical question is why does the U.S. tax code generally rely on a corporation's place of incorporation as the touchstone for defining residence? After all, if the place of incorporation is a mere formality devoid of substance, it seems

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250 See supra note 240.
251 Similarly, statements during Senate debates imply that the location of a corporation's management headquarters and production and service facilities might be a better determinant of residence than is the place of incorporation. For example, Senator Levin, in arguing for applying a domestic taint test to the post-inversion parent corporation, described corporate inversions as "when a U.S. corporation reincorporates on paper in a tax haven and establishes a headquarters there when, in reality, its primary offices and production or service facilities remain right here in the United States." 149 CONG. REP. S2520 (daily ed. Feb. 14, 2003). Also, a "sense of the Congress" provision approved by the House Ways and Means Committee implies that factors other than place of incorporation — particularly the location of the owners of the corporation — are more accurate gauges of whether a corporation is a "United States corporation." See H.R. 1531, 108th Cong. § 402(a) (as reported in the House April 9, 2003) (using the term "domestically-owned corporation" synonymously with the term "United States corporation").
difficult to justify imposing worldwide taxation, as well as the Subpart F anti-deferral regime, based solely on that factor.

The remainder of this part examines this inherent tension between the recently-enacted domestic taint provision for inverted corporations and the general place-of-incorporation test. In particular, Subpart B examines the allegations by supporters of the new provision that a corporation's place of incorporation, and thus a change in its place of incorporation, is merely a matter of paperwork with no substantive meaning. In particular, it focuses on the extent to which the benefits, rights, and obligations of the corporation and its stakeholders are dependent on the place of incorporation. The subpart concludes that there are some substantive non-tax consequences that depend on the place of incorporation, but that these factors might not be sufficient to justify the significant tax consequences that flow from a domestic characterization under the place-of-incorporation test. Subpart C then considers whether any other considerations might justify a distinct test for determining corporate residency in the context of a corporate expatriation. Subpart D concludes that the recently enacted two-tiered system is not justifiable, and that Congress should adopt a uniform rule for determining whether a corporation is treated as domestic or foreign for tax purposes. This could be accomplished by either retaining the place-of-incorporation rule, with its inherent weaknesses described in Subpart B and its inherent facilitation of inversion transactions, or, preferably, by eliminating the place-of-incorporation rule and replacing it with a more substantive test of corporate residence as the general rule.

Before proceeding to the analysis, it is important to consider one additional preliminary issue. The following discussion of a corporation's residence implies that residence is relevant in determining a corporation's tax liability. In particular, it assumes that the United States will retain a residence-based tax system that taxes domestic corporations (however defined) on their worldwide income, providing a foreign tax credit to alleviate the potential for double taxation.\footnote{The general differences between a worldwide residence-based tax system and a territorial tax system are discussed supra notes 20–22 and accompanying text. The article also assumes that the United States will, as a general matter, continue to treat a corporation as a separate entity from its shareholders and subsidiaries. Cf. Graetz, supra note 12, at 316:}

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United States should retain a residence-based system for corporations or should, instead, move toward a territorial system. That issue has been addressed in detail by other commentators.254

B. Substantive Aspects of Place of Incorporation

As discussed in the prior subpart, supporters of the recently-enacted provision, which imposes a domestic taint on a corporation that undergoes an inversion, argue that the inversion transaction should be ignored because it is merely a shuffling in paperwork, devoid of substance. This subpart explores this claim.

1. Corporate Governance

One potential difference between the pre-inversion corporate parent (incorporated under the laws of a U.S. state, such as Delaware) and the post-inversion corporate parent (incorporated under the laws of a foreign country, such as Bermuda) concerns corporate governance. The laws of the two jurisdictions regarding shareholder

that no longer reflect the economic realities of international business, if they ever did. The continuing insistence of the international tax regime in treating different divisions of an integrated multinational business as separate entities, whenever their legal status implies such separation, is but one illustration of the problem.

Id. (footnote omitted).

254 For a summary of articles advocating the adoption of a territorial, or exemption, system, whereby the United States generally would tax only a corporation's income that arises in the United States, see Fleming et al., supra note 32, at 303 n.9. Recent articles defending worldwide taxation of U.S.-resident corporations and arguing for its expansion by eliminating the opportunities for deferral include Fleming et al., supra note 32; Fleming et al., Deferral: Consider Ending It Instead of Expanding It, 86 TAX NOTES 837 (Feb. 7, 2000); Peroni et al., supra note 1. Even if the United States were to move toward a territorial system, there would probably still be a need to define corporate residence. In particular, many proponents of territoriality do not advocate the full exemption of all foreign source income but, instead, contemplate only the exemption of foreign business income. See, e.g., Graetz, supra note 12, at 330. Broadly exempting all foreign income "would create a substantial incentive to move mobile and portfolio capital abroad, creating an unacceptable risk to both the U.S. Treasury and U.S. residents." Id. Accordingly, to the extent that the United States under a territorial system might still tax domestic corporations on some residual categories of income (e.g., foreign portfolio income earned in tax haven countries), there would still be a need to define a "domestic" corporation. Cf. id. at 323 (arguing that the "fragility and manipulability" of corporate residence tests suggest that "U.S. international tax policy, to the extent possible, should reduce the tax consequences of determinations of residence for corporations.").
rights and the actions of directors and officers might differ significantly.

Indeed, these potential differences have led to some of the most vocal criticisms of corporate inversions. In particular, numerous institutional investors and labor unions have objected to the potential loss of shareholder rights following a corporate inversion.\textsuperscript{255} For example, the California Public Employees' Retirement System (CalPERS), in urging the Tyco Board of Directors to undo Tyco's expatriation by reincorporating in the United States, argued that:

Shareowners lost a significant level of accountability when Tyco reincorporated from Delaware to Bermuda.... Bermuda incorporation makes it more difficult for shareholders to hold companies, their officers and directors legally accountable in the event of wrongdoing; class actions are generally not available under Bermuda law; and shareholders have extremely limited ability to sue officers and directors derivatively on behalf of the corporation.\textsuperscript{256}

\textsuperscript{255} These critics of inversions often adopt rhetoric similar to that of supporters of the recently-enacted tax provision. For example, the California Public Employees' Retirement System (CalPERS) has referred to inversion transactions as "sham relocations." Laura Mahoney, \textit{CalPERS Calls on Expatriate Companies to Return Incorporation to United States}, \textit{DAILY TAX REP. (BNA)}, Nov. 20, 2002, at G-5, \textit{available at LEXIS, 224 DTR G-5}. However, these institutional investors, by criticizing inversions based on the accompanying loss of shareholder voting rights, implicitly acknowledge that the change in place of incorporation has at least some substantive consequences.


\textsuperscript{256} Laura Mahoney, \textit{CalPERS Urges Tyco's Largest Shareholders to Move
Moreover, inversion opponents have criticized the lack of transparency and predictability of Bermuda corporate law relative to Delaware law. The expatriated corporations have challenged some

(c) When a company expatriates, its shareholders are generally left without the opportunity to pursue derivative lawsuits and without the ability to enforce legal judgments against the company under the United States and California securities laws. Therefore, matters relating to standard fiduciary duties of officers and directors of the corporation may be less dutifully monitored or controlled.

(d) Further, the shareholders of expatriate companies stand to lose their rights to submit a shareholder proposal, inspect or obtain copies of the company’s corporate records, or approve a sale, lease, or exchange of all or substantially all of the corporation’s assets. In some cases, an expatriate company may significantly limit shareholder voting rights or dissenting shareholders’ appraisal rights.

(e) This diminution of shareholder rights... undermine[s] the faith and confidence of investors in the integrity of the financial markets.


257 In written testimony submitted to a Senate Appropriations subcommittee, the AFL-CIO asserted:

Delaware... has an advanced and flexible corporate law, expert specialized courts dealing with corporate-law issues, a responsive state legislature and a highly developed body of case law that allows corporations and shareholders to understand the consequences of their actions and plan accordingly. Bermuda, by contrast, does not even have published reports of legal cases, making it difficult to determine how the courts have ruled on corporate law issues. It is also difficult to obtain access to books on Bermuda law, since public law library resources are almost non-existent. We believe the stability, transparency and predictability of Delaware’s corporate law is superior to Bermuda’s and provide advantages to shareholders.

AFL-CIO Testimony on Corporate Inversions, TAX NOTES TODAY (Oct. 17, 2002) (LEXIS, FEDTAX lib., TNT file, elec. cit., 2002 TNT 201-22). Similarly, the New York Times reporter who first brought the expatriation phenomenon to widespread public attention observed:

[T]here were two practical benefits of choosing Bermuda as a tax headquarters. Bermuda does not have law books that neatly organize and arrange the decisions of its court. Lawyers who want to know Bermudian case law must either ask their peers or go through the court decisions in the court clerk’s office one case at a time. Even better from the point of view
of the assertions about post-expatriation diminution of shareholder rights, but have acknowledged that at least some of these concerns regarding shareholder rights "are well-founded."

of managements who want to run companies as they see fit without interference from shareholders, there are no Bermuda law firms that specialize in representing plaintiffs against corporations. Bermuda is a country with a one-sided bar.

Johnston, supra note 3, at 237; cf. Bernard S. Black, Is Corporate Law Trivial?: A Political and Economic Analysis, 84 NW. U. L. REV. 542, 589–90 (1990) (arguing that Delaware's prominence in attracting corporate charters primarily is attributable to the expertise of its judges in interpreting the law); Marcel Kahan & Ehud Kamar, The Myth of State Competition in Corporate Law, 55 STAN. L. REV. 679, 746 (2002) (arguing in another context that even though there are many indeterminacies in Delaware corporate law, it offers more predictability than other jurisdictions, particularly because "Delaware currently offers a single corporate tribunal that regularly hears corporate cases with expert judges and without juries.").

For example, the Tyco Board of Directors recently stated that

the proponent's assertion that shareholders have extremely limited ability to sue officers and directors derivatively, on behalf of the Company is based on a misunderstanding of Bermuda law. Bermuda law does in fact permit shareholders to bring claims, on behalf of the Company, where it is alleged that there has been wrongdoing at the expense of the Company and the alleged wrongdoers are in control of the Company. Similarly, the proponent's assertion that Bermuda law does not allow class action litigation fails to take into account that Tyco is fully subject to all U.S. federal securities laws, as well as all U.S. federal law concerning the ability of shareholders to initiate class action litigation asserting violations of those securities laws.

Tyco International Ltd., supra note 255, at 65.

Id. According to a recent Tyco proxy statement,

The Board also determined, however, that some of the arguments advanced by the proponents and others regarding differences between Bermuda and U.S. law are well-founded. With respect to those arguments, the Board considered whether those differences could be addressed by changes to the Company's governing documents. As a result, the Board has concluded that the rights of shareholders [concerning sales of substantially all the company's assets and the adoption of shareholder rights plans] can be adequately protected by two amendments to the Bye-laws [sic].

Id. In addition, the Tyco Board noted:

The proponent also contends that a Bermuda court may not enforce a U.S. judgment. While it is true that Bermuda courts have refused to enforce certain U.S. judgments in very limited circumstances and that Bermuda courts, as a general matter, do not enforce non-compensatory damage awards, Tyco has assets in the U.S. sufficient to satisfy any judgment, and, even if Tyco attempted to use its Bermuda domicile to avoid a U.S.
The differences in shareholder rights before and after an inversion flow from the judicially created "internal affairs" doctrine. As summarized by the Supreme Court:

[...] the internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs — matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders — because otherwise a corporation could be faced with conflicting demands.  

judgment, Bermuda courts generally enforce final judgments of U.S. courts (other than awards of non-compensatory damages) where jurisdiction in the U.S. court was proper, the U.S. proceeding observed the rules of natural justice, the judgment was not obtained by fraud, and its enforcement would not contravene the public policy of Bermuda.

Id. See also INGERSOLL-RAND COMPANY LIMITED, SEC FORM S-4 (Oct. 16, 2001), at 16 (acknowledgement in Ingersoll-Rand prospectus that "enforcement of judgments in shareholder suits against [the company] may be more difficult" following the expatriation).

260 Edgar v. MITE Corp., 457 U.S. 624, 645 (1982). The internal affairs doctrine also is reflected in the Model Business Corporations Act. See MODEL BUS. CORP. ACT § 15.05(c) (1998) ("This Act does not authorize this state to regulate the organization or internal affairs of a foreign corporation authorized to transact business in this state."); see generally Detlev F. Vagts, Extraterritoriality and the Corporate Governance Law, 97 AM. J. INT'L L. 289, 293 (2003) (arguing that the internal affairs doctrine "has been regularly observed in the United States and forms the basis on which Delaware's preeminence as a home to corporations rests. Departures have been few and insignificant."). Professor Gilson has noted that

[b]ecause in the United States a corporation's internal affairs (including especially its corporate governance) is governed by its state of incorporation without regard to its principal place of business, a U.S. corporation can choose the state corporate law that governs its affairs by choosing its state of incorporation. The aggregated choices of a majority of publicly traded U.S. corporations have resulted in a convergence on the Delaware General Corporation Law as a de facto national corporate law.


The doctrine does not, however, extend to transactions between a corporation or its shareholders and a third party. See, e.g., MITE Corp., 457 U.S. at 645 (holding that the doctrine does not extend to transactions between stockholders and a third party, such as tender offers); RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 301 & cmt. a (1971) (explaining that the rights and liabilities of a corporation to a third person —
The internal affairs contemplated by this doctrine include the election or appointment of officers and directors, the adoption and amendment of bylaws, the holding of directors' and shareholders' meetings, and the determination of methods of voting.\textsuperscript{261} Indeed, the Delaware Supreme Court applied the internal affairs doctrine to a shareholder rights dispute following an early corporate inversion, finding that Delaware corporate law did not apply to a voting rights dispute after the corporation was incorporated in Panama.\textsuperscript{262}

Thus, the internal affairs doctrine appears to support, at least to a limited extent, the concern of inversion opponents concerning the possible loss of shareholder rights after a corporate parent reincorporates from a U.S. state to a foreign country that has less protective (or less transparent) corporate governance laws.

There is one additional consideration that might limit this corporate governance concern, particularly with respect to publicly traded corporations that expatriate. Following recent inversions, the corporations generally have retained significant benefits concerning the marketability of their stock — in particular, the expatriating companies remain included on the S&P 500 (if they were included prior to the inversion),\textsuperscript{263} and the stock of the new parent corporations

\textsuperscript{261} According to the Restatement (Second) of Conflict of Laws, matters falling within the internal affairs doctrine include:

\begin{quote}
steps taken in the course of the original incorporation, the election or appointment of directors and officers, the adoption of by-laws, the issuance of corporate shares, preemptive rights, the holding of directors' and shareholders' meetings, methods of voting including any requirement for cumulative voting, shareholders' rights to examine corporate records, charter and by-law amendments, mergers, consolidations and reorganizations and the reclassification of shares.
\end{quote}

\textsuperscript{262} See McDermott Inc. v. Lewis, 531 A.2d 206 (Del. 1987).

\textsuperscript{263} See, e.g., \textit{COOPER INDUSTRIES, LTD.}, SEC FORM S-4 (June 11, 2001), at 12:

The S&P 500 tracks the performance of 500 stocks considered
continues to be listed on the New York Stock Exchange (NYSE). As a result of this continued NYSE listing, the corporations remain subject to the exchange’s listing agreement, which includes certain corporate governance-related provisions. However, these listing agreement provisions are relatively limited, and foreign-incorporated entities are exempt from several of them.

In summary, while the claims of labor unions and institutional investors regarding the diminution of shareholder rights upon an expatriation might be somewhat overstated, there is at least some merit in them. Accordingly, claims by proponents of the recently-enacted AJCA legislation that corporate inversions are mere

representative of the U.S. economy generally. [The pre-inversion corporation] is currently included in the S&P 500 Index. There are a number of companies incorporated outside the United States that have been included in the S&P 500 Index. Based on a review of the factors considered by the S&P to determine inclusion in the S&P 500 Index, we believe that [the post-inversion corporation] will satisfy the criteria for continued inclusion in the S&P 500 Index.

COOPER INDUSTRIES, LTD. at 12; INGERSOLL-RAND COMPANY LIMITED, supra note 259, at 16 (containing language substantively identical to that in the Cooper Industries prospectus). In a mid-2002 press release, the committee responsible for supervising the Standard & Poor’s market indices observed:

Lately there has been a lot of discussion regarding U.S. companies that transfer their registration to Bermuda to reduce their U.S. tax liability. In situations where the only factor suggesting that a company is not a U.S. company is its tax registration in Bermuda or another location chosen for tax-related reasons, Standard & Poor's normally determines that the company is still a U.S. company.


264 See, e.g., COOPER INDUSTRIES, LTD., supra note 263, at 19 (“Immediately following the reorganization, . . . common shares of [the post-inversion corporation] will be listed on the New York Stock Exchange under the symbol ‘CBE,’ the same symbol under which [pre-inversion corporation] common stock is currently listed.”); INGERSOLL-RAND COMPANY LIMITED, supra note 259, at 22 (containing language substantively identical to that in the Cooper Industries prospectus).


266 See id at 687.
paperwork shams, with no substantive non-tax consequences, are themselves not fully accurate in light of these corporate governance consequences.

2. Trade, Commerce, and Investment Benefits

Although a thorough analysis of the trade, commerce, and investment law implications of corporate inversions is beyond the scope of this article, it is useful to consider briefly whether the place of incorporation has significant consequences for international trade, commerce, and investment law purposes.

With respect to the broad range of international treaties and agreements dealing with trade in goods to which the United States is a party, such as the North American Free Trade Agreement (NAFTA), a corporate parent’s place of incorporation has only limited effects. In particular, the focus of these trade treaties is the origin of the goods — where they are produced — rather than the place of incorporation of the producer. However, a company's

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267 It is possible to interpret some of these claims as merely stating that there is, in substance, no change in the corporate headquarters as a result of the inversion. For example, the California legislature limited its finding regarding the substance of inversions transactions as follows: “[a]n expatriate company is a United States based company that has moved in name and on paper only to a tax haven country and has no substantial business activities in the country of reincorporation.” S.B. 640, 2003 Leg., Reg. Sess. (Cal. 2003). However, much of the rhetoric of inversion opponents has been more reaching, claiming that there are no substantive consequences to the inversion. See supra note 246 and accompanying text.

268 However, given the fact that numerous inversions nonetheless occurred, these corporate governance consequences may not have constituted significant enough “friction” to offset the anticipated benefits of reincorporating abroad. See generally David M. Schizer, Frictions as a Constraint on Tax Planning, 101 COLUM. L. REV. 1312 (2001) (analyzing the extent to which non-tax frictions act as a constraint on aggressive tax planning).


271 Id. at Art. 401; see also Proceedings of the Seventh Annual Conference on Legal Aspects of Doing Business in Latin America: Adapting to a Changing Legal Environment, 9 FLA. J. INT’L L. 1, 33 (1994) [hereinafter Proceedings] (“If your clients are dealing in goods, if you have a trade issue, you need to think about the origin of
place of incorporation might have some relevance in determining eligibility with respect to cross-border services under NAFTA.\[272\]

the goods, and their North American content. \dots [T]he points of attachment for trade are the origin of the goods."); Cao, supra note 269, at 462–63 (discussing importance of origin of goods under free trade agreements and other preferential regimes).

\[272\] For example, a place-of-incorporation rule generally applies to determine an "enterprise of a Party" that is eligible for NAFTA benefits in the other country. Thus, a Bermuda-incorporated corporation is not eligible for benefits. However, a U.S.-incorporated subsidiary of that Bermuda corporation is eligible for benefits. See Eric Leroux, NAFTA and the Financial Services Sector, in 1 North American Free Trade Agreements Commentary C.19, p. 16 & n.88 (James R. Holbein & Donald J. Musch eds., 1998). Accordingly, while the corporate parent following an inversion would not be covered by the trade-in-services provisions of NAFTA, a U.S.-incorporated subsidiary would be. As summarized by a former Deputy Assistant Commerce Secretary for Service Industries and Finance:

Which service firms are entitled to benefit from these [NAFTA benefits]?

There are two options for standards. The nationality of a service firm can be judged based upon where it is incorporated, or alternatively on the basis of its ultimate parentage. For example, consider the Deutsche Bank USA; is it a U.S. bank or a German bank? Under the place of incorporation standard, it is a U.S. bank, entitled to all of the benefits of NAFTA. Under the ultimate parentage test, it is a German bank, not entitled to any of the benefits of NAFTA.

In the general services chapter, Cross-Border Trade in Services (Chapter 12), the standard selected is the place of incorporation. The United States considers this appropriate because we want subsidiaries of U.S. firms in Europe to be treated the same as if they were indigenous European firms. This is in our bilateral investment treaties. Unfortunately, in the Financial Services Chapter, we were unable to get Canada to agree with that. Canada insisted on an ultimate parentage test. Thus, in the Financial Services Chapter, each of the three countries will select which standard it is going to use. The United States and Mexico will still use the place of incorporation standard; thus, it will only be Canada which will use the ultimate parentage test.

Linda Powers, NAFTA and the Regulation of Financial and Other Services, 1 U.S.-Mex. L.J. 65, 68–69 (1993) (footnotes omitted); see also Proceedings, supra note 271, at 33 ("[I]f you are dealing with a services or an investment issue, think of the nationality of those who own the capital stock of your client and its place of incorporation, because for services and investment the points of attachment are nationality of the company and place of incorporation."). Even if the corporate group's parent would lose some benefits under the NAFTA service provisions as a result of a change in place of incorporation, a U.S.-incorporated subsidiary of the group would still be considered a U.S. national to the extent the place-of-incorporation rule applied, thereby limiting potential adverse consequences to the group.
The United States also has a network of more than three dozen Bilateral Investment Treaties (BITs), which protect foreign investments of U.S. investors. The current draft of the Model BIT defines an “enterprise of a Party,” which is entitled to investment protection under the treaty, to mean “an enterprise constituted or organized under the law of a Party, and a branch located in the territory of a Party and carrying out business activities there.” Thus, under this language, eligibility for protection under a BIT is not dependent solely on a corporate parent’s place of incorporation, but would apply also to a business branch of the corporate parent in the United States (in the unlikely event the post-expatriation parent had such a branch). However, earlier iterations of U.S. BITs use only a place-of-incorporation rule to define the company eligible for BIT


The Supreme Court in Sumitomo Shoji America applied the plain language of the U.S.-Japan FCN treaty to find that a place-of-incorporation rule applies to determine whether a corporation is a “company of” a particular treaty country for purposes of the treaty. 457 U.S. at 188. Accordingly, the Court held that a New York-incorporated subsidiary was a company of the United States for purposes of the treaty (and thus not eligible for benefits otherwise available to a Japanese company), even though it was wholly owned by a Japanese company. Id. at 182–83. However, the Court then noted that many other operative provisions of the FCN treaty apply not only to a company of a treaty country (i.e., a company incorporated under the laws of that country), but also to a company controlled by nationals or companies of a treaty country. Id. at 183 & n.8. Thus, it is possible that a corporate parent, following an expatriation to a third country, might still be eligible for certain FCN treaty benefits to the extent it is controlled by U.S. nationals or companies.


276 The Model Bilateral Investment Treaty would also cover a U.S.-incorporated subsidiary of the group.
coverage. Thus, under these earlier BITs that are still in force, place of incorporation has some relevance.

In addition to these potential treaty consequences, a change in place of incorporation might affect eligibility for various trade and commercial benefits under U.S. law. The Homeland Security Act contract ban on expatriated corporations could be viewed as one such adverse consequence. However, as discussed supra, this alternative sanction is primarily symbolic and has little instrumental effect on an expatriating corporation.

Another potential example of the relevance of place of incorporation concerns recent reconstruction-related contracts arising from the recent war in Iraq. In a highly publicized action, the Deputy Secretary of Defense announced that twenty-six major construction and services contracts to be awarded by the Coalition Provisional Authority and by the Department of Defense would only be awarded to “firms from the United States, Iraq, Coalition partners and force contributing nations.” The Deputy Secretary’s declaration listed sixty-three countries whose companies were eligible to bid on these prime contracts, but it did not contain any details specifying how to determine whether a company was “from” a particular country. However, subsequent contract solicitations by

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277 See, e.g., Investment Treaty with the Republic of Ecuador, Aug. 27, 1993, U.S.-Ecuador, S. TREATY DOC. NO. 103-15, art. I(1)(b) (“[C]ompany of a party means any kind of corporation ... legally constituted under the laws and regulations of a Party or a political subdivision thereof.”).

278 See supra notes 72–78 and accompanying text.

279 See supra notes 101–134 and accompanying text. As noted supra notes 79–81, several states have enacted contract bans with respect to expatriated corporations. To the extent an expatriated corporation would otherwise have bid on a state contract, these state bans would have some instrumental effect because they do not have the significant exceptions contained in the Homeland Security alternative sanction.


the Department of Defense set forth a narrow definition of a company's home country for this purpose.\textsuperscript{284} In particular, a company is considered to be "from an eligible country" only if it is "organized under the laws of an eligible country and... has its principal place of business in an eligible country. Further, the corporation... cannot be a subsidiary (wholly owned or otherwise) of a parent company that is organized under the laws of a non-eligible country."\textsuperscript{285}

Accordingly, a corporate expatriation might have substantive consequences in this context. In particular, if the post-expatriation corporate parent were incorporated in a non-eligible country, neither the parent nor its subsidiaries (even subsidiaries incorporated in the United States and with their principal place of business in the United States) would be eligible to bid as a prime contractor.\textsuperscript{286}

In summary, U.S. laws, treaties, and administrative guidance regarding international trade and commerce do not adopt a uniform standard regarding the relevance of place of incorporation.\textsuperscript{287} As a


\textsuperscript{285} U.S. ARMY CECOM, supra note 284, at 58.

\textsuperscript{286} The principal countries in which expatriate corporations reincorporate are Bermuda and the Cayman Islands. See Desai & Hines, supra note 1, at 418–20. Neither of these countries is an eligible country for purposes of the Iraq contract bids. See DEPUTY SEC’Y OF DEF., U.S. DEP’T OF DEF., supra note 281, attachment 2. However, McDermott International, which is considered to have undertaken the first modern corporate inversion in 1983, reincorporated its parent in Panama. See Desai & Hines, supra note 1, at 418. Because Panama is an eligible country for purposes of Iraq contract bids, a McDermott subsidiary that is incorporated in the United States and that has its principal place of business in the United States would be eligible to bid.

\textsuperscript{287} In this regard, an observation made at the outset of a 1989 Congressional hearing concerning the appropriate definition of a “U.S. Company” in another context remains true:

The swirl of answers and the variations on logic that this question provokes can lead one to believe he has been transported through the looking glass, where Humpty Dumpty told Alice, “When I use a word, it means just what I choose it to mean, neither more nor less.” Alice responded, “The question is whether you can make words mean so many different things.”

\textit{What is a U.S. Company?: Hearing Before the Subcomm. on Science, Research and
broad generalization, the place of incorporation of the parent corporation is significant in some isolated circumstances, such as the Iraq contract ban, but a corporation's place of incorporation would not appear to have substantial relevance in many significant trade and commercial areas. This conclusion is buttressed by the fact that recent prospectuses of companies considering expatriations have not mentioned the potential loss of trade or other commercial benefits as a potential adverse consequence of the expatriation.288

3. Other Possible Benefits

There are other potential benefits to being incorporated under the laws of a U.S. state. For example, from a symbolic perspective, there might be additional prestige associated with being incorporated under U.S. law. Similarly, there may be some marginal benefit to being perceived by the U.S. public as an "American" corporation to the extent the U.S. public prefers to "buy American." However, there is some question as to whether the public would base this buying decision on a seller's place of incorporation (as opposed to where it actually manufactures its goods or other factors).289

In addition, a U.S. legislator might be more willing to champion the cause of a corporation incorporated within the United States and U.S. diplomatic personnel might be more willing to provide aid to such a company.290 However, it is reasonable to assume that such

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288 See, e.g., INGERSOLL-RAND COMPANY LIMITED, supra note 259, at 14-16 ("Risk Factors" section makes no reference to adverse trade or commerce consequences); id. at 4 ("The reorganization should have no material impact on how we conduct day-to-day operations."); COOPER INDUSTRIES, LTD., supra note 263, at 11 ("Risk Factors" section makes no reference to adverse trade or commerce consequences); id. at 2 ("The reorganization ... will have no immediate impact on how we conduct day-to-day operations."). It should be noted that these prospectuses were issued prior to the December 2003 Department of Defense determination regarding Iraq contract eligibility, so that factor was not incorporated into the prospectuses' analyses.

289 The 1998 merger of Chrysler Corporation and Daimler-Benz AG to form DaimlerChrysler AG illustrates this issue. The parent corporation resulting from this merger is incorporated under German law. Nonetheless, it is reasonable to assume that most people continue to view Chrysler automobiles as "American."

benefits — particularly support from legislators — would also be available to a U.S. branch or subsidiary of a foreign-incorporated entity. For example, even had Stanley Works completed its proposed Bermuda inversion, it is reasonable to assume that Senators and Representatives from Connecticut would have continued to represent the interest of the company to the extent necessary to keep manufacturing and headquarters jobs located in New Britain, Connecticut, and elsewhere in the state.

4. Tax Policy Implications

a. Benefits Theory

As discussed in the preceding sections, a corporation’s place of incorporation might have some limited significance regarding corporate governance, international trade and commerce, and other areas. It is important to consider the tax policy implications of this conclusion with respect to the general place-of-incorporation rule for determining a corporation’s tax residence.

One possible justification for the place-of-incorporation rule for determining tax residence is under a benefits theory. To the extent a corporation receives benefits by being organized under the laws of a country, those benefits might justify the country treating the corporation as a resident.

291 Cf. Mabry, supra note 269, at 566 (“What companies comprise the ‘domestic’ industries we seek to promote and protect? Simply put, what is an ‘American company’?”)

292 At least one vocal defender of corporate inversions views the benefits theory as the principal justification for the place-of-incorporation test. See Herman B. Bouma, Corporations that Reincorporate Abroad are Not Traitors or Tax Cheats, DAILY TAX REP. (BNA), Oct. 16, 2002, at J-1, available at LEXIS, 200 DTR J-1 (“The apparent rationale for this distinction [based on place of incorporation] is that companies incorporated in the United States receive benefits that justify taxing them on their worldwide income.”); Herman B. Bouma, Two Arguments Against an Alternative View of Deferral, 86 TAX NOTES 1303, 1303 (Feb. 28, 2000) (“Incorporation in the United States does not provide any benefits that justify taxing a U.S. corporation on a worldwide basis.”).

293 Whereas the text is concerned with the applicability of benefits theory to the place-of-incorporation test of corporate residence, on a more fundamental level, the benefits theory has been applied in analyzing the appropriateness of imposing a separate income tax at the corporate level. See, e.g., JOSEPH A. PECHMAN, FEDERAL...
In order for a benefits theory to support a place-of-incorporation test, it is not sufficient that the corporation receive benefits within a country. For example, a corporation incorporated abroad but doing business through a branch in the United States might receive certain benefits, such as the protections of property and contract law, the benefits of the transportation infrastructure, and other public services including police and fire protection. While these broad benefits might justify the imposition of source-based taxation of income earned in the United States by a foreign-incorporated entity,\(^\text{294}\) they do not

\(^{294}\) Numerous articles discuss the role of benefits theory in justifying a source-based income tax. See, e.g., Graetz, supra note 12, at 298 ("[F]oreigners, whose activities reach some minimal threshold, should contribute to the costs of services provided by the host government. . . . One need not thoroughly embrace the benefit theory of taxation . . . to recognize a country's legitimate claim to tax income produced within its borders.") (footnotes omitted); Graetz & O'Hear, supra note 8, at 1036–37, 1076 n.220 (discussing the extent to which the early scholars of the modern income tax viewed benefits theory as justifying source-based taxation); Robert A. Green, The Future of Source-Based Taxation of the Income of Multinational Enterprises, 79 CORNELL L. REV. 18, 29–30 (1993) (questioning the benefits rationale as a justification for source-based taxation of corporations). As one commentator observed:

[T]he best reason for taxing corporations is that they benefit from services provided by the state. Corporations enjoy police, fire, health, education, and transportation services. And they should pay for those services at least a little. Now the true beneficiaries of the public services provided to
provide a basis for a definitional distinction between domestic and foreign corporations, because they are available regardless of the place of incorporation. Accordingly, under a benefits theory, in order to justify treating a corporation as domestic based on its place of incorporation, the relevant benefits must be available only to a corporation incorporated in that jurisdiction. 295

Certain corporate governance benefits arising from the internal affairs doctrine satisfy this standard. For example, as noted above, shareholders of corporations incorporated under Delaware law might have a greater ability to hold directors legally accountable for wrongdoing than might shareholders of corporations incorporated under Bermuda law. Similarly, certain limited international trade and commerce benefits, such as certain trade-in-service benefits and the ability to bid on Iraq reconstruction contracts, might arise by reason of incorporating under the law of a U.S. state.

However, it is questionable whether these benefits of incorporation in the United States are sufficient to justify the significant adverse tax consequences that flow from being treated as a domestic corporation under the place-of-incorporation test. After corporations are the shareholders. And the shareholders generally do not reside in the state — this is especially true of publicly traded and multinational corporations.

The only way of ensuring that the shareholders will pay for benefits provided by the state is through a corporate income tax.


Federalism considerations arguably might limit the ability of the United States to treat corporations as domestic under this benefits theory. Within the United States, corporations are generally incorporated under state, rather than federal, law. Accordingly, under a strict interpretation of the benefits standard, the federal government might have difficulty treating corporations as domestic to the extent the benefits flow from incorporation under a U.S. state's laws. Because the relevant inquiry concerns the general distinction between U.S. corporations and foreign (non-U.S.) corporations, the analysis in this section adopts a looser interpretation, considering benefits arising by reason of incorporation in a U.S. state to be benefits arising in the domestic jurisdiction.

295 See supra notes 260–262 and accompanying text.
296 See supra notes 255–259 and accompanying text.
297 While shareholders presumably would view this feature as a benefit, directors might not.
298 See supra note 272 and accompanying text.
299 See supra notes 280–286 and accompanying text.
300 As discussed above, if a corporation is domestic, it is subject to tax on its
all, a significant number of benefits, including the general protection of U.S. law as well as trade-in-goods treaties, may be available to the U.S. branch of a foreign-incorporated entity. Moreover, with respect to those benefits that are available only to a U.S.-incorporated entity, many such entities might not be in a position to utilize the benefits. For example, it is reasonable to assume that the vast majority of corporations incorporated in the United States are not viable candidates for the contracts to rebuild Iraq. Accordingly, due to the relatively limited scope of benefits available solely by reason of incorporation in the United States, it is difficult to support a benefits theory as the normative basis for a place-of-incorporation test for corporate residency.

b. Other Theories

Given the shortcomings of benefits theory in justifying a place-of-incorporation test, this subsection briefly considers other theories that might justify the use of a place-of-incorporation test.

i. Legal Personhood

Perhaps the most fundamental justification for a place-of-incorporation test is that the corporation derives its legal existence from the jurisdiction in which it is incorporated. Under this view, the corporation, as an artificial person, resides in the country whose laws create the legal fiction. This justification formed the early basis for using a place-of-incorporation rule to determine a corporation's nationality in non-tax areas, particularly in conflict of laws inquiries.

302 worldwide income and is subject to the Subpart F anti-deferral regime with respect to certain foreign income of its non-U.S. subsidiaries. See supra notes 19–40 and accompanying text.

Also, some additional benefits might be available with respect to a U.S.-incorporated subsidiary of a foreign-incorporated parent, thereby enabling a portion of the corporate group to obtain U.S. benefits without subjecting the corporate parent to worldwide taxation or Subpart F.

333 See Linda A. Mabry, Multinational Corporations and U.S. Technology Policy: Rethinking the Concept of Corporate Nationality, 87 GEO. L.J. 563, 583–84 (1999). In the conflict of law context, Mabry observed:

The place of incorporation rule is rooted in the concession or artificial person theory of the corporation that was prevalent in the first part of the nineteenth century, before the adoption of general incorporation statutes. This theory held that the corporation was a legal fiction: an artificial person created by the state that existed only in contemplation of the law. Insofar as the corporation owed its very existence to some national system, jurists
It is difficult, however, to justify a place-of-incorporation rule based solely on legal personhood apart from the potential benefits that such legal personhood conveys (and hence the benefits theory discussed above). Various core benefits associated with the corporate form, including limited liability, continuity of life, centralized management, and transferability of shares, generally are determined by the laws of the place of incorporation. As a practical matter, however, it is unlikely that the laws of a foreign jurisdiction will differ

reasoned that the corporation logically could be a citizen only of the state whose laws created it.  

Id. at 584 (footnotes omitted).  

These basic corporate characteristics were recognized in Flint v. Stone Tracy Co., in which the Supreme Court upheld the Corporate Excise Tax of 1909, a precursor to the modern corporate income tax. Flint v. Stone Tracy Co., 220 U.S. 107, 161–62 (1911) See generally Marjorie E. Kornhauser, Corporate Regulation and the Origins of the Corporate Income Tax, 66 IND. L.J. 53, 122 (1990) (analyzing the Flint case). Indeed, the Supreme Court subsequently relied on these characteristics in determining whether an unincorporated association should be taxed in the same manner as a corporation. See Morrissey v. Commissioner, 296 U.S. 344, 359 (1935). These four characteristics also formed the basis for the so-called Kintner Regulations, Treas. Reg. §§ 301.7701-1 to -11 (1961), and T.D. 6503, 1960-2 C.B. 409, which formed the basis for determining whether an unincorporated association was taxable as a corporation from 1960 until the adoption of the “check-the-box” regulations in 1996. For the check-the-box regulations, see Treas. Reg. §§ 301.7701-1 to -3 (as amended in 2002). But cf. Gregg D. Polsky, Can Treasury Overrule the Supreme Court?, 84 B.U. L. REV. 185 (2004) (arguing that the Treasury Department did not have authority to issue the check-the-box regulations, which overrule the Supreme Court’s interpretation in Morrissey).

Under the check-the-box regulations, it is possible that an entity (regardless under whose laws it is organized) may elect to be taxed as a corporation, even though it does not have these traditional corporate characteristics. See Treas. Reg. § 301.7701-3(a) (as amended in 2002). The present article focuses on entities traditionally characterized as corporations, rather than unincorporated business entities that elect to be treated as corporations for tax purposes under this regulation.

See Treas. Reg. § 301.7701-3(b)(2)(ii) (as amended in 2001) (stating that the determination of whether the owners of a foreign entity have limited liability, such that the entity might be classified as a corporation for tax purposes, “is based solely on the statute or law pursuant to which the entity is organized . . .”). Similarly, IRS guidance under the Kintner Regulations, see supra note 304, made clear that the relevant focus in determining the presence of limited liability, continuity of life, centralized management, and transferability of shares is the law of the country in which the entity is organized. See Rev. Rul. 88-8, 1988-1 C.B. 403, 404 (stating that, with respect to foreign entity, “it is the local law of the foreign jurisdiction that must be applied in determining the legal relationships of the members of the organization among themselves and with the public at large, as well as the interests of the members of the organization in its assets”), obsoleted by Rev. Rul. 98-37, 1998-2 C.B. 133.
significantly from the laws of a U.S. state with respect to these core benefits of the corporate form.\textsuperscript{306}

The legal personhood justification for a place-of-incorporation standard is further undermined by considerations of federalism in the United States. In particular, given that corporations are created under state law, rather than federal law, it is difficult for the federal government to define a state-law corporation as a federal tax resident under a legal personhood theory.\textsuperscript{307}

**ii. Administrative Simplicity**

Perhaps the strongest justification for a place-of-incorporation test for determining corporate residence is its administrative simplicity. Unlike other potential tests for corporate residence, such as place of management,\textsuperscript{308} place of principal business, or residence of shareholders, which may involve subjective or difficult-to-measure inquiries, a place-of-incorporation test is straightforward. It merely requires an inquiry as to the jurisdiction under which the corporation’s charter or other organizing document is created.\textsuperscript{309} Accordingly, a place-of-incorporation test provides certainty for both taxpayers and tax administrators.

Professor Avi-Yonah has acknowledged that a place-of-incorporation test “draw[s] a bright line,”\textsuperscript{310} while other residency tests, such as a focus on where the corporation is managed and

\textsuperscript{306} The check-the-box Treasury Regulations for determining whether an entity is taxable as a corporation list numerous foreign-organized entities that are treated as per se corporations for U.S. tax purposes. See Treas. Reg. § 301.7701-2(b)(8)(i) (as amended in 2002). That list was developed, at least in large part, based on whether the entity’s owners have limited liability under the entity’s country of organization. See I.R.S. Notice of Proposed Rulemaking and Notice of Public Hearing, Simplification of Entity Classification Rules, PS-43-95, 1996-1 C.B. 865, 867 (Apr. 16, 1996).

\textsuperscript{307} See supra note 295 (discussing federalism concerns in the context of the benefits theory).

\textsuperscript{308} In some jurisdictions that focus on the place of management to determine corporate residence, that inquiry has evolved into an easily manipulable “formal test by focusing on easily controlled events like the place at which the board of directors meets, rather than the situs of day-to-day management decisions.” AULT ET AL., supra note 243, at 371 (emphasis added).

\textsuperscript{309} Unlike a partnership, which can be created de facto, a corporation is created only by complying with specific legal requirements. But see supra note 304 (suggesting that under the check-the-box regulations, some unincorporated entities can be taxed like corporations for federal tax purposes).

\textsuperscript{310} Avi-Yonah, supra note 24, at 1797.
controlled, "involve[] some measure of uncertainty." However, he downplays the importance of this factor. According to Avi-Yonah:

[the management and control test] is clear enough, and far more congruent with business realities (and thus less manipulable) than place of incorporation. U.S. taxpayers have been living with less well-defined terms, such as "effectively connected" and "U.S. trade or business." They can learn to live with "managed and controlled" as well.

This assertion is strengthened by the recent protocol amending the U.S.-Netherlands income tax treaty, which entered into force on December 28, 2004. In particular, the protocol adds a "substantial presence" test to the treaty's limitation on benefits provision. Under this test, a publicly traded corporation that is otherwise eligible to claim treaty benefits may not claim the benefits if the company has "no substantial presence in the State of which it is a resident."

\[\text{Id.}\]

\[\text{Id. at 1797--98. See also supra note 244 (discussing the departure from the place-of-incorporation rule for some aspects of determining the source of income).}\]


\[\text{See U.S.-Netherlands Protocol, supra note 313, art. 7, S. TREATY DOC. NO. 108-25 at 11 (adding a new art. 26, para. 2(e)(i) to the treaty). The limitation on benefits provision is "intended to limit the benefits of the treaty to qualified residents of the United States and the Netherlands." STAFF OF J. COMM. ON TAXATION, supra note 313, at 46.}\]

\[\text{See U.S.-Netherlands Protocol, supra note 313, art. 7, S. TREATY DOC. NO. 108-25 at 11 (adding a new art. 26, para. 2(c)(i) to the treaty). An exchange of diplomatic notes at the time the protocol was signed provided additional guidance regarding this determination:}\]

In making the determination . . ., it is understood that the determination is based on an assessment of the decision making activities of all of the executive officers and senior management employees who are members of the Executive Board or the Board of Directors of the company, as the case may be, unless such persons merely provide formal approval of decisions
company has no substantial presence under this test if, inter alia, "the company's primary place of management and control is not in the State of which it is a resident." Thus, for example, a corporation incorporated in the United States whose shares are regularly traded on the New York Stock Exchange could not invoke the U.S.-Netherlands treaty to lower Netherlands taxation if the company's primary place of management and control is not in the United States.

Under this protocol, publicly traded corporations invoking the U.S.-Netherlands tax treaty will have to satisfy a fact-based inquiry into their place of management and control in order to obtain treaty benefits. According to the Treasury Department's Technical Explanation of the protocol, this inquiry is intended to focus on the actual day-to-day management activities of the corporation (and its subsidiaries), rather than an easily manipulable focus on the place where the board of directors meets. Despite this fact-based inquiry, no publicly traded corporations objected to the provision, either on administrability or other grounds. Indeed, the representative of a significant trade group representing major publicly traded corporations advocated "full support" of the protocol at the Senate.

... that are in fact made by others.

Understanding Regarding the Convention Between the Kingdom of the Netherlands and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income para. XXVI(a), attached to Exchange of Diplomatic Notes Between Boudewijn van Eenennaam, Ambassador of the Kingdom of the Netherlands, and A. Elizabeth Jones, for the United States Secretary of State, Mar. 8, 2004, in U.S.-Netherlands Protocol, supra note 313, S. TREATY Doc. No. 108-25 at 39.


This test should be distinguished from the "place of effective management" test which is used in the OECD Model and by many other countries to establish residence. In some cases, the place of effective management test has been interpreted to mean the place where the board of directors meets. By contrast, the primary place of management and control test looks to where day-to-day responsibility for the management of the company (and its subsidiaries) is exercised.

Id.
iii. Symbolic Importance

Another possible justification for the place-of-incorporation test is based on symbolic perceptions. To the extent that members of the public base their perception of whether a corporation is "American" on its place of incorporation, it might be important to align the tax definition with this perception. In particular, if members of the public believe that the tax definition and its resulting tax consequences give unfair benefits to certain multinational corporations that are incorporated abroad, that perception might undermine their own voluntary tax compliance.\(^{321}\)

As a practical matter, such public disillusionment is unlikely to arise in this context. If a member of the public did, indeed, view place of incorporation as the appropriate definition of corporate residence,

\(^{319}\) See William A. Reinsch, President, National Foreign Trade Council, Testimony on the Ratification of Two Protocols Before the Senate Comm. on Foreign Relations, 108th Cong., Sept. 24, 2004, at 1, available at http://foreign.senate.gov/testimony/2004/ReinschTestimony040924.pdf. The trade group was principally interested in the substantive tax benefits provided by the protocol (e.g., the elimination of withholding tax on certain cross-border dividend payments and favorable tax treatment for cross-border pension contributions). See id. at 3. Nonetheless, if the trade group had been worried about the administrability of the new substantial presence test, it presumably would have raised its concern.


\(^{321}\) See generally Kirsch, supra note 16, at 937 & nn. 318–19 (discussing the importance of the public's perception of tax compliance by others in determining their own compliance); Diane M. Ring, One Nation Among Many: Policy Implications of Cross-Border Tax Arbitrage, 44 B.C. L. REV. 79, 122 (2002) (noting, in another international tax context, "[i]f the taxpaying public perceives cross-border tax arbitrage as an abuse available to (and used by) a limited pool of taxpayers (those with capital, as opposed to wage income, who have the potential for cross-border operations), then public support for and confidence in the tax system may be undermined"). Moreover, "[t]his confidence risk to the tax system can develop even where the belief that some taxpayers are benefiting is factually inaccurate . . . ." Id.
yet the United States adopted some other test for tax purposes (e.g., place of management), the individual's expectations would be violated only in the unlikely scenario that the corporation was incorporated in the United States but had its management in a foreign country. Such a scenario would be the opposite of the pattern presented by corporate expatriations.

Moreover, it is not clear that the public views place of incorporation, standing alone, as the proper measure of a corporation's residence. For example, most Americans probably view Chrysler to be an "American" company, despite its merger into a German parent corporation. Indeed, it is unlikely that the average individual is aware of the place of incorporation of any particular corporation, unless that corporation's place of incorporation has been widely publicized in the context of an inversion or some other context.

iv. Revenue Needs

A final justification for a place-of-incorporation rule might be that the United States collects more tax revenue by determining residence under that test than it would under some other test. This is an empirical question that this article cannot accurately answer. However, at least in the short and medium terms, the factual assumption underlying this as a justification for retaining a place-of-
incorporation rule might not be correct.

The United States collects a significant amount of tax revenue from corporations that have substantial worldwide operations and that are incorporated under the law of a U.S. state. It is reasonable to assume that a large portion of these corporations currently have their management headquarters in the United States. If the United States were to change its test for corporate residence from place of incorporation to a more fact-specific test, such as the place of primary management and control, it is unlikely that, in the short or medium term, a significant number of corporations would change their management headquarters to a country outside the United States. Such a change, particularly if it avoided an overly formalistic determination of management and control, would involve more substantive considerations than the mere change in place of incorporation. After all, key management personnel might object to being uprooted from their long-established homes in the United States. While it is possible that in the long term a corporation might change its management headquarters — for example, by hiring more foreign executives in the future — even in the long term this test is less manipulable than the place-of-incorporation test.

327 U.S. domestic corporations that claimed a foreign tax credit in 1999 “reported foreign-source taxable income of $165.7 billion, which represented approximately 42.9 percent of the $385.8 billion in ‘worldwide taxable income’... reported by these companies.” Brian Raub, Corporate Foreign Tax Credit, 1999, IRS STATISTICS OF INCOME BULLETIN, Fall 2003, at 205. Although the worldwide taxable income was subject to a 35.2% effective tax rate before credits, these corporations claimed foreign tax credits equal to 28.2% of their worldwide taxable income. Id. at 213 fig. F.

328 Given the current tax implications arising from the place-of-incorporation rule, it seems unlikely that a foreign-headquartered corporation would have selected the United States as its place of incorporation.

329 See supra notes 313–320 and accompanying text.

330 In some jurisdictions that focus on the place of management to determine corporate residence, that inquiry has evolved into an easily manipulable “formal test by focusing on easily controlled events like the place at which the board of directors meets, rather than the situs of day-to-day management decisions.” AULT ET AL., supra note 243, at 371 (emphasis added). However, more recent formulations, such as that envisioned by the U.S.-Netherlands Protocol, supra note 313, look beyond these formalistic approaches. See supra note 318 and accompanying text.

331 See supra note 312 and accompanying text. The long-term effect of the place-of-incorporation test is demonstrated by testimony of Robert Perlman, a Vice President of Intel Corporation, before a Senate Finance Committee hearing. Mr. Perlman testified that “if Intel were to be founded today, I would strongly advise that the parent company be incorporate[d] outside the United States.” Unofficial Transcript of Finance Hearing on International Tax Laws, TAX NOTES TODAY (Mar.
Thus, given the significant number of U.S.-incorporated entities that have their management headquarters in the United States, a shift from a place-of-incorporation test to management headquarters test is unlikely by itself to result in any significant additional revenue loss, at least in the short term.

c. Summary

As the foregoing analysis illustrates, the normative justifications for a place-of-incorporation rule are somewhat tenuous. The strongest justification is the rule's administrative simplicity. More substantive theories — in particular, a benefits theory analysis — provide only limited support for determining a corporation's tax residence solely based on place of incorporation, particularly in light of the significant tax consequences that flow from a determination of U.S. residence. Similarly, theories of legal personhood provide only limited support for the rule, particularly when federalism concerns are taken into consideration.

C. Implications for Expatriating Corporations

The preceding subpart considered the possible justifications for a place-of-incorporation test of corporate residence. This subpart extends that analysis of the place-of-incorporation justifications to the corporate expatriation phenomenon. In particular, it considers the extent to which the new AJCA inversion provision, which applies a domestic taint to an expatriated corporation, can be defended in light of the (tenuous) normative justifications for the place-of-incorporation rule. It also considers whether any other policies might support a special domestic taint for expatriated corporations. This subpart concludes that the special domestic taint of the new provision cannot be reconciled with the existing place-of-incorporation rule, and that the provision implicitly supports an abandonment of the place-of-incorporation rule as the general test.

1. Fundamental Inconsistencies in New Tax Provision

Subpart B, above, concluded that administrative simplicity...
provides the strongest argument in favor of a place-of-incorporation rule for corporate residence, and that benefits theory and legal personhood considerations provide lesser support. It is important to consider the extent, if any, to which these justifications for the general definition of corporate residence can be reconciled with the AJCA provision that treats the corporate parent as a domestic corporation even after a reincorporation outside the United States. As the following discussion demonstrates, the two approaches are not easily reconciled.

As discussed above, one justification for the place-of-incorporation rule is its administrative simplicity. The enactment of the new legislation, which retains the general place-of-incorporation rule for most corporations but adds a separate test for certain corporate expatriates, retains this administrative simplicity for the large majority of corporations that do not undertake inversion transactions. Thus, for most corporations, the new law is not inconsistent with this normative justification for the general place-of-incorporation rule.

However, administrative simplicity standing alone is a feeble normative basis upon which to base a definition with such significant tax consequences. After all, many arbitrary rules might be administratively simple, yet would not form a sound basis for imposing tax. Accordingly, it is important to consider the extent to which the new provision is consistent with the other justifications for a place-of-incorporation rule.

The benefits theory justification for the place-of-incorporation test is of particular concern. As discussed above, this theory provides only limited support for the place-of-incorporation test. However, to the extent the benefits theory underlies the general place-of-incorporation test, the new AJCA provision is flatly inconsistent

332 See supra notes 308–312 and accompanying text.
333 The details of the legislation are discussed supra notes 235–240 and accompanying text.
334 It adds some limited subjective complexity to the residency determination for those corporations that undertake inversions. In particular, it requires a comparison of the pre- and post-inversion shareholders to determine whether the ownership continuity test is triggered, and an inquiry regarding the business activities, if any, conducted in the new country of incorporation. See supra notes 239–240 and accompanying text.
335 It is reasonable to assume that, even though the actual benefits flowing from place of incorporation may be limited, a significant number of legislators view the benefits theory as an important justification for the place-of-incorporation rule.
with it. In particular, a post-inversion parent incorporated in a foreign country would receive none of the benefits associated with being incorporated in a U.S. state, yet that corporation might be treated as a domestic corporation under the new law in the same way as a corporation incorporated in a U.S. state and receiving the benefits associated therewith.

A similar inconsistency exists to the extent the legal personhood theory is used to justify the place-of-incorporation rule. Following the inversion, the parent corporation is a legal creation of a foreign country and derives its existence from that country's laws. Accordingly, to the (limited) extent a legal personhood theory justifies treating a U.S.-incorporated corporation as a domestic corporation, it should follow that the post-inversion corporate parent should be treated as a foreign corporation. The AJCA legislation provides otherwise.

2. Other Possible Justifications for Special Expatriation Rule

Despite these inconsistencies between the new tax provision applicable to expatriated corporations and the policies underlying the place-of-incorporation rule, the new law might still be defensible if significant independent policy justifications exist for creating a special residence test for expatriated corporations. This section briefly considers this possibility.

a. Neutrality

A separate residency test might be justifiable to the extent it is necessary to make the act of expatriation tax-neutral.\(^{336}\) Existing law — in particular, Code section 367 — already attempts to make a corporate inversion tax-neutral by treating the inversion as a recognition event for the shareholders and, to a certain extent, the corporation itself.\(^ {337}\) In this way, existing law ensures that neither the shareholders nor the corporation may escape tax on built-in gain that arose with respect to the corporate stock or the corporation's assets during the time the corporation was incorporated in the United States. This limits the tax benefits that could be obtained by expatriating, but

\(^{336}\) See Abreu, supra note 293, at 1109–20 for an analysis of tax-neutrality in the context of individuals who surrender citizenship to avoid taxes, concluding that legislative proposals in the mid-1990s regarding individual expatriation would not achieve neutrality.

\(^{337}\) See supra notes 62–65 and accompanying text (discussing the Code section and the immediate tax consequences to shareholders and the corporations).
fails to achieve pure neutrality because it does not eliminate the future tax benefits that will arise under existing law after the inversion is completed. Moreover, when timing differences are considered, existing law is not neutral even with respect to pre-inversion gains.338

In contrast, the new AJCA provision achieves tax neutrality for inversion transactions, at least in the short term, because an inversion would result in no current or future tax effect on the corporation. Assuming the provision was triggered,339 the post-inversion corporate parent would continue to be treated as a domestic corporation.

However, in the long-term, the new law might not be tax neutral. Given the possibility of perpetual domestic treatment, persons organizing new corporations might be more likely to incorporate them outside the United States.340 Moreover, even if the provision is tax neutral, this policy must be weighed against the justifications underlying the place-of-incorporation rule. For example, tax neutrality considerations will not necessarily be paramount to the extent that the place-of-incorporation rule is justified under a benefits theory and there are even limited benefits associated with incorporation in the United States. After all, if there is even a limited

338 For example, section 367 would require gain recognition upon an inversion even though the shareholder had not yet disposed of her stock. I.R.C. § 367. Thus, the inversion would accelerate gain recognition to earlier than required under the regular tax rules. This might impose ability-to-pay problems on a taxpayer who has not yet disposed of her stock. Cf. Abreu, supra note 293, at 1112 (mentioning the potential burden imposed by a proposal to require expatriating citizens to mark-to-market their assets upon loss of citizenship). Concern over the acceleration of shareholders’ recognized gain has been an important consideration for corporations contemplating expatriation. See, e.g., COOPER INDUSTRIES, LTD., supra note 263, at 2 (prospectus discussion of tax consequences to shareholders); INGERSOLL-RAND COMPANY LIMITED, supra note 259, at 3 (same). But see supra note 66 and accompanying text (noting that the recent fall in stock prices has made this gain acceleration more palatable to shareholders, particularly when compared to the expected post-inversion corporate tax benefits).

339 See supra notes 239–240 and accompanying text (discussing ownership continuity and no substantial business activity tests, which would trigger the domestic taint).

340 The incentive to incorporate a new organization outside the United States existed before enactment of the AJCA tax provision. See supra note 331. Theoretically, the AJCA provision makes this incentive slightly stronger. Whereas pre-AJCA law held out the possibility of a U.S.-incorporated entity expatriating in the future, the new provision generally forecloses this possibility by establishing a perpetual domestic taint on the corporate parent. However, as a practical matter, it is doubtful that this change in the law will have much effect on an ex ante decision of where to incorporate.
substantive difference between a U.S.-incorporated and a foreign-incorporated entity, then the equal treatment of the two might not be justified.

b. Fairness

The new provision that perpetually taints expatriated corporations might also be justified based on symbolic perceptions of corporate expatriation. To the extent the public views an inversion as a mere paper change, allowing the corporation to "get away with" something that individual taxpayers could not easily accomplish, the public faith in the tax system and voluntary compliance might suffer. The AJCA domestic taint provision prevents such a result by eliminating any tax benefits from the expatriation.

Even so, a significant element of unfairness still exists. The provision's special expatriation rule leaves in place the general place-of-incorporation rule. Accordingly, a corporation originally incorporated abroad might retain a significant tax advantage over a corporation originally incorporated in the United States, even if both companies have similar U.S. management and operations. This inequity is particularly difficult to justify to the extent that there are not significant benefits associated with U.S. incorporation.

Moreover, to the extent that the public perceives an expatriating corporation as achieving an unfair advantage in violation of social norms, a legal-based response might not be necessary. Informal

341 While an individual could accomplish an analogous exit from the U.S. tax system by surrendering his citizenship, such an act would have significant substantive consequences. See Kirsch, supra note 16, at 874–75 (by renouncing citizenship, a citizen "would lose his unrestricted right to enter the United States, his ability to travel using a United States passport, his right to vote in the United States, the assistance of United States consular services while abroad, and the protection of United States diplomatic or military intervention abroad") (footnotes omitted); see also Alice G. Abreu, The Difference Between Expatriates and Mrs. Gregory: Citizenship Can Matter, 67 TAX NOTES 692, 695 (May 1, 1995) (declaring that the renunciation of citizenship "is not just another formalistic act replete with tax significance but devoid of consequences for any other area of a person's life").

342 See supra note 321 and accompanying text (discussing importance of public's perception of tax compliance by others); see also NY STATE BAR INVERSION REPORT, supra note 3, at 25 ("Even though [the tax benefit] of the inversion may be consistent with the letter of the law, it may undermine public confidence in the integrity of the U.S. tax system.").

343 As discussed above, the initial Congressional response to expatriation may have had an information-providing effect in social norm enforcement. See supra notes 198–203 and accompanying text.
nonlegal sanctions might be sufficient to deter corporations from expatriating, as in the Stanley Works example.\textsuperscript{344}

\textit{D. New Tax Provision as Harbinger of Place-of-Incorporation Rule’s Demise}

If the United States continues to put “flesh into fiction”\textsuperscript{345} by assigning a residence to a corporation, Congress should ensure that the chosen method remains justifiable in the increasingly globalized world in which multinational corporations operate. Subpart B discussed the tenuous normative support underlying the general place-of-incorporation rule. Even in the absence of the expatriation phenomenon, these normative shortcomings indicate a need for Congress to reconsider the fundamental definitional test underlying the U.S. residence-based tax system.

Subpart C demonstrated the additional stress that the expatriation phenomenon has placed on the place-of-incorporation test.\textsuperscript{346} In particular, the recent AJCA provision, which attempts to prevent expatriations by disregarding for tax purposes the change in place of incorporation, is flatly inconsistent with the benefits theory and legal personhood theories partially underlying the place-of-incorporation test.\textsuperscript{347}

This inconsistency shows that Congress should address the expatriation phenomenon in a broader manner. In particular, it should begin by focusing on the threshold issue underlying expatriations: determining what makes a corporation domestic for tax purposes. In so doing, it should consider the broader implications of

\textsuperscript{344} See supra notes 162–196 and accompanying text. As noted previously, these informal nonlegal sanctions are most effective when the corporation relies on retail sales to the public. See supra note 196 and accompanying text.

\textsuperscript{345} Graetz, supra note 12, at 320. Professor Graetz has argued that “[t]he fragility and manipulability of the residence of corporations suggests . . . that U.S. international tax policy, to the extent possible, should reduce the tax consequences of determinations of residence for corporations.” Id. at 323. See generally supra notes 253–254 and accompanying text (discussing this article’s assumption that the United States will continue to use a residence-based tax system).

\textsuperscript{346} See also Mitchell A. Kane, \textit{Strategy and Cooperation in National Responses to International Tax Arbitrage}, 53 EMORY L.J. 89, 137 n.117 (noting that “so-called corporate inversion transactions place . . . strain on the place-of-incorporation rule”).

\textsuperscript{347} There are some limited justifications for having a special residency test for expatriated corporations. See supra notes 336–344 and accompanying text. However, these policies do not eliminate the significant shortcomings of the place-of-incorporation test illuminated by the expatriation phenomenon.
that definition, including the ease of manipulation. Ideally, Congress would have sufficient confidence in the definition so that it can live with all of the consequences that flow therefrom.

The response to corporate expatriations demonstrates that neither legislators nor the public are confident that the place-of-incorporation rule is the appropriate test for whether a corporation is domestic. Rather, the expatriation debate rhetoric reflects a significant gap between the current legal standard for corporate residence and the public perception of what is an American company. Indeed, much of the debate assumes that the expatriated company, despite a change in the paperwork regarding its place of incorporation, is still in substance an American company.48

In the past, this gap between the place-of-incorporation rule and public perception was less visible because, as a practical matter, a corporation's place of incorporation tended to coincide with the place of its management, the location of its shareholders, the location of its principal business operations, and other factors that might be indicative of the "true" residence of a corporation.49 However, with the growth of multinational corporate groups, this overlap of factors has increasingly separated, revealing the shortcomings of relying exclusively on the place of incorporation to determine tax residence. This gap is already reflected in certain Code and tax treaty provisions that determine whether a corporation's place of incorporation reflects its legitimate residence for purposes of claiming U.S. tax treaty benefits.350

348 For example, the California legislature, in passing the California Taxpayer and Shareholder Protection Act, supra note 79, made a legislative finding that "[a]n expatriate company is a United States based company that has moved in name and on paper only to a tax haven country and has no substantial business activities in the country of reincorporation." S.B. 640, 2003 Leg., Reg. Sess. (Cal. 2003); see also Office of Public Affairs, Dep't of Treasury, supra note 84 (statement of then-Secretary of Treasury Paul O'Neill implicitly assuming that, even after an expatriation, the corporation will be a "U.S. company headquartered offshore"); 148 CONG. REC. S10,576 (daily ed. Oct. 16, 2002) (statement by Sen. Grassley that "[i]nverting corporations set up a folder in a foreign filing cabinet or a mail box overseas and call that their new foreign 'headquarters'"). For additional examples, see supra notes 251–252 and accompanying text.

349 See supra note 324.

350 See I.R.C. § 884(e) (allowing a foreign corporation to claim a tax treaty exemption from the branch profits tax only if that corporation is a "qualified resident" of the foreign country, generally determined by reference to the residence of the corporation's shareholders); U.S. MODEL TAX CONVENTION, supra note 26, art. 22 (limitation on benefits provision precluding a foreign corporation from claiming
A recent development in the United States' tax treaty policy shines particular light on this gap. As discussed supra, a new protocol amending the U.S.-Netherlands income tax treaty recently entered into force. That protocol adds a requirement that a publicly traded corporation have its "primary place of management and control in the State of which it is a [treaty] resident" in order to claim treaty benefits. In effect, this requirement represents an acknowledgement that place of incorporation (and place where corporate shares are traded) is not, in and of itself, a sufficient indicator of the "true" residence of a corporation. As summarized by the Treasury Department's Technical Explanation of the protocol, this provision (and related provisions) of the protocol "effectively determine[] whether an entity has a sufficient nexus to [a country] to be treated as a resident for treaty purposes . . . ."

The gap between place of incorporation and "true" residence of a corporation is also reflected in numerous non-tax areas that look beyond the place of incorporation in determining a corporation's residence. The new AJCA provision, by placing some reliance on the identity of the corporation's shareholders and the location of the corporation's place of business operations, reflects a limited attempt
to bridge the gap in the narrow situation of a corporate inversion.

Rather than addressing the shortcomings of the place-of-incorporation rule in an ad hoc manner through the new AJCA provision, Congress should consider addressing the rule's shortcomings in a more general way.\(^3\) Given the important tax consequences that flow from the residency determination,\(^4\) if the place-of-incorporation rule fails accurately to reflect legislators' and the public's understanding of what makes a corporation American, that definition should be revisited across-the-board, not merely when enterprising corporations seek to turn the rule's shortcomings to their advantage.\(^5\) Possible alternatives include a focus on the residence of the corporation's shareholders, which would be consistent with existing provisions governing corporate eligibility for tax treaties,\(^6\) or a focus on the place of the corporation's management and control, as numerous commentators have advocated.\(^7\) The recent U.S.-

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3. Some commentators have endorsed a sunsetting form of the Senate-passed proposal as a temporary stopgap measure, but have argued that a more comprehensive change should follow. See NY State Bar Inversion Report, supra note 3, at 3-4.

4. As a commentator observed in a non-expatriation context, "[p]articularly with regard to juridical entities such as corporations and partnerships, it is far from clear that the traditional point of beginning, namely place of organization, represents an appropriate thread on which to hang the full weight of taxing jurisdiction." Andrus, supra note 244, at 848.

5. Some members of the New York State Bar Tax Section Committee believed that "it may make sense, as a long-term solution, to change the definition of a domestic corporation" because of the shortcomings of the place-of-incorporation test. NY State Bar Inversion Report, supra note 3, at 60; see also Hale E. Sheppard, Fight or Flight of U.S.-Based Multinational Businesses: Analyzing the Causes for, Effects of, and Solutions to the Corporate Inversion Trend, 23 NW. J. INT'L L. & BUS. 551, 578-79 (2003) (discussing possibility of replacing place-of-incorporation test with a management and control test).

6. See supra note 350 and accompanying text. Fleming, Peroni and Shay have supported this approach. See Fleming et al., supra note 32, at 326. Those commentators' favored approach is an integration scheme that would ensure the taxation of shareholders that are themselves U.S. residents. Id. at 318-23. However, in the absence of such a solution, they advocate an ownership-focused test of corporate residence because it would further an important "purpose of the U.S. tax on corporate income[, which] is to serve as an anti-deferral device that preserves the efficacy of the shareholder-level tax on the worldwide incomes of U.S. shareholders." Id. at 326 (footnote omitted). In this context, they suggest that the place-of-incorporation test might be defensible only to the extent that, as an empirical matter, most U.S.-incorporated corporations are substantially owned by U.S. residents. Id.

7. Professor Avi-Yonah in particular has been a frequent advocate of a
Netherlands protocol, with its focus on the “primary place of management and control,” is particularly intriguing as a possible test that might be incorporated into the Code as the general test of corporate residence, particularly given its focus on day-to-day management activity, rather than the easily manipulable focus on where the board of directors meets.\(^\text{361}\)

A departure from the formal place-of-incorporation test not only would align the definition more closely with legislative and public expectations, but would also bring an additional benefit of particular relevance to this article: it would address Congressional and public concern over expatriations by eliminating the ability of corporations to fundamentally alter their U.S. tax profile merely by changing their place of incorporation.\(^\text{362}\) In so doing, it would also eliminate the unfairness that Stanley Works complained of when its competitors,

management and control test. See Reuven Avi-Yonah, The Ingenious Kerry Tax Plan, 103 TAX NOTES 477, 479 (Apr. 26, 2004); Avi-Yonah, supra note 24, at 1796–98. It is important that a management and control test, if enacted, be implemented in a way that itself does not create easily manipulated formalities. Professor Avi-Yonah noted that

[the 'managed and controlled' test has a long history, some of which is not very distinguished. In particular, many former U.K. colonies have interpreted it in a mechanical way to focus on where the Board of Directors meets, which makes the test not less manipulable than the U.S. test. Boards do not mind meeting twice a year in Bermuda. . . .

. . . And yet, if properly defined and interpreted, the managed and controlled test offers the most promising current definition of corporate residency — the one most congruent with business realities and therefore least open to abuse.

Id. at 1797; see also NY STATE BAR INVERSION REPORT, supra note 3, at 49 n.87 (“Crafting an appropriate standard may not be so simple; for example, many ‘managed and controlled’ standards have historically focused on board meetings, a criterion that the REPO Bill appears to reject (and sensibly so).”).

The United Kingdom enacted a combined test that treats a corporation incorporated in the United Kingdom as a domestic corporation, and also treats a non-U.K. incorporated entity as a domestic corporation if it is managed and controlled in the United Kingdom. See Kane, supra note 346, at 91 n.4. Such a test, if enacted in the United States, would eliminate the tax incentive for most corporations to undertake inversion transactions, but seems to reflect a “heads I win, tails you lose” approach at the expense of theoretical consistency.

\(^\text{361}\) TECHNICAL EXPLANATION, supra note 318, at 23; see also supra notes 313–320 and accompanying text (discussing the U.S.-Netherlands protocol).

\(^\text{362}\) While a corporation’s tax residence might still change under a revised test, presumably that change would reflect a more substantive change in the corporation’s ownership, management, or other factor underlying a new general residence test.
Ingersoll-Rand and Cooper Industries, engaged in an inversion transaction but Stanley Works was prevented from doing so by public and political pressure.\textsuperscript{363}

At a minimum, the discussion in this part demonstrates the important choice that Congress faces if, as this article assumes, a residence-based tax system is retained. On one hand, Congress can retain the existing place-of-incorporation definition, with its tenuous normative underpinnings, and live with the consequences when some corporations choose to manipulate it through inversion transactions.\textsuperscript{364} Alternatively, it can replace it with a single corporate residence test with stronger normative support that more accurately reflects the realities of a globalized world, so that the actions necessary to change a corporation’s tax residence will have some substantive meaning. The new AJCA provision reflects a difficult-to-defend middle ground.

**CONCLUSION**

In the past few years, corporate expatriations have attracted widespread attention. Both the media and Congress have focused on the image of huge U.S.-based multinational corporations engaging in seemingly meaningless shuffling of paper to change their status from domestic to foreign and thereby save millions of dollars in U.S. taxes.

For nearly three years, Congress considered responses to this phenomenon. Much of Congress’s energies during that period focused on symbolic posturing. Indeed, as discussed in Part III, the initial expatriation-targeted legislation Congress enacted — an alternative sanction purporting to ban expatriated companies from entering into contracts with the Department of Homeland Security — is prototypical symbolic legislation. That is, it purports to assure the public that Congress is “doing something” to stop a perceived problem (corporate expatriations), yet it is enacted in a manner that does not actually impose instrumental costs on the intended target.

\textsuperscript{363} See STANLEY WORKS, supra note 185, Exhibit 20(i) (“Not only are we disadvantaged against our foreign competitors, but two of our major U.S. competitors, Cooper Industries and Ingersoll-Rand Company have a significant advantage over Stanley Works because they have already reincorporated.”). As long as all three companies retained their relevant profile (e.g., ownership or management) under a new test, the mere fact that Ingersoll-Rand and Cooper reincorporated would not alter their U.S. tax profile. This conclusion assumes that Ingersoll-Rand and Cooper would not be protected by any grandfathering transition rules.

\textsuperscript{364} Despite the pejorative implications of this alternative, it is not merely rhetorical. As discussed in Part III, supra, Congress’s initial symbolic response reflected this approach.
(the politically powerful group of expatriated corporations).

As Part IV demonstrates, however, the initial Congressional attention had some indirect instrumental effects on the expatriation trend even in the absence of effective legislation. In particular, by keeping public attention focused on the phenomenon, Congress served an information-providing role with respect to the informal enforcement of social norms. In so doing, it caused some corporations to reconsider their expatriation plans in fear of possible public backlash.

Perhaps most importantly, the corporate expatriation trend has focused attention on U.S. tax policy—in particular, the manner in which the United States taxes corporations in an international setting. Like a Rorschach test, legislators have projected their own tax policy belief systems when interpreting the causes of, and appropriate responses to, corporate expatriations. Some politicians view expatriations sympathetically as an understandable response to a flawed and overreaching U.S. tax system. Accordingly, they advocate a change in the underlying tax system that would reduce the tax burden of U.S.-based multinational companies and thereby eliminate the incentive to expatriate. Others view expatriating corporations as improperly taking advantage of a loophole in the tax code. Accordingly, they advocate legislation, as evidenced by the recently-enacted AJCA provision, that would close this loophole by continuing to treat a post-expatriation corporation as domestic.

This article argues that both sides in the Congressional debate misinterpret the expatriation ink-blots, projecting too much of their own pre-existing notions regarding appropriate tax policy. Rather than demonstrating the need for a radical overhaul of our international tax system or the need to selectively target corporations exploiting perceived loopholes, the expatriation trend primarily demonstrates the need to reexamine the definition of what is a U.S. corporation for tax purposes. Given the tenuous normative underpinnings of the place-of-incorporation rule and its ability to be manipulated, Congress should focus its attention on this fundamental building-block of the international tax system. Of course, this tax policy-grounded inquiry is unlikely to occur unless Congress is able to move beyond the political allure of symbolic responses to the phenomenon.