Meaningless Comparisons: Corporate Tax Reform Discourse in the United States

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MEANINGLESS COMPARISONS: CORPORATE TAX REFORM DISCOURSE IN THE UNITED STATES

Omri Y. Marian

"To say simply that we want to adopt certain territorial features and low statutory rates offered by other countries' tax systems is somewhat like going out to shop for a car and saying, I would like to have a Corvette engine without worrying about anything else."1

This article examines the role that international comparisons play in current corporate tax reform discourse in the United States. Citing the need to make the U.S. corporate tax system more competitive, comparisons are frequently used to assess other jurisdictions' tax-competitiveness, and many legislative proposals are supported by such comparative arguments. Examining such discourse against the background of several theoretical approaches to comparative law, this article argues that, to the extent that comparisons are aimed at providing guidance for prospective reform, this purpose is not well served. Participants in the corporate tax reform discourse, from both sides of the aisle, lack any comparative methodological discipline. They execute comparisons in an incoherent way, often ignoring important differences between the United States and the jurisdictions it is compared to. The result is proposals that are based on misperceptions of the way that corporate tax laws operate in the compared

1 Assistant Professor of Law, University of Florida Levin College of Law. For helpful guidance, comments and critique I am indebted to Reuven Avi-Yonah, participants in the 15th Annual Critical Tax Conference held at Seton Hall Law School in March 2012, and participants in the Law and Society Annual Conference held in Hawai‘i in June 2012. Any errors or omissions are my own.

jurisdictions. The article further suggests that a coherent methodology, if explicitly harnessed to promote a well-defined agenda, could make international comparison a constructive instrument of tax policymaking.

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I. INTRODUCTION

"U.S. companies face a high tax burden as compared to their foreign-based competitors." In fact, they face the second-highest (!) effective tax rate in the world. Also, it is a fact that "United States corporations pay only slightly more on average than their counterparts in other industrial countries." Wait! What? Didn't you just say that . . . ? Yes, I did. But wait! There is more. Some indicators imply that U.S. corporations face a tax burden that is "the second lowest among . . . leading industrialized nations."

Confusing, isn't it? Arguably, U.S. corporations either pay more, the same, or less tax in comparison to corporations in other countries, and these three options are mutually exclusive. So which is it? The second highest or the second lowest?

Of course, there may well be a very simple explanation for this apparent inconsistency. As one well-known TV ad puts it: "90 percent of all statistics can be made to say anything . . . 50 percent of the

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Corporate taxation is a highly politicized issue, and the results of cross-jurisdictional corporate tax burden comparisons may depend on the agenda that the comparative researcher intends to serve. Even if a researcher is not “serving an agenda” per se, corporate tax burdens can be calculated in many different ways and the choice of which methodology is used carries with it certain assumptions, some of which may stem from the researcher’s political and ideological beliefs.

But there is another explanation for this phenomenon – one that is not as simple but carries much more significance – and this explanation is the focal point of this article. This article argues that, within the vibrant political debate on possible corporate tax reform in the United States, international legal comparisons are usually so poorly executed by the participants in this discourse, that it is doubtful the comparisons serve a truly useful purpose. The resulting misuse of the comparative methodology enables contradicting arguments to flourish (where presumably there should be one correct answer) and produces legislative proposals that are based on misperceptions of the operation of legal tax models.

Some background is helpful. Recently, corporate tax reform discourse has taken center stage. This discourse has a very important and unique characteristic: It is predominantly a comparative legal discourse. Participants in the discourse, whether they are elected officials, nonprofit organizations, lobbying groups, the media, tax practitioners, or the academic community (I refer to all members of these groups as “participants” throughout this article), frequently set their arguments in a comparative posture. To a significant extent, the international competitiveness of U.S. multinational corporations (MNCs) dictates the agenda. Significantly, arguments about

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6 sigler1776, Statistics Direct TV Commercial2, YOUTUBE (Feb. 29, 2012), http://www.youtube.com/watch?v=q2loC03Vh6Q.
7 Tax reform in the United States, with particular emphasis on corporate tax reform, is always on someone’s agenda. For a historical survey of corporate tax reform proposals in the U.S., see Steven A. Bank, The Rise and Fall of Post-World War II Corporate Tax Reform, LAW & CONTEMP. PROBS., Winter 2010, at 207 [hereinafter Bank, The Rise and Fall].
international competitiveness are, by definition, comparative arguments. They imply that someone else is trying to achieve the same goals as U.S. MNCs, and may be better (or worse) at it. And indeed, at times, this discourse is even defined by its participants as a comparative discourse. The House Committee on Ways and Means (Ways and Means Committee) and the Senate Finance Committee (Finance Committee) have each specifically dedicated time in recent hearings on tax reform to comparative tax law.⁹ This comparative political discourse provides a unique opportunity to assess how comparative law is used as an instrument in advancing real-life legal reforms in the United States, specifically in the context of the making of tax laws. This article finds, however, that if the purpose of comparing the U.S. corporate tax system with those of other nations is to somehow advance successful corporate tax reform in the United States, this purpose is not well served. Even worse, such comparisons – in the way they are currently executed – may create misperceptions about what legal changes have taken place elsewhere, why they were pursued, whether they were successful, and whether all of this is at all relevant to a U.S. corporate tax reform. The worst-case outcome could be corporate tax legislation that simply will not bring about the hoped-for results because it is based on a fundamental misunderstanding of comparisons to other jurisdictions. I have previously argued that scholarship in comparative tax law is flawed for lacking any coherent theoretical background.¹⁰ This article complements that theoretical stance by demonstrating how that lack of theoretical discipline negatively affects actual tax policymaking.


The article is structured as follows: Part I sets out the theoretical background to be used in assessing any comparative tax reform discourse. It presents several competing approaches that legal comparativists might exercise when harnessing cross-jurisdictional comparisons for the benefit of tax reform. Part II briefly describes the conditions that produced the current debate on corporate tax reform in the United States and notes some major initiatives taken in this respect. Part III demonstrates the central role that comparative law plays in this debate and refines and explains some (but not all) of the comparative arguments most commonly made in respect of possible corporate tax reform. Part IV examines these comparative arguments in the context of the theories presented in Part I. It demonstrates how many participants in the discourse failed to follow any coherent methodology in their comparisons (regardless of the participants’ political stance) and how, as a result, their comparative arguments are frequently questionable. When analyzing these failures, Part IV will also point to possible remedies. The argument here is that the wheel of comparative tax discourse does not need to be reinvented. It simply needs to be used correctly. Finally, I conclude that such a failure is not only a technical one. It also stems from the fact that the participants wrongly perceive the comparative process to be an objective one rather than a legitimate (and useful) instrument for advancing political agendas.

It is important to note at the outset that the purpose of this article is not to take a stand in the tax reform debate. It does not suggest paths to corporate tax reform. Rather, the article is posed to answer the question of what role does comparative law play in corporate tax reform discourse in the United States. To the extent that such a role is viewed negatively, the article explains how the process of comparison should be executed so as to improve its utility in this debate.

II. THEORIES OF COMPARATIVE LAW AS A MECHANISM OF TAX REFORM

A. Competing Approaches to the Use of Comparisons in the Tax Reform Process

In what way should we approach comparison if the purpose is to use comparison as an instrument to advance tax reform? Generally, the spectrum of answers can be divided into two main approaches. Both approaches have many offshoots and sub-schools of thinking,
but, for purposes of this article, I shall only discuss the two ends.\textsuperscript{11}

The first approach adheres to the comparisons and identification of similarities and is commonly referred to as the functional approach. Functional legal comparativists operate under the assumption that “the legal system of every society faces essentially the same problems, and solves these problems by quite different means, though very often with similar results.”\textsuperscript{12} Comparative legal functionalism is evident in the writings of several tax scholars (some more explicitly than others). Such commentators repeatedly pointed to the remarkable degree of similarity in the tax laws of different jurisdictions, which have started quite far apart.\textsuperscript{13} A comparative tax functionalist would typically see convergence of tax laws not only as an easily observed phenomenon but also as a desirable process from a normative perspective. Thus, within the context of tax reform, the borrowing of legal models of taxation and their transplantation in the systems that undergo reform is desirable.\textsuperscript{14}

Of course, when a comparative study is aimed at adopting legal models from other jurisdictions, a question of benchmarking is inherent. We do not want to simply adopt any tax model; we want to adopt the most successful tax model. Economic analysis plays an important part here.\textsuperscript{15} For example, if the purpose of our reform is to improve the efficiency of the tax system, our comparative analysis will “begin the comparison from a ‘neutral scale’ that can be validated by

\textsuperscript{11} For more detailed surveys of schools of thought in comparative taxation see \textsc{Reuven Avi-Yonah, Nicola Sartori \& Omri Marian}, Global Perspectives on Income Taxation Law 1-16 (2011); Marian, supra note 10.


\textsuperscript{15} This form of analysis is sometimes described as a separate school of thought, namely Comparative Law and Economics. See, e.g., \textsc{Ugo Mattei}, Comparative Law and Economics (1997); Raffaele Caterina, Comparative Law and Economics, in \textit{Elgar Encyclopedia Of Comparative Law} 161 (Jan M. Smits ed., 2006).
In essence, such a study is aimed at comparative inquiries into the deviations of different jurisdictions from an economically efficient benchmark: a so-called model legal institution or legal system.

The second research approach concentrates its efforts in identifying and explaining differences and is commonly associated with the cultural approach to comparative law. Cultural comparativists reject the functional assumption of similarities of social problems and legal solutions. Rather, cultural comparativists assume that law is part of a broader cultural phenomenon. Each culture contains elements such as values, traditions, and beliefs that give each culture its uniqueness. According to such an approach, this differentiation of "legal cultures" entails that the laws (which are embedded in these cultures) are also necessarily different. Under the cultural approach, convergence of law is not only improbable but it is also probably undesirable because difference among jurisdictions "satisfies the need for self-transcendence."

Differences also guide the critical approach to comparative law. Critical studies in comparative law are aimed at exposing the pretended apolitical nature of so-called mainstream comparative law and to suggest alternative discursive agendas. According to this view, comparative legal studies should be a liberating project, releasing us from the cognitive cage of abstract relativist dichotomies (such as common law/civil law, Western/Oriental, self/other), which are

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17 Of course, it is not necessary that an economic benchmark will be that of efficiency. For example, if we seek tax reform for the purpose of making taxation more fair in terms of having the tax burden shared among taxpayers in an equitable manner (assuming we know what “equitable” means), we would start with a well-accepted benchmark of income measurement (such as the Haig-Simons model) and see how other countries deviated from such a model to effect the desired economic redistribution. See William B. Barker, Expanding the Study of Comparative Tax Law to Promote Democratic Policy: The Example of the Move to Capital Gains Taxation in Post-Apartheid South Africa, 109 PENN. ST. L. REV. 703 (2005); William B. Barker, A Comparative Approach to Income Tax Law in the United Kingdom and the United States, 46 CATHOLIC U. L. REV. 7 (1996).

18 See Roger Cotterrell, Comparative Law and Legal Culture, in THE OXFORD HANDBOOK OF COMPARATIVE LAW 709 (Mathias Reimann & Reinhard Zimmerman eds., 2008).

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wrongly perceived to be objective.\textsuperscript{20}

In the context of difference-oriented approaches, legal borrowing is hardly an obvious exercise of legal reform. Any borrowed models must undergo a modification, at times a significant one, which is intended to ensure the acceptance of the borrowed model in its new local environment.\textsuperscript{21} Such alteration may be heavily influenced by local considerations, and the ultimate outcome may be completely different from the original rule.

Between the two ends of the spectrum described above, opinions regarding the comparative process will differ as to the extent that local considerations need to be taken into account.

For example, the functional approach will tend to view a legal model widely adopted by many jurisdictions as a successful model. The fact that many jurisdictions adopted such a model validates its effectiveness. Regarding tax reform, such an approach is evident in the calls to adopt a VAT or reduce corporate tax rates. These calls are based on the experiences of many other jurisdictions. On the other hand, comparative cultural approaches to reform will be more skeptical of such models, and such skepticism will show itself on two different levels. First, cultural comparative reformers may question that the model adopted in so many jurisdictions is indeed the same model. It is possible that local social, political, and cultural considerations have affected the model differently in each jurisdiction so that this “same” model is actually many different models. This means that we are looking at not just one possible model to adopt in our home jurisdiction. VAT may mean different things in different jurisdictions. We still need to understand which of these models is the correct one for our purpose because “[t]here is a pronounced tendency for the tax argument to become an argument about something else; but what that ‘something else’ is, and how it impacts the tax process, differs substantially between different countries.”\textsuperscript{22}


\textsuperscript{21} In the tax context, see, e.g., Assaf Likhovski, Is Tax Law Culturally Specific? Lessons from the History of Income Tax Law in Mandatory Palestine, 11 Theoretical Inquiries L. 725 (2010) (explaining how British income tax law was transplanted in Mandate Palestine and the modification it went through on account of local considerations); Anthony C. Infanti, The Ethics of Tax Cloning, 6 Fla. Tax Rev. 251, 336–37 (2003).

\textsuperscript{22} Michael A. Livingston, From Milan to Mumbai, Changing in Tel Aviv: Reflections on Progressive Taxation and “Progressive” Politics in a Globalized but Still Local World, 54 Am. J. Comp. L. 555, 582 (2006); see also, Michael A. Livingston,
On the second level, cultural comparativists will question the argument that we should adopt a model because it succeeded elsewhere. Success in another jurisdiction is not necessarily a good indicator for its success in our home jurisdiction. Contextual differences may dictate different results.

B. Processes of Tax Law Comparisons

To be useful, the insights gleaned from the process of comparison must be at least materially accurate and workable. If we intend to implement legal models from a foreign jurisdiction into our local system, we need to first make sure that we understand how these models work in the other jurisdiction. We then need to assess whether, given the tension between local and global contexts, these models are at all appropriate for application in our system. If they are not, we need to consider whether modifications can be made that will make the models workable for our system, while making sure that such changes will not drastically alter the manner in which such models work (assuming this is at all an achievable goal).23

One of the main difficulties here is that legal comparativists, while fiercely debating what approaches should be deemed appropriate for the comparative study of law, have failed to produce any coherent methodology for the process of legal comparison.24 This debate does provide, however, insights as to what such a process should include and what considerations should be taken into account in each stage of the process. The process of tax comparison is not dealt with here at length, and only the key points are summarized.25

1. Defining Purposes

To start, we should carefully consider the purpose of comparison. As previously noted, it is frequently argued that the purpose of current tax reform contemplated in the United States is to create a corporate tax system that is more "competitive."26 Thus, a functional
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analysis can be successful only if our comparison includes models that are aimed at the same result of creating “competitive” tax systems. A cultural approach will force us to question whether the term “competitiveness” means the same thing in the compared jurisdiction and to make sure that the model we refer to as a “competitive” model will work in the same way if we were to import it into our own jurisdiction. Defining a purpose for the reform necessarily limits the models available for comparison.

Once the purpose has been determined, we must design a comparative process that will serve such a purpose. This process needs to include, first, a selection of jurisdictions to be compared; second, the selection of laws to be compared; and, third, a methodology of comparison.\(^2\) I address each in order.

2. Jurisdictional Selection

Because functionalists operate under the assumption of similarities, the implication is that the target system should be compared with “comparably similar” jurisdictions. This means comparing jurisdictions that are at “the same evolutionary stage,”\(^2^8\) share similar values, and are thus likely to face similar social problems. Assuming that a tax comparativist adopts such an approach, classification to legal families can provide a useful starting point since classification provides us with a preapproved list of comparable jurisdictions. In the tax context, Victor Thuronyi pioneered the taxonomy of legal “tax families.” Thuronyi suggests that we compare jurisdictions that are “representatives” of a larger tax family or tradition.\(^2^9\)

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\(^2^7\) For comparativists that follow these general guidelines, see, for example, ZWEIGERT & K•TZ, supra note 12, at 32–47; W. J. Kamba, Comparative Law: A Theoretical Framework, 23 INT’L & COMP. L.Q. 485, 511–12 (1974); Esin Örüçü, Developing Comparative Law, in COMPARATIVE LAW: A HANDBOOK 43, 47–53 (David Nelken & Esin Örüçü eds., 2007); Esin Örüçü, Methodology of Comparative Law, in ELGAR ENCYCLOPEDIA OF COMPARATIVE LAW, supra note 15, at 442, 447–49.


\(^2^9\) Thuronyi proposes Germany, France, the United States, and the United Kingdom as natural choices for tax comparison. 2 INT'L MONETARY FUND, TAX LAW DESIGN AND DRAFTING xxiii–xxxv (Victor Thuronyi ed., 1996); See also VICTOR THURONYI, COMPARATIVE TAX LAW 23–44 (2003). According to Thuronyi, these countries can be regarded as “leaders in influencing the tax laws of other countries.” THURONYI, supra at 9.
On the other hand, cultural tax comparativists will be somewhat more flexible in their jurisdictional selection. The comparison of different "legal cultures" is specifically useful when comparing jurisdictions that are different in their social and cultural backgrounds, thus exposing themes of taxation that are affected by local considerations even amid globalization. It is also helpful to examine arguably "similar" jurisdictions, particularly to show that any similarity might be a superficial one and that the underlying cultural traditions, which are by definition different, significantly affect the execution of such so-called similar policy choices even when the jurisdictions being compared face similar problems. In the tax context, such an approach is evident in the writings of Michael Livingston.30

3. Selection of Legal Models

In terms of the laws to be compared, functional analysis calls for the comparison of tax laws and institutions that essentially fulfill the same social functions. In this context, we must avoid the trap of abstractness. The fact that different laws carry the same name (for example "corporate tax") does not necessarily mean that both fulfill the same function. We must make sure that the legal models being compared function to address the same social need.

Assessing the breadth of the laws to be compared is also important. On one end of the spectrum, tax laws can be compared in a "macroscopic sense, [referring] to broad beliefs and practices and their impact upon the contemporary tax system."31 On the other end of the spectrum, comparison is narrower in focus, concentrating on a particular area of law.32 Both ends of the spectrum are undesirable. "[C]omparisons must be versatile enough to shift between the micro and macro level. . . . If not, comparisons risk falling into over-generalization on the one hand . . . and extra-contextual specificity on the other. . . ."33

This is an issue of particular importance in the area of tax law. Tax law is a notoriously complicated area of law showing "remarkable variations [as regards] the interactions between statutes, administrative guidelines, case law and opinions of scholars," even

30 Livingston, From Milan to Mumbai, Changing in Tel Aviv, supra note 22.
32 Id. at 122–23.
when common tax models are adopted.\textsuperscript{34} If we seek to adopt a specific tax model, such a model must be compared with other models in the context of some larger picture. For example, one must not only look at how corporate distributions are taxed, but must understand the function of taxing distributions within the system of corporate taxation; one must not only look at "corporate taxation", but must also understand its particular function within the general tax system and its interaction with other parts of this tax system. Finally, we must understand the broader legal and cultural context in which each tax system operates. Contrarily, it is easy to fall into over-generalized comparisons so abstract that they hide the manner in which the tax model actually works in real life. A tax comparativist should seek to adopt an intermediate level to compare legal models (or cultures), one that is narrow enough to be manageable from a practical point of view but is meaningful enough in terms of explaining or exemplifying the context in which the legal models operate.\textsuperscript{35}

4. The Technique of Comparison

Lastly, the methodology of the comparison itself needs to be addressed. The functional approach suggests that, once a common problem has been identified, we need to question the way in which it is solved in each of the compared jurisdictions (the "problem-solving approach"). Another possible approach is to take an institutional view, namely, to ask which institutions in the countries compared perform the same problem-solving functions best ("the institutional approach").\textsuperscript{36} The answer, in turn, will depend on how we define what "best" is. If we seek efficiency, economic models may be used to assess the success of specific legal solutions in advancing efficiency.

From a cultural comparative point of view, the idea is to identify "tax cultures" and, by doing so, point to real differences in policy choices. A tax comparativist must assume a priori that tax cultures are different and that a tax culture does not necessarily correlate with a society's general culture.\textsuperscript{37} This approach suggests that tax cultures are best understood as a general category from which narrow indicators can be subsumed and relatively easily compared. Such indicators might be the education and training of tax elites; the relationship among lawyers, economists, and other tax professionals; the nature of

\textsuperscript{34} Garbarino, \textit{supra} note 13, at 686.
\textsuperscript{35} Livingston, \textit{supra} note 31, at 123.
\textsuperscript{36} Örüçü, \textit{Methodology of Comparative Law}, \textit{supra} note 27, at 443.
tax administration; attitudes toward tax compliance and evasion; and
the unwritten traditions that govern the making and implementation
of tax policy in the country in question.  

III. CURRENT CORPORATE TAX REFORM DEBATE: BACKGROUND
AND PURPOSES

In what follows, I examine the current comparative corporate tax
reform debate, as developed since the current administration took
office. In doing so, I do not advocate (for the most part) the adoption
of one comparative approach over the other. Rather, I follow the path
taken by participants in the discourse. I should note that Parts II and
III are purely descriptive. Readers who are well familiar with the
current political discourse on tax reform, as well as the scholarly
discussions surrounding such discourse, are invited to skip to Section
IV, where I analyze the discourse against the background of the
theories presented in Section I.

I want to start by explaining what I mean by the “current debate.”
As previously noted, corporate tax reform proposals are always “out
there”; however, few “comprehensive” reforms take center stage
employing both tax-writing committees and the White House to the
same significant extent that is apparent since the Obama
administration took power. The last time that such an engagement in
tax reform could be witnessed was between 1984 and 1986, before the
comprehensive Tax Reform Act of 1986 brought about a significant
corporate tax rate reduction coupled with a broadening of the taxable
base.

By November 2008, when then-Senator Barack Obama became
President-Elect Barack Obama, the magnitude of the economic
downturn and its effects on the United States economy had started to
become evident. To a significant extent, the current corporate tax
reform debate is shaped by the 2008 global financial crisis. The crisis
inserted a sense of urgency to the reform talks and also reshaped the
substance of the reform proposals. Even though the financial crisis is
an important factor, it is ill advised to view the crisis as the only major
catalyst of the tax reform debate. Many other factors, both local and
global, played an important role here.

Even before the financial crisis emerged, federal budget deficits
drew much attention. While Republicans and Democrats spend much

38 Livingston, From Milan to Mumbai, Changing in Tel Aviv, supra note 22, at
557.
energy pointing fingers (Democrats blaming tax cuts from the Bush administration; Republicans blaming Democrats for excessive spending), all parties involved seemed to agree that something needed to be done about the deficit. The economic downturn made things more complicated. For example, Obama’s pre-election proposal to “close loopholes” and raise taxes on high-income tax earners lost traction amid financial losses and a disastrous job market.  

The deficit problem and the downturn resonated loudly when combined with another problem frequently noted by many commentators. Some argue that the corporate tax system in the United States is “broken” and that it does not fulfill its role in revenue collection. The argument that the U.S. corporate tax system needs “fixing” can be divided into three sub-arguments. The first argument is that the corporate tax system in the Unites States fails to keep pace with the rest of the world. Other countries have taken significant measures to adjust their corporate tax systems to make them more competitive in the global market, specifically in terms of statutory rate cuts. The second argument is that the corporate tax system is riddled with loopholes and preferences to such an extent that little revenue is actually collected. The third argument, which, to a great extent, is a result of the second, is that the corporate tax system is far too complex, making compliance and administration inefficient. In purposeful terms, the current debate is aimed at creating a corporate tax system that is more “competitive,” “simple,” and “fair”, and at the same time addresses the deficit concerns. While this article primarily addresses the issue of competitiveness, simplicity and fairness should also be kept in mind. Some or all of these three purposes were considered by other jurisdictions suffering from deficits as well, and


41 A summary of the need for tax reform as perceived by current senior tax writers follows:

While our major trading partners have spent the last two decades reducing their corporate tax rates, the U.S. corporate rate is actually higher than it was 20 years ago... At the same time, the tax code is full of tax preferences that attempt to pick winners and losers rather than just allowing the most promising business investments to flourish.

this fact is of significance.

The factors of global competitive pressures, financial decline, and an ill-functioning corporate tax system culminated in the current reform debate. With this background, several major initiatives for a comprehensive reform have been put forward since President Obama’s inauguration. In late 2008, less than a month after his election, President-Elect Obama announced the establishment of the President’s Economic Recovery Advisory Board (PERAB). The aim of PERAB was “to enhance the strength and competitiveness of the Nation’s economy and the prosperity of the American people by ensuring the availability of independent, nonpartisan information, analysis, and advice to the President as he formulates and implements his plans for economic recovery.” PERAB has been given the mandate to discuss “the pros and cons of a spectrum of reform ideas relating to tax simplification, improving compliance with existing tax laws, and reforming the corporate tax system.” PERAB members were primarily professionals representing various fields of expertise and business sectors. As such, this task force was charged with presenting an informative rather than a prescriptive report. PERAB published its report on tax reform options in August 2010.

The political task of making actual legislative proposals for tax reform was assigned by the President in February 2010 to the bipartisan National Commission on Fiscal Responsibility and Reform (named the Bowles-Simpson commission after its co-chairs). The Bowles-Simpson commission considered, among other items, tax reform issues for ten months before publishing its report, titled the “Moment of Truth,” in December 2010. The Bowles-Simpson report reiterated that the proposed tax reform is intended to achieve several basic goals: reducing rates coupled with broadening the base to eliminate hidden tax expenditures, reducing the deficit, maintaining progressivity, and improving the competitiveness of U.S. companies.

Starting in late 2010, the two tax-writing committees enlisted


45 The Moment of Truth, supra note 8.

46 Id. at 26-30.
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themselves for the project of “comprehensive,” or “fundamental,” tax reform. In September 2010, the Finance Committee, citing complexity, fairness, and competitiveness as its drivers, started a series of hearings on possible tax reform. The Ways and Means Committee joined ranks in January 2011, when it held the “Hearing on Fundamental Tax Reform,” citing “the cost of complexity borne by American families, the cost of a corporate tax system that is increasingly out-of-step with the rest of the world, and the broader cost to the U.S. economy of a tax system that fails to maximize job creation and impedes economic growth.” By August 2011, both committees had held, in the aggregate, dozens of hearings dedicated to tax reform. This bipartisan interest in tax reform also induced other initiatives taking place off the beaten path of the tax-writing committees, such as the one taken by six senators, three from each side of the aisle, cooperating in trying to come up with workable solutions for tax reform legislation. This “Gang of Six” started meetings in February 2011 and published its budget proposal, inclusive of a plan for a comprehensive tax reform, in July the same year, noting competitiveness of the tax system as a key issue that needs addressing.

Regardless of the political divide in terms of substance, the interest in tax reform in general, and corporate tax reform in particular, was very high between 2009 and 2011. It is not clear if this will result in real comprehensive reform, though some commentators did opine that, notwithstanding the disagreements about the content of any prospective reform, “corporate tax reform looks like a sure bet, with broad bipartisan backing, not to mention the support of America’s powerful business community.” Agreement regarding the purposes of the reform remains elusive, with participants divided on the relative emphasis on competitiveness versus fairness (though everyone seems to agree about simplicity). Even so, competitiveness,
simplicity, and fairness still lead the discussions, and, with these three purposes in mind, I turn to the analysis of comparative discourse in current debate.

IV. COMPARATIVE NATURE OF THE DEBATE

A. Competitiveness in General

Of the three purposes of competitiveness, simplicity, and fairness, to a significant extent, the defining element of current corporate tax reform debate is competitiveness. Many participants in the debate constantly argue that the current corporate tax system in the United States is uncompetitive and therefore in need of reform.51 Unfortunately, in spite of the heavy reliance on the competitiveness argument to justify many specific reform proposals, participants in the discourse have refrained from developing a workable definition of competitiveness (with very few exceptions). It is sometimes observed that “it is not countries that are competitive, it is companies that are.”52 If so, we must determine how corporate taxes affect the competitiveness of U.S. firms. One commentator recently criticized U.S. MNCs, noting that “U.S. multinational firms can fairly be said not to be deeply troubled by any terminological ambiguity. To such a firm, an ‘anticompetitive’ measure is any cost that along any dimension might be greater than the comparable cost faced by a firm not domiciled in the United States.”53

Michael Knoll recently made a sophisticated attempt to make amends to this definitional ambiguity.54 Knoll refers to

51 See, e.g., CEO Perspectives on How the Tax Code Affects Hiring, Businesses, and Economic Growth: Hearing Before the S. Comm. on Fin., 112th Cong. (2011) [hereinafter Finance July 27 Hearing] (testimony of Thomas J. Falk, Chairman and Chief Executive Officer, Kimberly-Clark Corporation) (arguing that “current U.S. corporate tax system . . . puts American companies and workers at a competitive disadvantage in the global marketplace . . . ”); Ways and Means Jan. 20 Hearing, supra note 47 (testimony of Robert A. McDonald, Chairman, Fiscal Policy Institute Business Roundtable) (arguing that the U.S. corporate tax system is “one of the least competitive tax systems among developed countries”); On certain occasions, entire hearings were framed in terms of competitiveness. See, e.g., Ways and Means May 12 Hearing, supra note 8; Ways and Means May 24 Hearing, supra note 1.
54 Knoll, supra note 8.
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competitiveness not as a characteristic of a country or a company but as one that should be attributed to a "local industry." For that purpose, U.S. local industry can be defined in one of two ways. The more frequently used sense of this term is "U.S.-based and U.S.-incorporated" companies of a specific industry. Under this first definition of local industry, a U.S. industry competes in the global market against other national industries based in other countries. They compete to invest elsewhere, and to sell their products around the world and in their respective national markets. Under this view, for example, a U.S. industry is more competitive than country X's similar industry if the U.S. industry outbids country X's industry in a contest to acquire an industry plant located in country Y. Thus, U.S. taxes negatively affect the competitiveness of a U.S. industry by lowering the after-tax return of such industry when investing abroad. The higher the tax burden, the lower the bidding price it could offer. I refer to this form of competition as "outbound competition."

Under the second definition, a local industry is the "total production" of a specific industry segment made within the United States. Under this definition, a U.S. industry is competitive compared to other countries' industries if it is able to attract more investment into the United States such that more of an industry's production is made in the United States (and not in other countries). Here, tax may negatively affect competitiveness if it reduces the after-tax return of an investor in the United States compared to the return on an alternative investment in another jurisdiction. If the other jurisdiction taxes profits from within its territory at lower rates than does the United States, then the U.S. industry is at a competitive disadvantage. I refer to this type of competition as "inbound competition."

As shall be discussed below, most participants in the discourse refrain from noting this distinction. Ignoring this distinction is significant because some suggestions for reform may indeed induce one kind of competitiveness but may hurt the other. Whatever the case may be, for now, noting that competitiveness is a comparative argument is sufficient. Competitiveness means that someone else, not

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55 Id. at 774.
56 Id.
57 Id. at 776-777.
58 Id. at 780-81.
59 Id. at 774.
60 Id. at 778.
61 Id. at 784-85.
a U.S. industry (whatever the definition may be), is competing with a U.S. industry for the same limited resources but is subjected to a different (more or less "competitive") taxation system than the U.S. industry is.

In what follows, I describe some of the main competitiveness arguments that rely on legal comparisons in promoting tax reform proposals (for example, I do not discuss the important debt/equity distinction and only briefly mention some issues relating to corporate/shareholder integration). These arguments are made, counter-argued, and debated as part of a conscious process aimed at advancing specific legislative tax reform proposals. The idea is to provide a factual background of the current comparative reform discourse rather than to portray the outlines of a theoretical academic debate. To achieve this aim, the description below obtains its vitality primarily from specific legislative proposals, legislative committees' hearings, and official background papers produced for purposes of such hearings. The comparative arguments immediately described below are critically reviewed in Part IV.

**B. Comparative Corporate Tax Rates Debate**

1. Statutory Rates

At the outset of its discussion on corporate tax reform, the PERAB Report notes: "[t]he United States has the second highest statutory corporate income tax rate in the Organization for Economic Co-operation and Development (OECD) behind Japan."\(^{62}\) The Bowles-Simpson report, along the same lines, notes that the fact that U.S. statutory corporate tax rates are "significantly higher than the average for industrialized countries" is among the reasons why U.S. corporations are put "at a competitive disadvantage against their foreign competitors."\(^{63}\)

These two reports demonstrates the importance of the role that statutory corporate tax rates play in the corporate tax reform discourse, as well as the almost unanimous (comparative) consensus in respect thereof. Both reports start with a comparison of statutory rates and immediately conclude that the fact that the United States

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\(^{63}\) The Moment of Truth, supra note 8, at 28.
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has higher rates than the rest of the world is "bad." The Bowles-Simpson report explicitly calls for a reduction in the statutory corporate tax rate combined with a broadening of the tax base to compensate for the resulting revenue loss. This "lower the rates, broaden the base" theme is a repeating theme among many participants in the discourse (from both sides of the aisle).

It is hardly questionable that the United States currently imposes a statutory corporate tax rate that is among the highest in the world. According to OECD data, the combined federal and average state corporate tax rate for 2010 faced by a corporation domiciled in the United States was about 39.2%, far above the unweighted average of 25.6% for other OECD countries (meaning, excluding the United States).

Interestingly, as many participants in the discourse correctly note, this has not always been the case. In the early 1980s, the U.S. rate of

64 Ways and Means May 12 Hearing, supra note 8 (statement of Gregory J. Hayes, Senior Vice-President and Chief Financial Officer, United Technologies Corp.) ("Combined with state income taxes, the U.S. statutory income rate imposed on corporations hovers at or near the highest among all developed economies."); Ways and Means May 12 Hearing, supra note 8 (statement of Mark A. Buthman, Senior Vice President and Chief Financial Officer, Kimberly-Clark Corp.); Ways and Means May 12 Hearing, supra note 8 (statement of Rep. Dave Camp, Chairman, H. Comm. on Ways and Means) ("America's combined federal-state corporate tax rate... is only outpaced by Japan's rate...."); Does the Tax System Support Economic Efficiency, Job Creation, and Broad-Based Economic Growth?: Hearing Before the S. Comm. on Fin., 112th Cong. (2011) [hereinafter Finance Mar. 8 Hearing] (statement of Prof. Alan Auerbach, University of California Berkeley) ("Among the lowest tax rates in leading economies just after the Tax Reform Act of 1986, the U.S. corporate tax rate is now much higher than those in most of these other economies."); Finance Mar. 8 Hearing, supra (statement of Prof. Glenn Hubbard, Dean, Columbia University Graduate School of Business) ("Combining national and subnational tax rates, the United States has the second highest rate of tax among OECD countries, just behind that of Japan."); Ways and Means Jan. 20 Hearing, supra note 47 (statement of Robert A. McDonald, Chairman, Fiscal Policy Initiative Business Roundtable) ("[T]oday, the U.S. corporate tax system stands out as an outlier relative to the tax systems of our trading partners, imposing a high rate of tax on corporate income...."); Ways and Means Jan. 20 Hearing, supra note 47 (statement of Kevin A. Hassett, Director of Economic Policy Studies, American Enterprise Institute).

65 This summary of OECD data is found in Kleinbard, supra note 53, at 758–63.

66 Id. at 759. There are some minor variations in the figures among participants. The American Enterprise Institute, for example, puts the U.S. ETR average at 39.2%. See Hassett & Mathur, supra note 2.

67 See, e.g., Ways and Means May 12 Hearing, supra note 8 (statement of Robert A. McDonald, Chairman, Fiscal Policy Initiative Business Roundtable); Merrill, supra note 8, at 1010; Hassett & Mathur, supra note 2, at 3.
fifty percent was only moderately higher than the OECD average (excluding the United States) of about forty-seven percent. The 1986 Tax Reform Act included a significant rate reduction, bringing the combined state and federal corporate tax rate in the United States to its approximate current level. This placed the U.S. statutory rate slightly below the then-average OECD rate. However, while U.S. statutory rates have remained pretty much constant since then, other countries have continued to cut their statutory rates. Participants in the discourse frequently cite recent examples that include Germany dramatically lowering its rates by ten percentage points as part of a 2008 reform; the UK lowering its statutory rate from 28% to 27% in 2011, with further gradual reductions planned over the next three years to 24%; Canada lowering its statutory rate from 22% in 2007 to 18% last year, with a planned gradual reduction to an eventual 15% starting in 2012; and China lowering its corporate tax rate from 33.3% to 25% in 2008. Other countries cited as examples for corporate tax rate-reducing reforms include, among others, Greece, Turkey, Poland, the Slovak Republic, Iceland, Ireland, Mexico, Macedonia, Vietnam, and Taiwan.

With such overwhelming evidence of differences in black-letter rates, the fact that some commentators note that "[t]here is increasing recognition in Washington that the U.S. corporate tax rate is out of step with the lower tax rates of most industrialized and emerging nations" is hardly surprising. This recognition brings with it calls, from almost all participants in the discourse, for the reduction of the U.S. statutory corporate tax rate. These calls are evidenced in

68 Hassett & Mathur, supra note 2.
69 Hodge & Dammert, supra note 8.
70 Ways and Means May 12 Hearing, supra note 8 (statement of Robert A. McDonald, Chairman, Fiscal Policy Initiative Business Roundtable); Hodge & Dammert, supra note 8.
72 These countries' tax-lowering reforms were reported by participants of the discourse, among others, in Hodge, supra note 71; PRICEWATERHOUSECOOPERS LLP, GLOBAL EFFECTIVE TAX RATES (2011) [hereinafter PwC REPORT].
73 Hodge, supra note 71 at 1.
74 See, e.g., Tax Reform and Foreign Investment in the United States: Hearing Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means, 112th Cong. 4 (2011) [hereinafter Ways and Means June 23 Hearing] (statement of Nancy L. McLernon, President & CEO, Organization for International Investment (OFII)) ("OFII is united with the broader American business community"
multiple bills and other legislative proposals that include corporate tax rate reduction.\textsuperscript{75}

Yet, the issue of statutory rates comparisons is not without controversy. Edward Kleinbard argues that "the gap between U.S. and world corporate [statutory] tax rate norms is sometimes overstated."\textsuperscript{76} To begin with, he notes that the dataset usually used for purposes of these comparisons "includes sub-central government taxes on corporate income."\textsuperscript{77} He argues that, for purposes of comparing competitiveness among corporate taxpayers, to include such subcentral taxes is appropriate:

when comparing the competitive tax environment of U.S. \textit{domestic} firms to foreign firms, or when measuring the \textit{foreign} tax burden on inbound investment in a particular country, but it is not appropriate to include U.S. sub-central government taxes when measuring an actual or hypothetical U.S. statutory tax burden on U.S.-domiciled multinational firms contemplating an outbound investment, because as a general matter foreign income is not taxed by the states of the United States.\textsuperscript{78}

In Knoll’s terms, Kleinbard argues that only for "inbound competitiveness" are local taxes relevant. When state income taxes are taken out of the picture, the U.S. federal corporate income tax rate of 35\% is the one to be used in the comparisons rather than the combined state and federal rate of 39.2\%. This reduces in its support for reducing the U.S. federal corporate income tax rate."; Scott A. Hodge, \textit{Ten Benefits of Cutting the U.S. Corporate Tax Rate: Special Report No. 192}, \textsc{Tax Foundation} (May 2011), http://taxfoundation.org/sites/taxfoundation.org/files/docs/sr192.pdf (enumerating the benefits of corporate income tax rate reduction); \textit{The Moment of Truth, supra} note 8, at 32 (recommending establishing a single corporate tax rate between 23\% and 29\%). A few objections to tax cuts were also made, but these are rare expeditions. \textit{See, e.g.}, Chye-Ching Huang, \textit{Corporate Tax Rate Cut Likely to be Ineffective as Stimulus}, \textsc{Ctr. on Budget and Policy Priorities} (Jan. 23, 2009), http://www.cbpp.org/files/1-23-09tax.pdf.


\textsuperscript{76} Kleinbard, \textit{supra} note 53, at 759.

\textsuperscript{77} \textit{Id.}

\textsuperscript{78} \textit{Id.} (emphasis added).
“uncompetitiveness” by 4.2 percentage points, which is significant.

In addition, Kleinbard argues that the unweighted average of such taxes overstates the role of small and insignificant economies and understates the role of larger economies. When the size of the economy is taken into account, “[t]he unweighted average of the maximum statutory corporate income tax rates of member states of the OECD in 2006 was just about 28 percent (25.6 percent in 2010, excluding in this case the United States),” This difference is hardly as alarming as the 13.6 percentage point difference between the U.S. rate and the OECD average rate when unweighted calculations are used.

Finally, when throwing non-OECD countries into the mix, Kleinbard is careful to compare the U.S. tax rate only with those he considers to be significant economies, such as the BRIC countries (Brazil, Russia, India, and China), with an average statutory rate of 28.25% among the four. This is not the huge difference portrayed by other studies, which looked at statutory rate reductions in non-OECD countries.

2. Effective Rates and Revenue Collection

Media reports frequently note the paradoxical contrast between the high U.S. statutory corporate tax rates and the low real tax burden borne by U.S. MNCs, noting that “by taking advantage of myriad breaks and loopholes that other countries generally do not offer, United States corporations pay only slightly more on average than their counterparts in other industrial countries.” A recent well-known New York Times story portrayed the nation’s largest corporation, General Electric, as an aggressive tax planner that pays little or no taxes in spite of the fact it reports billions of dollars in profits. The story resulted in a nationwide outrage that forced General Electric into a defensive public relations battle.

80 Kleinbard, supra note 53 at 740.
81 Id. at 761.
82 Kocieniewski, supra note 4.
84 General Electric, among others, posted an elaborate response on its website. GE and Taxes, GE REPORTS (Mar. 28, 2008), http://www.gereports.com/setting-the-
This is clearly a much more complex story than the story of statutory rates, certainly from a comparative perspective. To start with, participants in the discourse use the term “effective rates” to refer to several different measurements of the tax burden faced by corporate entities. These different measurements, when compared globally, produce significantly different results.\(^8\) This explains the lack of consensus among the participants in the discourse in respect of the issue. With no agreed upon method of comparison, no consensus exists regarding whether U.S. corporations actually face a higher, similar, or lower burden compared to their foreign counterparts. It is important to note that all of these measurements are purely economic, meaning they are more an exercise of comparative public finance than an exercise in comparative law. Such comparative financial studies, however, contain implicit assumptions about how corporate tax laws work in the compared jurisdictions.

The most straightforward measurement for the actual tax burden, which is simply referred to as effective tax rate (ETR), is defined as the total amount of actual taxes paid divided by the pretax income. A PricewaterhouseCoopers (PwC) study found that the ETR faced by U.S. multinationals for a period between 2006 and 2009 was 27.7\%, which is only moderately higher than the unweighted average in the OECD countries (excluding the United States) of 22.6\%.\(^8\) Interestingly, the PwC report also compared U.S. rates with those in countries outside the OECD. The fifty-eight-country unweighted average, including many less-developed economies, stood at 19.5\%, and the average in non-OECD countries stood at 16.5\%, both significantly lower than the ETR in the United States.\(^8\)

The PwC survey, which was commissioned by the Business Roundtable,\(^8\) was harshly criticized for ignoring the size of the economies and the companies surveyed.\(^8\) Indeed, if the size of the

\(^8\) For the different measures of effective tax corporate tax rates (ETR, EMTR, and collection-to-GDP ratio), see footnotes 86-96 infra and accompanying discussion.

\(^8\) PwC REPORT, supra note 72, at 2. See also JANE G. GRAVELLE, CONG. RESEARCH SERV., R41743, INTERNATIONAL CORPORATE TAX COMPARISONS AND POLICY IMPLICATIONS 3 (2011) [hereinafter CRS CORPORATE TAX RATES COMPARISONS].

\(^8\) PwC REPORT, supra note 72, at 2.

\(^8\) The Business Roundtable is an association of chief executive officers of leading U.S. companies, founded with the aim of voicing America's CEOs on public policy issues. See About Us, BUSINESS ROUNDTABLE, http://businessroundtable.org/about-us (last visited Aug. 18, 2012).

\(^8\) Kleinbard Critiques PwC Effective Tax Rate Study, TAXPROF BLOG (Apr. 18,
economy is weighted in, the OECD effective rate average is 27.7%, which means that, according to such weighted measurement, U.S. corporations actually face a slightly lower burden in terms of ETR than the OECD average. Some commentators contend that the argument according to which U.S. MNCs are disadvantaged compared to their foreign counterparts is simply “inconsistent with the data” and that “many U.S. multinational firms today enjoy global effective tax rates closely comparable to those enjoyed by foreign-based competitors.”

Other more sophisticated measurements of effective tax rates produce inconsistent results. A study from the American Enterprise Institute (AEI) presented in a Ways and Means hearing report that, in 2010, the effective average tax rate (EATR) faced by U.S. MNCs was 29.0%, which compares poorly with an OECD average (excluding the United States) of 20.5%. Other studies examine the effective marginal tax rate (EMTR). The AEI report finds that the EMTR faced by U.S. MNCs is 23.6%, which is substantially higher than the

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90. CRS CORPORATE TAX RATES COMPARISONS, supra note 86 (indicating that U.S. MNCs face an ETR of 27.1%).
92. Kleinbard, supra note 53, at 714.
95. Hassett & Mathur, supra note 2, at 6.
96. This tax rate applies to “marginal investment projects in which the last unit invested provides just enough pretax return to cause the project to break even after taxes.” Id. at 3 (citing Devereux & Griffith, supra note 94).
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OECD average (excluding the United States) of 17.3%.\textsuperscript{97} When the size of the economies is taken into account, however, a Congressional Research Service (CRS) study finds that U.S. EMTR is only slightly higher compared to the OECD weighted average of 21.2%.\textsuperscript{98}

Another economic measurement frequently cited as a proxy for the effective tax burden borne by U.S. MNCs is the revenue collection from corporate taxes as a share of gross domestic product (GDP). Several recent reports by Citizens for Tax Justice (CTJ)\textsuperscript{99} argue that, while many other countries indeed lowered their corporate tax rates, such countries have also closed tax “loopholes.” At the same time, the reports argue, the United States expanded such loopholes.\textsuperscript{100} As a result, “the U.S. collects less corporate taxes as a share of GDP than all but one of the 26 OECD countries for which data are available.”\textsuperscript{101}

Many commentators counter this perception, noting that the measurement of the ratio of tax collection to GDP confuses cause with effect. It is not that U.S. companies manipulate the system, the argument goes, but rather the uncompetitive U.S. tax environment causes U.S. MNCs to shift their activities overseas. The result is less economic activity in the United States, which in turn results in less revenue collection.\textsuperscript{102} This line of reasoning calls for reform that will reduce the corporate tax burden and assumes that such reform will pay for itself. The argument here is that a behavioral response to a

\textsuperscript{97} Id. at 4-5. See also Hodge, supra note 74, at 3; Hodge & Dammert, supra note 8.

\textsuperscript{98} CRS CORPORATE TAX RATES COMPARISONS, supra note 86, at 5–6.


\textsuperscript{101} CTJ June 30 Report, supra note 100 at 2. For documentation of the decline of effective corporate tax rates in the U.S. over time, see Corporate Income Tax as Share of GDP 1946-2009, TAX POLICY CENTER (Apr. 15, 2010), http://www.taxpolicycenter.org/taxfacts/Content/PDF/corporate_gdp.pdf.

\textsuperscript{102} Ways and Means June 23 Hearing, supra note 74 (statement of Gary Clyde Hufbauer, Reginald Jones Senior Fellow, Peterson Institute for International Economics) (“Large firms who have a choice . . . when other things are equal . . . they would rather invest — produce elsewhere, than in the United States . . . our tax system does a good job of encouraging the best and brightest firms to invest abroad.”).
favorable tax environment is expected to bring with it a significant increase in economic activity in the United States, which in turn will increase revenue collection in spite of a lower overall tax burden.\textsuperscript{103}

Another frequently cited reason for the relatively small amount of revenue collected from corporate taxpayers in the United States is that, under the Code, only per se corporations (so-called C corporations)\textsuperscript{104} are subject to corporate-level taxes. The owners of C corporations are subject to a second level of tax once a distribution of earnings is made from the corporation to them, resulting in double-level taxation (once at the corporate level and again at the shareholder level). Significantly, other forms of business entities, most notably limited liability companies (LLCs), S corporations, and other forms of business partnerships, are treated as “pass-throughs” for tax purposes. This means they do not pay entity-level taxes. Rather, the tax liability passes through to the owners, who are subject to a single level of tax (at the owner’s level). A 2007 report by the CRS notes that “liberal rules . . . allow firms to obtain benefits of corporate status (such as limited liability) while still being taxed as unincorporated businesses.”\textsuperscript{105} The CRS report also notes a significant rise of the share of total business income in the United States received by unincorporated businesses since 1980.\textsuperscript{106}

The natural preference created by the U.S. tax rules to operate a business as a pass-through for tax purposes and the tax planning opportunities associated with it brought about several calls to consider corporate tax reform to address this issue. For example, some commentators suggested introducing imposition of entity-level taxes on what are currently treated as pass-throughs in certain cases.\textsuperscript{107} Recently, Senate Finance Committee Chairman Senator Max Baucus said that Congress should consider taxing pass-throughs as corporations.\textsuperscript{108} Such proposals have met with fierce resistance.\textsuperscript{109}

\textsuperscript{103} For a summary of studies regarding behavioral responses to tax rate cuts as well as critique thereof, see JANE G. GRAVELLE & THOMAS L. HUNGERFORD, CONG. RESEARCH SERV., RL34229, CORPORATE TAX REFORM: ISSUES FOR CONGRESS (2007) [hereinafter CRS 2007 REPORT].

\textsuperscript{104} Meaning, corporations subject to tax under subchapter C of title A of the Code.

\textsuperscript{105} CRS 2007 REPORT, supra note 103, at 4.

\textsuperscript{106} From twenty-one percent of total business income to sixty percent (!) in 2007. Id.

\textsuperscript{107} Martin A. Sullivan, Why Not Tax Large Passthroughs as Corporations?, 131 TAX NOTES 1015, 1015 (June 6, 2011).

\textsuperscript{108} Nicola M. White & Drew Pierson, Baucus Says Congress Should Look at
Taxing pass-throughs, without a corresponding reduction in corporate tax rates, the argument goes, will put "jobs at risk", as much of the U.S. work-force is employed by pass-through entities.\(^{109}\)

But here is the crucial point for purposes of this article: the debate on whether we should tax pass-throughs is in its very essence a debate about corporate classification for tax purposes. The issue is what kinds of business entities should be subject to entity-level tax (hence being a source of revenue collection). Significantly, this debate is almost always posed in the context of a revenue collection debate or as a sub-discussion of the issue of tax evasion. With the exception of very few comments, this issue is almost never discussed from a stand-alone comparative prism. One of these notable exceptions is a testimony by Robert Carroll, a former Deputy Assistant Secretary for Tax Analysis in the Ways and Means Committee.\(^{111}\) According to Carroll, among the OECD countries, the United States has almost the largest unincorporated business sector in terms of percentages as a share of total businesses, second only to Mexico.\(^{112}\)

\[C. \text{ Who Carries the Corporate Tax Burden?}\]

"Corporations don’t pay taxes, they collect them."\(^{113}\) This observation adds another comparative twist to the story of tax reform, which concerns the question of who ultimately bears the burden of corporate taxation in each jurisdiction. This question is the subject of a lively, sometimes heated, debate in the community of public finance economists.\(^{114}\) Theoretically speaking, this question has a few possible

\(^{109}\) Ways and Means May 24 Hearing, supra note 1 (statement of the U.S. Chambers of Commerce).


\(^{112}\) Id. at 7.

\(^{113}\) Finance Mar. 8 Hearing, supra note 64 at 9 (quoting Paul H. O'Neill) (statement of Prof. Michael J. Graetz, Columbia Law School).

\(^{114}\) For a recent comprehensive review of literature on this issue, see WILLIAM M. GENTRY, DEP'T OF THE TREASURY, OFFICE OF TAX ANALYSIS, OTA PAPER 101, A REVIEW OF THE EVIDENCE ON THE INCIDENCE OF THE CORPORATE INCOME TAX
answers: "corporate tax could be borne by some combination of the shareholders of corporations, investors in all capital through a decrease in the overall return to capital, workers through a decrease in wages, and customers through increased output prices." While the traditional assumption is that the owners of the corporations bear the burden through lower after-tax returns, recent empirical analysis suggests that, in a world where capital is much more mobile than labor, much of the burden is shifted to workers in the form of lower wages. Several comparative studies found a negative correlation between corporate tax rates and wages. That is to say, the higher corporate tax rates are in a given jurisdiction compared to other jurisdictions, the lower the wages are in that jurisdiction compared to other jurisdictions. One recent study suggests that in the United States, between forty-five and seventy-five percent of the corporate tax burden is borne by labor, with the rest borne by capital.

Participants in the discourse occasionally use this evidence to justify a reduction in U.S. corporate tax rates. The argument is that with tax rates higher in the United States compared to the rest of the world and with labor carrying most of the tax burden, the U.S. worker is worse off compared to workers in other countries. One report even explicitly cited higher wages for U.S. workers as an anticipated benefit of a tax reform that would decrease corporate tax rates.

(2007).

Id. at 1.

Finance Mar. 8 Hearing, supra note 64 at 9 (testimony by Prof. Michael J. Graetz, Columbia Law School) ("As the economy has become more open internationally, a number of recent economic studies have concluded that the corporate income tax is less likely borne by capital generally, but rather — at least in some substantial part — by workers in the form of lower wages.").


Hodge, supra note 74 at 2–3.
D. Debate About Territoriality

Practically every participant of the discourse takes note of the fact that the United States is among the few remaining nations to tax their corporate entities on a global basis. Global taxation means that the taxing jurisdiction imposes taxes on the worldwide earnings of its corporate residents without regard to the source of such income. To eliminate possible double taxation of the same earnings by both the United States and the jurisdiction from which such earnings are derived, a U.S. MNC is generally entitled to a credit in an amount of foreign tax paid in that other jurisdiction, capped at the amount of taxes that would have otherwise been paid in the United States.\(^\text{121}\)

The global taxation system employed by the United States is not a "pure" one in the sense that foreign-sourced profits of U.S. MNCs are not always immediately taxed. Generally speaking, profits from active foreign business earned by a controlled foreign corporation ("CFC") that is a subsidiary of a U.S. MNC are not subject to tax in the United States until actually repatriated (usually in the form of dividends). This feature of the U.S. tax system, known as "deferral," combined with the fact that U.S. corporations can still book such foreign-sourced gain in their financial statements for financial-reporting purposes,\(^\text{122}\) creates an obvious incentive to accumulate foreign earnings offshore (a phenomenon that is known as the "lock-in effect" or the "trapped earnings" problem). "Passive" income, on the other hand, such as rents, royalties, interest, and dividends, is generally not entitled to a deferral and is immediately taxed in the United States.\(^\text{123}\)

According to most participants, this system of global taxation stands in sharp contrast to the corporate tax systems of other nations. Many of the U.S. trading partners tax their corporations on a territorial basis.\(^\text{124}\) Under a territorial system, only the earnings of the corporations from sources within the taxing jurisdictions are taxed. Thus, for example, a German corporation investing in the United States will not be subject to taxation in Germany on the profits earned from sources in the United States. Citing the fact that the United

\(^{121}\) I.R.C. §§ 901(a), 904.

\(^{122}\) For a discussion of the benefit to U.S. MNCs of the difference between tax reporting versus financial reporting of foreign earnings, see Christopher H. Hanna, Corporate Tax Reform: Listening to Corporate America, 35 J. CORP. L. 283, 308–309 (2009).

\(^{123}\) I.R.C. §§ 951–965 (known as "Subpart F").

States is almost the last practitioner of an “archaic”\textsuperscript{125} system, multiple commentators have vigorously advanced reform proposals with the aim of changing the current global system of taxation of U.S. MNCs to a territorial one.\textsuperscript{126}

Proponents of territoriality argue that the isolation of the United States in taxing its corporations on a worldwide basis puts U.S. MNCs at a competitive disadvantage. This competitive comparative argument can be summarized as follows: Because most other countries employ a territorial tax system, the active foreign earnings of such countries’ corporate taxpayers are exempt from taxation in their home country. For example, a German corporation making an investment in a country X subsidiary only suffers the burden of the taxes imposed by country X on the country X subsidiary. Assume, for example, that country X imposes a relatively low tax rate (lower than the tax rate in the United States). Germany will not impose any taxes on repatriated earnings of the German corporation from country X, as they are earned “outside” the German territorial taxing jurisdiction. On the other hand, a U.S. corporation investing in a country X subsidiary will be subject to the same country X taxes, as well as to an additional level of U.S. tax upon repatriation of such earnings to the United States. Because of this extra cost of capital in the form of additional taxes imposed on U.S. MNCs, they will not be able to place a lower bid than the German one when competing for the purchase of country X’s investment. In other words, U.S. worldwide taxation makes U.S. corporations less competitive in foreign markets. This is a problem of “outbound competitiveness.” In addition, proponents of territoriality note that the lock-in effect prevents U.S. corporations from bringing the money earned abroad back to the United States for reinvestment in the U.S. economy, thereby hampering the creation of

\textsuperscript{125} Id.
\textsuperscript{126} See, e.g., Ways and Means May 24 Hearing, supra note 1 (statement of Gary M. Thomas, White and Case); id. (statement of Stephen Edge, Slaughter and May); Finance July 27 Hearing, supra note 51 (statement of Michael T. Duke, President and Chief Executive Officer, Wal-Mart Stores, Inc.); id. (statement of Thomas J. Falk, Chairman and Chief Executive Officer, Kimberly-Clark Corporation); id. (statement of Gregory S. Lang, President and Chief Executive Officer, PMC-Sierra, Inc.); Ways and Means Discussion Draft: Tax Reform Act of 2011, supra note 75; The Moment of Truth, supra note 8, at 28. Others have suggested that if territoriality is not adopted, the alternative would be to maintain the current system of deferral so to not further hurt the competitiveness of U.S. MNCs. See, e.g., Robert Carroll, The Importance of Tax Deferral and A Lower Corporate Tax Rate: Special Report No. 174, TAX FOUNDATION (Feb. 2010), http://www.taxfoundation.org/sites/taxfoundation.org/files/docs/sr174.pdf.
U.S jobs. Rather, the lock-in effect encourages U.S. multinational corporations to seek investment opportunities overseas to avoid the repatriation tax.\(^\text{127}\) This is an “inbound competitiveness” problem but of a rather limited nature because foreign investors in the United States are unaffected by trapped earnings issues.\(^\text{128}\)

Some commentators, however, have been much more skeptical of the argument that U.S. MNCs are disadvantaged when compared to MNCs in jurisdictions that impose taxes on a territorial basis. In a testimony in a hearing in the Ways and Means Committee, Avi-Yonah rejected both comparative arguments mentioned above as justification for territoriality.\(^\text{129}\) With respect to the outbound competitiveness of U.S. multinationals, Avi-Yonah noted that no good evidence exists to suggest that the tax burden faced by U.S. multinationals in foreign jurisdictions is higher than that of foreign counterparts. U.S. MNCs take advantage of the foreign tax credit system and are free to move their foreign earnings from one foreign jurisdiction to another without having to pay substantial amounts of taxes.\(^\text{130}\) Avi-Yonah describes here the phenomenon Kleinbard denoted as “stateless income,” which Kleinbard defines as “income derived by a multinational group from business activities in a country other than the domicile (however defined) of the group’s ultimate parent company, but which is subject to tax only in a jurisdiction that is neither the source of the factors of production through which the income was derived, nor the domicile of the group’s parent company.”\(^\text{131}\)

Kleinbard argues that the combination of the ability of U.S. multinationals to freely move foreign earnings (meaning, without triggering U.S. tax) from one foreign jurisdiction to another, the foreign tax credit system, and the system of deferral actually enables U.S. corporations to avoid current taxation on foreign-sourced earnings and to even repatriate non-extraordinary amounts of such earnings back to the United States with no (or only very low) U.S. tax imposed.\(^\text{132}\) He then makes the functional argument that, in practice,


\(^\text{128}\) In addition, U.S. MNCs can borrow money in the U.S. at very low rates pledging as security most of their foreign assets. See I.R.C. § 956 and Treas. Reg. § 1.956-2(c)(2) (as amended in 2012).


\(^\text{130}\) Id.

\(^\text{131}\) Kleinbard, supra note 53, at 702-703.

\(^\text{132}\) Id. at 759 (describing the possibility of repatriating foreign income in ways...
U.S. tax rules do not operate as a “worldwide” system of taxation but function as an “ersatz variant on territorial systems.”

Both Kleinbard and Avi-Yonah also reject the argument according to which territoriality is the remedy to the trapped-cash phenomenon. They both suggest that the United States should move toward a purer worldwide consolidation system in order to currently tax all income of U.S. MNCs from whatever source, at a reduced rate. Current taxation will eliminate any incentive to keep earnings abroad (as they will be taxed anyway).

Finally, Avi-Yonah and Kleinbard note some defining differences between the United States and its trading partners that enable the latter to impose taxes on a territorial basis. First, our trading partners are all smaller economies. For residents of a small-market economy, their home jurisdiction is just another source country, meaning the inbound/outbound competition distinction plays a minor role. On the contrary, in the United States, the home market is of major importance to domestic MNCs. In other words, the efficiency argument in favor of territoriality is much weaker for U.S. MNCs since most of the economic attributes of their earnings (primarily, the consumer base) are located in the United States anyway. Second, geographic proximity of other jurisdictions to each other also plays a role. For example, Kleinbard notes that, within the European Union, territorial tax systems are easier to implement than are worldwide tax consolidation regimes in a manner consistent with the “tightly integrated nature of the European market.” Also, “[this] . . . makes it more likely that their [MNC]s will migrate (e.g., from the UK to Ireland) since they do not have a huge domestic market to serve (and many [MNC]s need to be close to their main market).” U.S. MNCs, on the other hand, are located within the territory that constitutes that avoid the foreign tax credit limitation).

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133 Id. at 700.


135 Ways and Means May 24 Hearing, supra note 1 (statement of Prof. Reuven S. Avi-Yonah, University of Michigan Law School); Kleinbard, supra note 134, at 139.

136 Kleinbard, supra note 134, at 139 (“By treating the residence country as just another source country, a territorial tax regime limits the residence country’s tax base to business activities in that country, thereby offering a neutral investment environment for third-country shareholders.”).

137 Id. at 139.

their biggest market. Finally, other jurisdictions rely much more heavily than the United States does on individual income taxes and consumption taxes such as VAT, allowing them to absorb revenue losses attributable to taxing corporations on a territorial basis.

E. Value Added Tax

The biggest difference between U.S. revenue composition and that of many other countries is “that most other nations rely much more heavily on consumption taxes.” The United States is “the only OECD country that does not impose a national level tax on sales of goods and services.” Such comparative assertions are frequently made in the current discourse when discussing the possibility of introducing VAT to the U.S. tax system as a revenue raiser that could, at least in theory, partially replace our “broken system” of income taxes (including corporate income taxes).

The exact mechanics of VAT (the complexities of which vary from country to country) are not important for the purposes of this article. It will suffice to note that VAT is “a type of consumption tax that is similar to a retail sales tax but is collected in smaller increments throughout the production process,” rather than at the point of sale to the ultimate consumer only.

VAT is effectively used “throughout the OECD and in more than 150 countries worldwide.” Noting that fact, multiple participants

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139 In any case, they also face “anti-inversion rules” that prevent a U.S. MNC from shifting its location overseas in order to avoid taxes. I.R.C. § 7874.
140 Ways and Means May 24 Hearing, supra note 1 (statement of Prof. Reuven S. Avi-Yonah, University of Michigan Law School).
142 Id.
143 Id.
144 Id. (statement of Prof. Rosanne Altshuler, Department of Economics, Rutgers University).
146 Ways and Means July 26 Hearing, supra note 141 (statement of Prof. Michael J. Graetz, Columbia Law School).
advocate tax reform that will introduce VAT in the United States.\textsuperscript{147} Such suggestions are not original. VAT has been considered in the United States for the past four decades.\textsuperscript{148} However, these considerations never culminated in the United States joining the rest of the world in adopting such a system. Recent tax reform debate induced fresh interest in VAT as part of a comprehensive reform that will include corporate tax reform.

According to its proponents, the advantages of VAT are many. Many such advantages are expressed as comparative arguments based on the experience of other jurisdictions. For example, it is argued VAT will enable the United States to finance significant rate reductions in individual and corporate tax rates (and maybe even transformation to territorial-based taxation)\textsuperscript{149} that will make the U.S. tax system more competitive. One example frequently cited here is the UK, which financed part of its recent corporate income tax reduction by a VAT increase. In addition, other countries' experiences demonstrate that VAT is easier and cheaper to administer than income taxes.\textsuperscript{150} This efficiency is comparatively proven according to some, who argue that "[g]iven its widespread application around the world, \textit{it is clear} that the U.S. can readily administer and comply with a VAT."\textsuperscript{151} Another advantage is that VAT is less destructive in its effects on the economy than income tax. VAT proponents point to the substantial body of economic research that finds that replacing income tax with a broad-based consumption tax has positive effects on economic growth in other countries.\textsuperscript{152} In addition, VAT reduces the ability and incentives of politicians to give tax breaks, easily interposed into the complex income tax system

\textsuperscript{147} \textit{Id.}; \textit{Ways and Means July 26 Hearing, supra} note 141 (statement of Prof. Rosanne Altshuler, Department of Economics, Rutgers University); \textit{Tax Reform Options: International Issues: Hearing Before the S. Comm. on Fin.,} 112th Cong. (2011) [hereinafter \textit{Finance Sept. 8 Hearing}]. In this hearing, all witnesses agreed that the adoption of VAT is desirable.

\textsuperscript{148} \textit{Ways and Means Mar. 3 Hearing, supra} note 111 at 47 (testimony of Robert Carroll, Principal, Qualitative Economics and Statistics, Ernst & Young LLP).

\textsuperscript{149} See, e.g., \textit{Ways and Means May 24 Hearing, supra} note 1 (testimony of Prof. Reuven S. Avi-Yonah, University of Michigan Law School).

\textsuperscript{150} \textit{Ways and Means July 26 Hearing, supra} note 141 (statements of Prof. Rosanne Altshuler, Department of Economics, Rutgers University and James R. White, Dir. Strategic Issues, Government Accountability Office).

\textsuperscript{151} \textit{Id.} (statement of Prof. Michael J. Graetz, Columbia Law School) (emphasis added).

\textsuperscript{152} See, e.g., \textit{id.} (statement of Prof. Rosanne Altshuler, Department of Economics, Rutgers University).
(which cannot so easily be done with a VAT).\textsuperscript{153} Finally, some argue that the introduction into the system of a tax model commonly used throughout the world will facilitate international coordination and fit well with existing tax and trade agreements. This will "harmonize our tax system with international standards."\textsuperscript{154}

Some commentators do caution, however, that what seems to be a worldwide phenomenon of legal convergence deserves a closer look. Differences exist among countries in the breadth and structure of the VAT base. In virtually all countries, certain transactions are exempted from VAT. The extent of such exemptions varies widely. For example, in New Zealand, ninety-eight percent of the consumption base is subject to VAT.\textsuperscript{155} In Mexico, on the other hand, only thirty-five percent of the consumption base is subject to VAT.\textsuperscript{156} The OECD weighted average is close to fifty-four percent.\textsuperscript{157} There are also substantial rate differences of the VAT imposed, from five percent in Japan to combined federal and local rates of up to forty percent in some Scandinavian countries.\textsuperscript{158} Some countries impose graduated tax rates, while others impose a flat-rate VAT. To summarize, "[n]ot only is there considerable variation in the top-line VAT rates across countries but also in the breadth of their tax bases and the use of multiple rates to address distribution concerns."\textsuperscript{159}

An interesting study in that respect, conducted by the Government Accountability Office (GAO),\textsuperscript{160} has been recently presented in a Ways and Means Committee hearing.\textsuperscript{161} The study compared the VAT systems in several countries, which were selected based on several criteria, including "the complexity of [the] VAT design, the age of the VAT system, and whether the country had a federal system."\textsuperscript{162} For each country studied, the GAO "performed in-depth literature reviews and conducted extensive interviews of government officials and VAT experts. [The GAO] also collected and

\textsuperscript{153} Id. (statement of Prof. Michael J. Graetz, Columbia Law School).
\textsuperscript{154} Id.
\textsuperscript{155} Id. (statement of Robert Carroll, Principal, Qualitative Economics and Statistics, Ernst & Young LLP).
\textsuperscript{156} Id.
\textsuperscript{157} Id.
\textsuperscript{158} Id.
\textsuperscript{159} Id.
\textsuperscript{160} GAO VAT REPORT, supra note 145.
\textsuperscript{161} Ways and Means July 26 Hearing, supra note 141 (statement of James R. White).
\textsuperscript{162} Id. at 2.
analyzed documents and data on the countries and their VAT systems."\textsuperscript{163}

The GAO report found that

[A]ll of the countries studied added complexity to their VAT design, mainly through the use of tax preferences... [S]ome economic sectors, such as certain consumer essentials like food and health care and public-sector organizations, are often provided VAT preferences because of social or political considerations. Other sectors, such as financial services, insurance, and real estate, are provided exemptions or exclusions because they are inherently hard to tax under a VAT system.\textsuperscript{164}

In noting such differences, the GAO study cautions us that not everything that looks the same is really the same. Countries with VAT still vary in their tax base (just like in the case of income tax), and such variations are a result of social and political preferences.

Finally, some commentators plainly reject VAT on the basis that this widely adopted model simply did not prove to be successful at all from a comparative point of view. First, unlike the general belief that VAT may help to reduce government deficits, many countries with VAT (such as Greece, Spain, and Portugal) face deficits much worse in real terms than the United States.\textsuperscript{165} Second, such commentators reject the argument that VAT is beneficial for competitiveness. In fact, in terms of tax-to-GDP ratio, countries that adopted VAT have seen an overall increase in tax burden. Prior to adoption of VAT in the 1960s, European nations had an overall tax burden of less than thirty percent of their GDP. Today, such nations' tax burden is nearly forty percent.\textsuperscript{166} In addition, comparative analysis shows that VAT actually does not reduce the burden of income tax (meaning, VAT does not actually replace income tax). While the income tax to GDP burden in the United States remained relatively constant since the 1960s, the adoption of VAT was followed by increased income tax burden in Europe.\textsuperscript{167}

Another comparative argument frequently made by anti-VAT

\textsuperscript{163} Id.
\textsuperscript{164} Id. at 6.
\textsuperscript{165} Ways and Means July 26 Hearing, supra note 141 (statement of Daniel J. Mitchell, Senior Fellow, Cato Institute).
\textsuperscript{166} Id.
\textsuperscript{167} Id.
Meaningless Comparisons

commentators is an ideological one. VAT, they argue, is a “money machine.” They point to comparative statistics that imply, so they argue, that adopting VAT is associated with bigger government spending and even bigger deficits. Based on such statistics, anti-VAT commentators caution that, by adopting VAT, “America will become a European-style welfare state. In other words, bigger government and lower living standards.”

V. WHAT IS WRONG WITH THIS COMPARATIVE DEBATE?

A. In General

In the most general terms, the process of comparison is aimed at “the search for new categories for understanding relevant similarities or dissimilarities, or rethinking exiting ones.” If comparative arguments are made in support of legislative proposals, they must be based on some materially accurate “comparative knowledge” to be valid. In turn, accurate comparative knowledge is the result of a successful comparative process.

I argue that the process of comparison within the discourse has shown various levels of sophistication but has generally been unsuccessful. The result is that many corporate tax reform proposals are based on misguided comparative practice. It is still possible that such proposals are good proposals, but if so, it is not comparative justification that supports their legitimacy. If anything, in some cases, better executed comparisons would point toward different policy choices.

Two main problems arise in the current corporate tax reform comparative discourse with respect to the execution of comparisons. The first problem is that the comparison lacks any rigorous process (or any process at all). Methodological coherence is almost nonexistent. Most participants simply “compare laws.” They do not always clearly (or coherently) define the purpose for the comparison. Even if they seemingly do so, the purpose is many times disengaged from the jurisdictional selection, the laws being compared, and the method of comparison.

The second problem is that within each stage of the process (to the extent any “process” exists), the tendency is to divorce functional
from cultural analysis. Ignorance of contextual differences among jurisdictions leads to misperceptions about how laws actually function in practice and misses the cultural background that supports such laws or that is expressed by them. This is better described as an ideological disengagement. The process of comparison is wrongly viewed to be objective. True, if comparison is successfully executed, it should produce objective understanding about factual similarities and differences among jurisdictions. There is, however, a choice to be made – what do we do with the similarities and differences we have identified? Discussion in this question is lacking. It seems that there is an implicit assumption in the debate that if other countries “have it,” we should probably have it as well, because it “must be right.” This assumption is made by participants from both sides of the aisle, but in respect of different models.

It is important to note that I do not advocate one method over the other. I do not argue that the participants in the debate should be functional or cultural comparativists. I argue that they should follow at least some coherent process of comparison and, at each stage, try to absorb the benefits of both comparative methods or at least explain why one approach is superior to the other. I previously expressed my skepticism about the use of functional analysis in the context of comparative tax law but not because I reject functional comparison on its face. Functional analysis has an inherent pitfall, which is the tendency to abstract or overgeneralize complex systems. Assumption of similarities between social problems and functions leads naturally to an attempt, not necessarily a conscious one, to fit sets of facts into presupposed patterns. This happens, for example, when a comparative question is posed in a terminological rather than a factual way (rather than asking how other countries dealt with capital flight, we ask how other countries dealt with “competitiveness”). It is easy to assume that, if many jurisdictions reduce their corporate tax rates, they all do it for the same reason. It is even possible that this is indeed the case. Most jurisdictions face the same global competitiveness concerns, and reducing tax rates is a natural response to capital flight. Namely, rate reduction can easily be assumed to respond to a similar problem across jurisdictions. Once the patterns are clear and fit into our presupposed model, we are tempted to stop the inquiry.

To be sure, I do believe that functional analysis is probably a correct way to launch a comparison. When multiple jurisdictions

171 Marian, supra note 10, at 460–69.
172 See generally Frankenberg, supra note 20, at 444–45.
adopt what seems to be a similar response to what seems to be a similar problem (such as in the case of corporate tax reform and international competition), it is a good starting point to assume that this model works. But it is important not to uncritically extend such assumption beyond its instrumentality as a heuristic device. We must be vigorous about questioning the validity of this assumption and try to identify differences about this “same model” as adopted in each jurisdiction. Only by doing so can we confirm or reject a comparative idea. And this is where cultural analysis comes into play, as it questions if what we believe to be functioning similarly in each jurisdiction does indeed function similarly in each jurisdiction.\(^\text{173}\)

In what follows, I show the failures (and note the few successes) in current corporate tax reform discourse. I do so by following the process that participants in the discourse should have followed and show that the failure to follow the process, together with the failure to coherently execute each stage of the process, resulted many times in questionable comparative arguments. Therefore, I will discuss in turn the expressions in the current debate of (a) the purpose of comparisons, (b) jurisdictional selections, (c) the choice of laws to be compared and their breadth, and (d) the method of comparison.

### B. Different Purposes for Different Tax Reforms

Many participants in the discourse refer to recent reforms that took place in other jurisdictions. When considering reforms, it makes a lot of sense to look at other reforms that recently took place. However, the fact that another reform happens somewhere else does not make it immediately relevant for our own reform process. We must consider the drivers for the other reforms, as well as their outcomes. Many commentators fail here. Some just point to recently adopted models without considering the problems that created the need to adopt such models elsewhere. Others simply misinterpret the reforms that took place elsewhere. Finally, an issue of framing exists. I

\(^{173}\) An excellent example for this combination of functional and cultural analytics in the field of comparative tax studies is Michael Livingston’s comparative research on the nature of progressivity. Progressivity is a well-accepted and almost globally adopted model of income taxation. However, questioning how progressivity actually functions in the context of varying cultural contexts, Livingston concludes that, while “nations face similar economic challenges, they have significant political and cultural differences that may cause them to take divergent paths.” Livingston, From Mumbai to Shanghai, with a Side Trip to Washington, supra note 22, at 559; see also Livingston, From Milan to Mumbai, Changing in Tel Aviv, supra note 22; Likhovski, supra note 21.
argue that when taking a comparative look, many participants frame the problem to be addressed in comparative inquiry in a way that makes the inquiry useless from the very beginning. When the Ways and Means Committee announces a “Hearing on How Other Countries Have Used Tax Reform to Help Their Companies Compete in the Global Market and Create Jobs,” it assumes a priori that other jurisdictions indeed reformed their systems in order “to help their companies compete in the global market and create jobs.” If this assumption turns out to be wrong, the entire comparative process is at peril.

I look at three frequently referenced reforms and demonstrate how each of them is, at least to a certain extent, misrepresented in terms of its purposes (probably unintentionally) in order to support certain arguments. The first is the Japanese 2009 corporate tax reform, which is frequently cited to support the move toward a territorial system. The second reform discussed is the German corporate tax reform of 2008, which is usually cited to justify a dramatic reduction in statutory rates. The third reform discussed is the set of recent business tax reforms in the United Kingdom, which frequently underlies arguments for reform that should include both rate reduction and territoriality.

1. Why Countries Reform Their Corporate Tax Systems

In the context of competitiveness arguments, Japan is repeatedly mentioned as an example of a country that passed a recent bold reform, transforming its system of corporate taxation from global to territorial.¹⁷⁴ Even if on paper Japan did move from a global to a territorial regime (I subsequently question whether this is indeed the case), whether competitiveness was the main driver of such reform is not clear. To be sure, competitiveness was considered in the context of the Japanese reform¹⁷⁵ but by no means to the same extent as it is considered in the United States.

In 2007, the Tax Commission of the Japanese Government published a document, titled “Basic Idea for Fundamental Reform of


The report starts by noting it is “designing the desired fundamental reform of the tax system that is based on the three-pillar principle of taxation ‘fairness, neutrality, and simplicity.’” Competitiveness was not mentioned as a primary consideration.

The discussion starts by noting the “fairness” purpose, explaining that fairness means “a tax system that supports the safety and security of the people.” The concern of the reform responds to a major social problem the committee sought to address: the “development of an aging society with fewer children at a speed unprecedented among the major developed countries and the beginning of Japan’s transformation into a super-aged society with a shrinking population.” This is a perfect example of a completely localized consideration that plays an important role in the design of tax reform. While aging is certainly a problem in the United States as well, it is not frequently discussed in the context of corporate tax reform. When the Basic Idea report moves to discuss the “neutrality” pillar of tax reform, it indeed addresses the need to “invigorate” the Japanese economy. But it does so in the context of the other relevant issues, noting that “Japan needs a vibrant and strong economy and society to provide the foundation that supports people’s secure and comfortable living as the population ages with the birthrate declining.”

These considerations evidently had an effect on the committee when considering corporate tax rates. The committee actively considered a dramatic reduction in Japan’s corporate tax rate, the highest in the world in statutory terms, to address competitiveness concerns raised by business groups. Unlike the Bowles-Simpson report, the committee made no conclusive recommendation in this respect, but noted that corporate tax rate reduction should be considered, along with base broadening and having larger parts of the public “share the burden of supporting social security.” Instead, the committee recommended introducing “a system of policy tax incentives designed to invigorate the economy led by the corporate sector . . . by focusing instruments upon the fields that really need

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\begin{align*}
\text{\textsuperscript{176}} & \quad \text{Tax Commission, Ministry of Finance Japan, } \textit{Basic Idea for Fundamental Report of Tax System} (2007), \text{ } \text{http://www.mof.go.jp/english/tax_policy/ tax_commission/e0711a.pdf.} \\
\text{\textsuperscript{177}} & \quad \text{Id. at 6.} \\
\text{\textsuperscript{178}} & \quad \text{Id.} \\
\text{\textsuperscript{179}} & \quad \text{Id. at 4.} \\
\text{\textsuperscript{180}} & \quad \text{Id. at 9.} \\
\text{\textsuperscript{181}} & \quad \text{Id. at 10.}
\end{align*}
\]
them."\^182

So why did Japan adopt a territorial system of corporate taxation after all? Apparently, the committee was concerned about a problem all too familiar to the U.S. tax legislator: the problem of trapped earnings. Until 2009, Japanese MNCs were taxed in a fashion similar to U.S. MNCs: worldwide basis of taxation, combined with foreign tax credit. Foreign active earnings were not taxed until repatriated, causing a "distinct bias against the repatriation of foreign earnings."\^183

In 2008, the committee published another policy recommendation. It noted that the current system distorts dividend policy. Specifically, in the 2008 report, the committee advanced a reform with three major aims: (1) viewpoint neutrality regarding corporate decisions on dividend policy, (2) maintaining relief from double taxation, and (3) simplicity.\^184 To emphasize, neutrality is the purpose advanced here, not competitiveness, which may or may not go hand in hand with neutrality (a system that subsidizes its local residents is certainly competitive in certain aspects but hardly neutral).

One way to deal with the dividend neutrality issue would be to reduce corporate tax rates. However, when push came to shove and legislation had to be introduced, this alternative was explicitly rejected. The deficit faced by the Japanese government was simply too big to absorb revenue losses from rate reduction and a move to a territorial system. It was also recognized that such a rate reduction would have to have been financed by taxpayers other than corporations. Instead, Japan adopted a dividend exemption system under which ninety-five percent of repatriated foreign dividends are exempted from taxation in Japan.

What can we learn from our brief discussion on the purposes for Japanese corporate tax reform? First, participants in corporate tax reform discourse in the United States sometimes ignore the different context in which the Japanese reform operated. An aging population and declining childbirth obviously played a role.

Second, participants in the discourse who urge us to look at how competitiveness is a catalyst in other countries' reforms and who cite Japan as an example miss the fact that competiveness played a role significantly less important than what it is playing in the U.S. discourse.

\^182 Id.


\^184 Id. at 243.
Third, some similarities of functions and problems do exist in both the United States and Japan, but these similarities are frequently ignored, too. Many participants of the discourse, who mention the Japanese reform as an example of recent transformation to territorially, are also calling for rate reduction in the United States. They seem to disregard the fact that Japan specifically considered meaningful rate reduction and rejected the idea due to deficit concerns.\textsuperscript{185} Deficit is certainly a problem in the United States too.

Seemingly, for the most part, proponents of territoriality look at Japan only because it adopted territoriality. They do not question whether Japan adopted territoriality for the same reason we might want to adopt it. They just point to the fact that the Japanese “have it.” Significantly, it is also not clear that the Japanese reform has been successful in “invigorating the economy” by eliminating the disincentive to repatriate earnings. Given that proponents of territoriality frequently explain that dividend repatriation will boost the economy by injecting capital into the home market, they refrain, surprisingly, from looking at recent evidence from other economies. The immediate outcome of the move toward territoriality in Japan has been a dramatic increase in repatriated earnings. While the reform is too recent to provide conclusive data, anecdotal evidence suggests that, so far, repatriated profits were used to support dividend payments and stock buybacks rather than invested in the Japanese home market.\textsuperscript{186} Thus, at least in the short term, it seems that the purpose for the move to territoriality, as framed by its supporters in the United States, has not been achieved.

This result should not come as a surprise to any U.S. tax scholar. In 2004, the American Jobs Creation Act\textsuperscript{187} added Section 965 to the Internal Revenue Code, allowing temporary repatriation relief in the form of a deduction of eighty-five percent of all dividends received from foreign corporations during the relief period. Significantly, the relief was conditioned on the adoption of certain domestic investment plans by the repatriating corporations. The idea was to make sure that repatriated earnings are actually invested so as to stimulate the economy. However, because money is fungible, it becomes almost impossible to enforce the domestic-investment requirement. It is well documented that this repatriation holiday bitterly failed. Multiple studies “generally conclude that reduction on tax rate on repatriated

\textsuperscript{185} Id. at 243-44.
\textsuperscript{186} Id. at 245.
earnings led to a sharp increase in repatriated earnings, but that the repatriations did not increase domestic investment or employment. [These studies] further conclude that much of the repatriations were returned to shareholders through stock repurchases.\footnote{DONALD J. MARPLES & JANE G. GRAVELLE, Cong. Research Serv., R40178, TAX CUTS ON REPATRIATION EARNINGS AS ECONOMIC STIMULUS: AN ECONOMIC ANALYSIS 3 (2011); See also U.S. PERMANENT SUBCOMM. ON INVESTIGATIONS OF THE S. COMM. ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS, REPATRIATING OFFSHORE FUNDS: 2004 TAX WINDFALL FOR SELECT MULTINATIONALS (2011).}

Another system recently reformed, which is also frequently referred to in current discourse, is the United Kingdom’s. From the point of view of the purpose for reform, this reform provides a much better functional comparison because competitiveness of U.K. MNCs was the defining objective of the reform. In 2007, the U.K. Treasury published a discussion document, titled “Taxation of the Foreign Profits of Companies” (the U.K. discussion paper).\footnote{HM TREASURY, TAXATION OF THE FOREIGN PROFITS OF COMPANIES: A DISCUSSION DOCUMENT, 2007 (U.K.).} The U.K. discussion paper explicitly cites the pressures of international competition as a driver of the reform\footnote{Id. §§ 2.7–2.8.} and summarizes one of the main reform objectives as “intended to improve the competitiveness and attractiveness of the U.K. as a location for multinational business.”\footnote{Id. § 2.19.}

Before the reforms, the taxation of foreign source income by the United Kingdom was quite similar to the tax system in the United States, with a worldwide basis of taxation, coupled with a foreign tax credit system. At that time, the United Kingdom had already begun a process of corporate tax rate reduction. The United Kingdom also had a controlled foreign corporation (CFC) regime in place. Interestingly, this regime was much more stringent than the U.S. regime. The old CFC regime operated as an “all or nothing” method under which all of the income of a CFC would have been immediately taxed regardless of its passive or active character. This was really a close functional equivalent of worldwide consolidation, meaning that there was relatively little incentive not to repatriate earnings from foreign subsidiaries.

Nevertheless, in 2009, the United Kingdom did adopt a dividend exemption system similar to the one adopted by Japan the same year. Why? The answer is rather simple: geography. In 2006, the European...
Court of Justice (ECJ) determined in *Cadbury Schweppes*\(^\text{192}\) that the United Kingdom could not impose its CFC regime on foreign subsidiaries of U.K. MNCs if those CFCs operated and created profits overseas because such a regime interferes with the EU principle of freedom of establishment. Effectively, the ECJ left the U.K.’s CFC regime in ruins.\(^\text{193}\) The U.K. discussion paper tried to mitigate this result a bit by introducing a suggestion for a “modernized” CFC regime in which only passive income will be taxed. This resulted in a standoff between the U.K. Treasury and the U.K. MNCs, which viewed the report as inconsistent with the *Cadbury Schweppes* decision.\(^\text{194}\)

You might wonder where the CFCs at issue in *Cadbury Schweppes* were located. Well, let me just say that the corporate tax rate in Ireland at the time was 12.5%, less than half of the rate then applicable in the United Kingdom. Following *Cadbury Schweppes*, the United Kingdom could not tax foreign subsidiaries of U.K. MNCs that had anything that even remotely resembled real-operations overseas. This was combined with the fact that the distance between (high-taxed) London and (low-taxed) Dublin is about 290 miles, which can be covered in about an hour flight. You do not need to be a tax expert to guess what happened after that. Indeed, U.K. MNCs and their subsidiaries started to flock across the Irish Sea.\(^\text{195}\) The U.K. move to a territorial system can be easily described as an attempt by the U.K. Treasury to save the U.K. corporate tax base.

The special challenge faced by the United Kingdom was a combination of the United Kingdom’s being an EU member and thus being bound by the ECJ decisions together with its geographic proximity to a low-tax industrialized jurisdiction such as Ireland. This is a unique set of circumstances that, as of the time of this article, is not applicable to the United States.\(^\text{196}\) Some participants in the

\(^{192}\) Case C-196/04, Cadbury Schweppes plc & Cadbury Schweppes Overseas Ltd. v. Comm’rs of Inland Revenue, 2006 E.C.R. 1-7995.

\(^{193}\) The decision made it possible for the United Kingdom to collect revenue from foreign sources only in the case of CFCs created as a “wholly artificial” arrangement, which is an extremely narrow standard. *Id.*

\(^{194}\) *Ways and Means May 24 Hearing, supra* note 1, at 96–97 (statement of Steve Edge, Slaughter & May).

\(^{195}\) In the year following the *Cadbury Schweppes* decision, ten U.K. MNCs migrated to Ireland and other low tax jurisdictions, compared to one in the year before. *Id*, at Appendix B.

\(^{196}\) It might become relevant if Canada continues reducing its corporate tax rates, though currently, no legal authority could force the U.S. to abandon its CFC regime or anti-inversion rules.
corporate tax reform discourse in the United States who advocate a move to territoriality cite the United Kingdom as an example. They point to such reform as a possible response to corporate migration away from the United States. When they do so, they misperceive the unique set of facts that the United Kingdom faced. Unlike the U.K. case, no documented evidence exists of real migration of U.S. MNCs to other jurisdictions due to tax reasons (by real migration, I mean the migration of the real economic activities and operations to another jurisdiction, not pocketbook incorporation). U.S. MNCs simply do not have a cheap enough option that is both geographically close to the home market and very lightly taxed. In other words, noting corporate migration in other jurisdictions that adopted a territorial system is not as comparatively relevant when making a case for adopting territoriality in the United States.

Another example of ill-executed functional comparison arises in the context of the German Business Tax Reform of 2008. The German reform included a dramatic cut in statutory corporate tax rates (from 38.6% to 29.83%, inclusive of local taxes) and thus is frequently invoked to justify similar cuts in the United States.

Discussions on comprehensive tax reform in Germany started in 2005 primarily as a response to the increasing complexity of the German tax system. Another driver of the reform was competitiveness, as German corporate tax rates at the time were among the highest in the European Union. Thus, the German reform makes an excellent candidate for functional comparison because it shared two of the purposes for the U.S. prospective reform: competitiveness and simplicity.

Improvement had to be achieved under the constraint of political compromise between the right-wing tax writers, who advocated dramatic rate reductions, and the left, who resisted such changes,

197 See, e.g., supra note 174. See, e.g., Ways and Means May 24 Hearing, supra note 1, at 10 (statement of Stephen Edge, Slaughter & May).

198 See, e.g., Ways and Means May 24 Hearing, supra note 1, at 195–98 (statement of Steve Edge, Slaughter & May); Finance Sept. 8 Hearing, supra note 147 (statement of Scott M. Naatjes, Vice President and General Tax Counsel, Cargill, Inc.).


200 Wolfgang Kessler & Rolf Eicke, Germany’s Corporate Tax Reform – The Road Not Taken, 46 TAX NOTES INT’L 1135, 1135 (June 11, 2007).

pointing to the increasing deficit and the need to support revenue collection. The political compromise called for a reform that will (1) reduce combined state and local corporate tax rates to thirty percent and (2) restrict revenue loss to EUR 5 billion (about one percent of the tax revenue).\footnote{Id. at 296, 310; Stefan Homburg, Fiscal Policy in Action: Germany’s Company Tax Reform Act of 2008, 63 PUB. FIN. ANALYSIS 591, 594 (2007).}

Clearly, the perception that corporate tax rate reductions “pay for themselves” has not been seriously considered a remedy to the increasing deficit in Germany, a fact regularly ignored by participants pointing to Germany as an example (who are also the participants sometimes arguing that rate reductions “pay for themselves”). Hence, it has been decided that, together with rate reduction, the corporate tax base will be significantly expanded. The specific details of the reform are discussed more elaborately below. Yet, in current debate in the U.S., the most visible feature of the German reform (always cited by U.S. reform commentators) is rate reduction and not the base-broadening measures.

The most striking functional failure associated with the frequent reliance on the German reform for competitiveness arguments is that many participants overlook the fact that, within Germany, many perceive the 2008 reform as unsuccessful (to say the least). In terms of achieving competitiveness for German corporations, views of the reform vary from mild improvement\footnote{Kessler & Eicke, supra note 200.} to an utter failure.\footnote{See Wright, supra note 201, at 319 (“[G]iven all. . . positive preconditions, the German Business Tax Reform 2008 is a failure.”); see also Homburg, supra note 202, at 609–11; Kessler & Eicke, supra note 200.}

One German commentator even labeled the reform as “reactionary.”\footnote{Wright, supra note 201, at 321.}

In terms of achieving simplicity, it seems that there is across-the-board agreement that the 2008 reform made things much worse.\footnote{See, e.g., Kessler & Eicke, supra note 200, at 1137; Wright, supra note 201, at 319; Homburg, supra note 202, at 610–11.}

I further discuss some specifics of the 2008 German reform below. But the first functional lesson of this reform is clear. Apparently, the German reform shared similar purposes with the corporate tax reform currently being advocated in the United States. The German reform failed to achieve those purposes. It thus seems weird that proponents of competitiveness and simplification in the United States insist that we should look at the German reform for guidance. Of course, we might make amends to this failure by taking a cultural approach, trying to identify the contextual differences between Germany and the
United States. Such an approach could potentially explain the failure in Germany and suggest why the German approach could nonetheless work in a U.S. context. No participant seems to suggest such an approach.

2. Framing Comparisons

The cases of recent reforms in Japan, the United Kingdom, and Germany are all perfect examples of how participants in the discourse fail to identify functional similarities and contextual dissimilarities in the drivers of corporate tax reforms undertaken elsewhere. The referral to such reforms is usually simplistic and frequently does not rise above the level of “let’s do what they did.” Generally, such comparisons lack real consideration of why “they” did what they did, whether we can (or should) do the same, and whether what “they” did actually achieved the targets “they” were hoping to achieve.

Such simplicity is many times induced by the way in which participants in the discourse access the legal comparison in the first place. Rather than identifying similarities (or differences) in reform purposes in other countries, participants in the discourse assume their existences a priori. Many times, the comparison starts with a question that frames the comparative problem in U.S. terms.

This argument is best explained with an actual example. On May 24, 2011, the Ways and Means Committee held a hearing on corporate tax reform in other countries. The hearing was titled a “Hearing on How Other Countries Have Used Tax Reform to Help Their Companies Compete in the Global Market and Create Jobs.” In his announcement of the hearing, the Way and Means Chairman Rep. Dave Camp explained:

as part of the Committee’s ongoing consideration of how best to reform the tax code in order to help grow the U.S. economy and create good jobs for hard-working Americans, this hearing will examine the experiences of other countries in order to identify best practices in designing stable, pro-growth tax policies that would help American companies compete against their foreign counterparts.\(^\text{207}\)

Framing the purpose of the hearing as such could prove to be successful if the witnesses invited would indeed testify on tax reforms aimed at competitiveness and job growth in their home countries. But three of the witnesses came from (a) Japan, a jurisdiction in which recent corporate tax reform was induced by neutrality and fairness to a much greater extent than competitiveness and jobs-creation; (b) the United Kingdom, in which reform was induced by competitiveness but under terms completely different from those faced by the United States; and (c) Germany, whose reform had been declared by some as a complete failure regarding competitiveness.

C. Improper Jurisdictional Selection

One of Kleinbard’s complaints about participants in the discourse is that when they discuss competitiveness they fail to compare the United States with “relevant” jurisdictions. The United States, he argues, “does not need to compete with the tax rates available to domestic firms in the Slovak Republic (19%, as it happens) for U.S. firms to be competitive on the global stage.”

Kleinbard’s argument about the relevance of jurisdictions to be compared seems to rest primarily on the size of their economy. I agree that participants in the discourse fail to properly select the jurisdictions for comparison. I also agree that the size of the economy is a relevant factor for selection. But additional relevancy factors need to be addressed as well. My aim in this subpart is to put jurisdictional relevancy in a theoretical context and explain how improper jurisdictional selection skews comparative arguments.

Interestingly, comparative tax legal academics made at least some effort to explain their jurisdictional selection. This is certainly of great importance in a reform discussion if we wish to adopt models widely adopted elsewhere. Unfortunately, in spite of such available guidance from legal tax scholars, participants in the discourse failed to follow a coherent method (if any) of jurisdictional selection. Many comparative arguments, resting primarily on studies of comparative finance, use one of three possible criteria as guidance for jurisdictional selection: the first criteria is to compare the United States to other OECD countries or other industrialized economies; the second is to compare the U.S. system with the systems of its so-called “trading partners”; and the third is to simply compare the U.S. system with—

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208 Kleinbard, supra note 134, at 158.
209 See Marian, supra note 10, at 446–49.
for lack of a better defining character—the rest of the world.

Of the three criteria for jurisdictional selection, comparing the United States to other OECD countries seems to be the most logical functional classification criterion, as the OECD members share certain economic and political characteristics that may make them functionally comparable. But this is not always the case. OECD countries represent multiple legal families with completely different legal traditions and varying sophistication of legal systems. The same argument is correct in respect to our “trading partners” and certainly in respect to the rest of the world (which is not a coherent criterion at all). There is, however, a more significant functional problem of jurisdictional selection in current discourse. Jurisdictional selection should support the purposes of the comparison. How any of the three criteria for jurisdictional selection described above support a reform that is aimed at competitiveness is not clear. If competitiveness is our reform purpose, we need to compare our corporate tax system to systems of jurisdictions with which we compete. As explained below, participants failed in this simple task.

The reason for this failure, in turn, is that participants in the discourse did not take the time to develop a sophisticated enough concept of competitiveness. As explained above, Knoll has done this, but his arguments have been largely ignored in the context of the discourse. For example, let us look at Knoll’s concept of competition to which I referred as outbound competition. To say that the tax environment in the United States is uncompetitive in that respect, we must compare it to the tax environment of other jurisdictions that are significant exporters of capital, meaning only jurisdictions that are home countries for investors making outbound investments, who actually compete with U.S. investors for opportunities outside their home jurisdiction. As Kleinbard suggests, the countries compared should also have significant enough economies to be able to export enough funds to pose a real competitive threat to U.S. investors. Estonia, Iceland, Israel, the Slovak Republic, Luxemburg, and Poland—all OECD member countries—do not meet these tests, nor do many other OECD member countries mentioned. An extreme example for such failure is the recent PwC survey of effective tax rates, which took into account countries such as Morocco, Egypt, Nigeria, Bermuda, Liechtenstein, and Venezuela. These countries are not homes to investors with which U.S. MNCs investing abroad compete. The PwC survey, I argue, is simply irrelevant for outbound competitiveness comparison because of its jurisdictional selection (regardless of its other methodological shortcomings).
Participants in the discourse are also at fault regarding jurisdictional selection in respect to Knoll's second type of competitiveness, to which I referred above as inbound competition. A more elaborate explanation is necessary here. We must start by noting the obvious, that investors do not decide where to locate their investments based on taxes. As one prominent tax practitioner once noted: "I have never met a businessman (or even a tax executive) who was actually involved in decision-making about the tax issues of where to locate a business (that actually employed people) who would agree that his MNC employer acted to invest somewhere because of an interest-free loan of residual U.S. corporate tax if the company invested in a foreign country rather than the United States. Businesses follow customers, efficient delivery of material and productive work forces to such an extent that tax incentives are often just an afterthought."210

Tax is a marginal investment consideration. When considering the U.S. tax system's inbound competitiveness, we must work through two steps. The first is to identify jurisdictions that offer investment opportunities in their territory that are comparable or substitutive (at least to a certain degree) with investments offered in U.S. territory. For example, a foreign investor wishing to make an investment in the automobile industry might consider the United States but might also consider Japan or Germany, making such jurisdictions successful choices for comparison. On the other hand, an investor looking to start a Scotch distillery is more likely to prefer Scotland over the United States, but not because of the former's lower tax rates. Therefore, it makes sense to compare jurisdictions that, in economic terms, have similar comparative advantages. It is not clear why countries such as Bermuda and the Cayman Islands, which have no substantial economies, were taken into account in the PwC survey (as well as other surveys). Investors do not consider such places for anything other than pocketbook incorporation of companies or for weekend retreats.

Second, even after we identify a comparable jurisdiction in terms of the investment alternative it offers, such jurisdiction must also be at least somewhat comparable to the United States in terms of investment considerations other than taxes, such that the investment decision will actually turn on taxes. In other words, if we seek to

reform the U.S. tax system to make it attractive to investment, it might make sense to compare the United States to, say, Germany, where one could assume that the costs of labor and capital are about the same. In such a case, the decision where to locate completely substitutive investments could actually turn on taxes since taxes make a marginal difference. On the other hand, it makes no sense to compare the United States to, say, China (as often is the case), where the costs of labor and capital investments are dramatically lower than in the United States. When a U.K. investor makes a decision to open a textile factory in China and not in the United States, it is not because of the U.S. tax rates. It is because the costs of building, machinery, labor, and the operation of the factory in China are much cheaper. To make the U.S. tax system competitive enough so investors will decide to locate their factories in the United States instead of China means that the U.S. Department of Treasury would have to start handing out checks to investors to compensate them for the much higher nontax costs associated with operating a real business in the United States.

Simply grouping together OECD countries and comparing their tax systems to ours provides no guidance for U.S. corporate tax reform aimed at "competitiveness." To be sure, I am not implying by any means that competition does not exist. Of course it does. The argument is that we do not compete with everybody for everything. Our local industries compete with some jurisdictions in world markets (outbound competition). Our local industries do compete for foreign investment (inbound competition). But any functional comparison must start by identifying the relevant jurisdictions with which we compete. These are the jurisdictions with which we need to compare ourselves, and, depending on the type of competition (inbound or outbound), these jurisdictions might be different in each case.

Jurisdictional selection in current discourse can also be criticized from a cultural point of view. As Livingston concluded, in the context of income tax progressivity, tax models that appear to be the same actually operate very differently depending on specific localized contexts, thus achieving very different results.211 The same holds true in current debate with respect to the VAT argument. Proponents for the adoption of VAT keep telling us that more than 150 other countries have adopted VAT and that this is a successful model. As explained in the descriptive part above, few commentators gave serious consideration to contextual differences. Such commentators noted that the VAT base varies substantially among jurisdictions both

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211 Livingston, From Milan to Mumbai, Changing in Tel Aviv, supra note 22.
in terms of the breadth of the base and in terms of the specific preferences and exemptions awarded to certain types of transactions or particular industry sectors. As any cultural comparative scholar would argue, this reflects local preferences that are most likely embedded in political, ideological, or cultural contexts. Such systems cannot simply be copied.

When localized contexts are taken into consideration, the "everyone else has it" argument might lose its appeal. For example, one of the most common critiques that VAT opponents frequently make is that it is not clear how federal VAT will interact with state consumption tax collection.\(^{212}\) The argument concerns, first and foremost, the difficulty of administering two types of consumption taxes imposed on each transaction. But the argument is also an ideological one about the power (or lack of it) of the federal government to interfere with revenue collection at the state level. Both of these issues are highly contextual to the United States. In fact, the only other country that in recent times successfully introduced federal-level VAT-like taxes where such taxes had to interact with existing local consumption taxes collected by the subdivisions of the federal government is Canada.

The experience of Canada GST's (gross sales tax) interaction with the provinces' consumption tax is regarded as successful. This probably makes Canada's GST reform a good candidate for comparison. That said, it is one system that experienced similar federal–local conflict in such context. An argument based on the successful experience of one jurisdiction is hardly as convincing as an argument based on the allegedly similar experience of 150 jurisdictions. Also, it is not clear that the political background of federal and state interaction in Canada operates the same as in the United States. Most comparative culturalists will assume it does not.

To summarize this point, most VAT proponents share the same sin as rate-reduction and territoriality proponents. Both point to what "everyone else did." Indeed, almost everyone else reduced corporate tax rates, but if we are functionalists seeking to achieve competitiveness, we should care only about countries with which we actually compete. Indeed, everyone else has VAT, but, if we are culturalists, we must be skeptical about the argument that VAT is the same thing in all places.

As discussed above, some more elaborate attempts to explain the

\(^{212}\) See, e.g., Ways and Means July 26 Hearing, supra note 141 (testimony by Daniel J. Mitchell, Senior Fellow, Cato Institute).
choice of jurisdiction were made in the case of the GAO VAT survey and by Kleinbard in his tax burden comparison. Unfortunately, those are the exceptions to the rule, and participants in the discourse seem to compare based on the availability of data (such in the case of the OECD). Availability of data is not a good criterion for jurisdictional selection.

D. Selection of Legal Models to Compare

I now turn to the selection of models to be compared. As discussed in the theoretical section, we must compare meaningful enough models to give a sense of how the system operates. First, if we are functionalists, we must identify non-abstract functionally-equivalent models to compare. Second, one needs to avoid compartmentalization, meaning the comparison of too narrowly defined models. A compartmentalized approach produces an unsystemic analysis, which provides little real guidance. Third, one must avoid overgeneralization. If we believe that tax systems perform a multiplicity of functions, consolidating them all into some single unit to be used as an object of comparison would necessitate the preference of some functions over others.

1. What Is the Comparative Function of Corporate Taxes?

A functional comparison of the corporate tax systems of different jurisdictions must be grounded in the conviction that the corporate tax systems of the compared jurisdictions essentially fulfill the same function. One of the shortcomings of the current discourse is that many participants simply assume this to be the case. This assumption could, at the least, be revisited.

The question of the justification of imposition of tax on corporate entities is a controversial one. Several justifications are given for the imposition of corporate tax. The first and most common one views the corporation as a proxy to the taxation of its shareholders. The argument is that, "[w]ithout a corporate tax, high income individuals could channel funds into corporations, and, with a large part of

\[213\] A full-blown discussion of the question "why we tax corporations?" is well beyond the scope of this article. I heavily draw here on Avi-Yonah's *Corporations, Society, and the State*, if only as a convenient source where some of the justifications for taxing corporations are summarized. See Reuven Avi-Yonah, *Corporations, Society, and the State: A Defense of the Corporate Tax*, 90 Va. L. Rev. 1193 (2004).

\[214\] Id. at 1201.
Meaningless Comparisons

earnings retained, obtain lower tax rates than if they operated in partnership or proprietorship form or in a way that allowed them to be taxed as such.\textsuperscript{215} In addition, it is administratively easier to collect tax in a centralized manner from one entity rather than from multiple shareholders.\textsuperscript{216} I refer to this functional justification as the “collection” justification.

The second justification is that the operation in a corporate form confers certain benefits to shareholders (such as limited liability) and corporate tax is a fee paid in return for such benefits.\textsuperscript{217} I refer to this justification as the “fee” justification.

Third, corporate taxes may be justified as a mechanism of corporate governance in public corporations. Under this argument, “corporate tax is necessary because otherwise the agency-cost problem will be exacerbated when management (which may or may not include shareholders) faces a different tax rate for corporate actions than those of some shareholders.”\textsuperscript{218} I refer to this justification as the “governance” justification.

The fourth justification for the imposition of corporate taxation is that it “is justified as a means to control the excessive accumulation of power in the hands of corporate management, which is inconsistent with a properly functioning liberal democratic polity.”\textsuperscript{219} I refer to this argument as the “democratic” argument.

While none of the justifications to the imposition of corporate taxes mentioned above is without controversy, clearly, corporate tax is a legal model that may serve multiple purposes in responding to various needs. When participants in the discourse are comparing corporate tax systems around the world and argue that the U.S. system should be more “in line with the rest of the world,” they implicitly assume that corporate taxes in all jurisdictions compared fulfill, at least to a certain extent, the same functions. Such an assumption is a perilous simplification of reality.

For example, the various roles of corporate taxation as a collection mechanism may be a result of strictly local context. One fascinating example of a comparative study showing exactly that is Steven Bank’s study in which he explored why the United States and

\textsuperscript{215} CRS 2007 REPORT, supra note 103, at 4.
\textsuperscript{216} Avi-Yonah, supra note 213, at 1201–02.
\textsuperscript{217} Id. at 1205–06.
\textsuperscript{218} Id. at 1208 (citing Hideki Kanda & Saul Levmore, Taxes, Agency Costs, and the Price of Incorporation, 77 VA. L. REV. 211, 229–31 (1991)).
\textsuperscript{219} Avi-Yonah, supra note 213, at 1244.
the United Kingdom diverge in their approaches to corporate-shareholder integration. The U.S. system is a “quasi-classical” system, which means it imposes tax at both the entity level and the shareholder level (albeit at reduced rates in the latter case, hence, quasi-classical). The United Kingdom, on the other hand, historically used some sort of imputation system that levied taxes at the corporate level but gave shareholders credit on the allocable part of such tax on the receipt of corporate distributions. Bank’s study aimed to unveil how “the U.S. and [the] U.K.—two countries with similarly developed economies and corporate cultures—diverge in their approach[] to corporate income taxation.”

Based on a detailed historical survey, Bank argues that U.K. corporations regularly distribute profits to shareholders. In the United States, however, at the turn of the twentieth century, U.S. corporations started to retain profits. This, in essence, was the result of different market dynamics in both jurisdictions. This divergence of policies crafted different roles for the corporate tax systems. In the United Kingdom, where profits are regularly distributed, the view that corporate tax is a proxy for the taxation of shareholders made sense. The collection at the corporate level is nothing more than a withholding-at-source regime rather than a substantive tax. But in the United States, the phenomenon of earnings retention at the corporate level distorted the system of progressive taxation. With no actual distributions to shareholders, Congress could no longer count on corporate tax as a system of withholding. The imposition of an increased “real” tax at the corporate level was the necessary response to revenue needs and the implementation of redistribution policy.

Note that Bank poses his question perfectly in a functional stance, comparing jurisdictions with similarly developed economies and corporate cultures. Yet, his study looks at differences rather than similarities of such comparable jurisdictions, which is why it so relevant to tax reform discourse. It shows that similar jurisdictions may face different local problems.

To turn to the governance argument, if we believe that the “resilience of the corporate tax is a manifestation of the most enduring source of problems in corporate law, the separation between ownership and control of large corporations,” then we must

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221 Id. at 2–3.
222 Jennifer Arlen & Deborah M. Weiss, A Political Theory of Corporate
question whether this “most enduring problem” is similarly experienced across jurisdictions. Corporate governance problems are different across jurisdictions depending, for one, on market structures. In concentrated markets, agency issues show themselves as conflicts between majority and minority shareholders, while, in dispersed markets, the conflicts arise between managers and public shareholders. If corporate taxation operates as a governance mechanism, it probably needs to address different governance issues, depending on the market in which it operates. The U.S. system of corporate taxation operates in a dispersed market. Yet, it is frequently compared with the systems of other OECD countries, many of which have concentrated markets.\(^{223}\)

If corporate taxation is a “fee” for limited liability, such a fee is much more broadly collected – for example – in France and Japan, where every business entity that provides limited liability to its owner is subject to corporate tax (including limited liability partnerships), than in the United States, which effectively collects corporate tax from only publicly traded corporations. Arguably, corporate taxation fulfills a function in France and Japan that is not present in the United States.

Finally, if we accept that corporate taxation in the United States is an instrument to alleviate the concentration of power in the hands of the few, it makes no comparative sense to compare such a system with systems of jurisdictions in which concentration of power is not necessarily perceived to be a problem.\(^{224}\)

2. Compartmentalization

I already noted that participants in the discourse who advocate rate reduction and the adoption of a territorial system frequently cite the U.K. corporate tax reform as a recent example that we should follow. However, corporate tax rate reductions and the adoption of a dividend exemption system are not the only meaningful changes

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\(^{223}\) Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, Corporate Ownership Around the World, 54 J. Fin 471, 472 (1999).

\(^{224}\) The competitiveness of the corporate tax system in the United States is sometimes compared with the systems of jurisdictions in such places as China, the Arab Emirates, and Venezuela. While I have not researched the issue myself, I suspect that, if we look into the role of corporate tax systems in these jurisdictions compared to those in the United States, functional dis-equivalences will surface. I doubt that in such jurisdictions power is heavily concentrated in entities in which the central government does not have influence (at least as a practical matter).
recently introduced to the U.K. tax code.

After a temporary VAT rate reduction to 15%, which took place in 2008, the United Kingdom reinstated its 15.5% VAT rate in 2010. Following the 2010 Emergency Budget, the VAT rate has been further increased to 20% as of 2011. The U.K. corporate tax rate reduction combined with the move toward territoriality had to be financed. The financial crisis of 2008 certainly did not help the constrained budget, and, with an increasing deficit, VAT was called on to save the day. As Chancellor of the Exchequer, George Osborne, remarked, “[o]nce we had decided that at least part of dealing with the deficit had to come from a tax rise, it struck us that VAT was the least damaging tax rise.” Interestingly, some participants in the discourse who advocate rate reduction and territoriality in the name of competitiveness point to the United Kingdom as an example supportive of their arguments. Sometimes, the same commentators also strongly oppose VAT but neglect to make the obvious connection between the VAT increase in the United Kingdom, and the corporate income tax rate cuts.

Another example of piecemeal comparison concerns the 2008 German reform. Advocates of rate reduction frequently cite Germany’s reform due to its significant ten percentage points of statutory rate reduction. Again, it is frequently ignored that the 2008 rate reduction had to be financed. To start with, as in to the United Kingdom, VAT rates were increased (by three percentage points). Much more interesting, however, are the measures that Germany took to expand its now lightly taxed corporate tax base. The base-broadening provisions adopted in the 2008 reform are truly staggering.

To start with, Germany significantly limited the ability of corporations to take depreciation deductions, repealing the declining-balance depreciation method, which allowed corporations to expense

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capital investments over a shorter period than the useful life of the assets. After the reform, generally, only the straight-line method of depreciation is allowed, significantly limiting the ability of German corporations to expense their investments. Second, the German-unique trade tax, which is imposed in Germany in significant rates on business income, used to be deductible for income tax purposes. This is no longer the case after the 2008 reform. To put this change in a functionally equivalent context, a similar measure in the United States would be, for example, the disallowance of deduction of state taxes for purposes of computing the federal income tax liability. Third, Germany introduced rules similar to those prescribed under Section 382 of the Code in the United States, significantly limiting the ability to utilize net operating losses of corporations in case of control transfers. Fourth, and the most significant, is the introduction of the “interest barrier rule.” This last feature deserves further elaboration.

Prior to the 2008 reform, interest payments by a corporation on a loan made by a related party would be allowed as a deduction only to the extent that the debt-to-equity ratio of a corporation’s capital structure did not exceed 1.5:1. This is, in very general terms, similar to the interest deduction limitation currently imposed under section 163(j) of the Code. This rule has been replaced with an interest barrier rule under which “interest expense incurred by the German parent in Germany is fully deductible only if the German parent on a standalone basis is no more than immaterially more highly leveraged than are its non-German operations.”\(^\text{227}\) This, in effect, eliminates the ability of German corporations to strip their German earnings by way of excessive leverage.

While proponents of rate reduction coupled with base expansion are numerous, only seldom do they actually compare anything other than rates. The German reform is sometimes mentioned in terms of base broadening but usually only in the context of the thin capitalization rules, and these are only generally discussed (Kleinbard being one notable exception). These measures put to question whether the German reform achieved competitiveness at all, and they certainly introduce further complexity into the German system. German commentators complain that “[t]he nominal reduction of the German business tax rate has been achieved at the expense of fundamental policy values, practical considerations and the consensus of the tax community.”\(^\text{228}\) One German commentator even called for

\(^{227}\) Kleinbard, supra note 134, at 141.
\(^{228}\) Wright, supra note 201, at 319.
the repeal of the base-broadening measures even if the price is an increase in the corporate tax rates.\footnote{Homburg, \textit{supra} note 202, at 610.}

The most acute example, in my view, of comparative functional negligence in choice of models for comparison, comes up in the case of the Japanese tax reform. Following the adoption of the territorial system of dividend exemption, Japan also revised its CFC legislation. Under the new CFC rules, a Japanese resident who owns ten percent or more of the equity of a controlled subsidiary resident in a foreign jurisdiction is immediately taxed on \textit{all} undistributed profits of such subsidiary if the foreign jurisdiction imposes tax at an \textit{effective} rate of less than twenty percent.\footnote{A narrow exception applies where the Japanese CFC has real presence and business in the foreign jurisdiction. For a description of such rules, see \textsc{Staff of Joint Comm. on Taxation, Background and Selected Issues Related To The U.S. International Tax System And Systems That Exempt Foreign Business Income}, JCX-33-11, at 21-22 (2011).} Compared to the CFC rules in the United States, which only taxes \textit{passive} income of foreign subsidiaries of U.S. MNCs, the Japanese rules are draconian.

As observed from studies of the 2004 repatriation holiday discussed above, much of the earnings repatriated to the United States under the temporary relief came from tax havens, providing anecdotal evidence that many (if not most) unrepatriated earnings of U.S. MNCs are “parked” in jurisdictions where the tax rates are less than twenty percent. In other words, from a comparative perspective, to cite Japan as an example for justifying the move to territoriality is functionally questionable, without noting its CFC regime. If the United States were to adopt such a regime, almost all currently unrepatriated earnings of U.S. MNCs would be \textit{immediately taxed.}\footnote{Kleinbard, \textit{supra} note 134, at 146.} This new Japanese regime of taxation of foreign earnings is so comprehensive, such that it “is not necessarily a radical departure from the worldwide income taxation of resident corporations. . . . Japan will continue to tax the worldwide income of resident corporations, only selectively exempting certain dividends distributed from foreign subsidiaries.”\footnote{Masui, \textit{supra} note 183, at 247.} Just as the United States has an ersatz territorial system, seemingly, Japan has an ersatz worldwide system.

These examples show that compartmentalized analysis distorts the functional comparative picture. The tendency of participants in the discourse to disengage the micro from the macro, such as in the case of VAT increases to finance the move to territoriality in the
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United Kingdom, and to disconnect parts of the corporate tax system as if they are unrelated areas of law, such as in the case of territoriality and the CFC regime in Japan or the case of corporate tax rate decreases and interest deduction limitation in Germany, simply creates a false picture of the reforms that took place elsewhere. The arguments that we should adopt territoriality because Japan and the United Kingdom did or reduce rates because Germany and the United Kingdom did are only possible because many participants in the discourse use a breadth of comparison that is frequently too narrow, which is primarily a failure in the execution of functional analysis.

3. Abstractness and Generalization

Another shortcoming of the comparative process as executed by many participants of the discourse is that they generalize corporate tax models into unworkable abstracts.

The basic feature of such abstraction is the frequent reference to corporate tax systems in the United States and elsewhere as some holistic models with defined boundaries and obvious functionality or as “whole” models of taxation that subject identical taxpayers to the same taxes in the same manner. This implicit assumption many times underlies the argument that the U.S. corporate tax “system” is less competitive than the corporate tax “systems” of other jurisdictions. This is a poor depiction of the effect of corporate taxes in real life. Corporate taxes operate differently in different jurisdictions but, more importantly, within each jurisdiction. Not all corporate entities in the United States suffer the same burden of corporate taxes. Participants, particularly when relying on studies in comparative public finance, refer to the business community as a bloc. However, “[w]e have big businesses, small business, we have manufacturing businesses that are quite different from service entities. They all have different tax structures, and they all have different tax problems.”

Different industry sectors face completely different corporate tax burdens. Wal-Mart, a retail chain that operates in the United States and thus must locate its stores, distribution facilities, and employees in the United States (because this is where the customers are), has very little room to maneuver in terms of income shifting. It therefore pays

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effective rates very close to the actual statutory rates. In other industries, factors such as the use of depreciable property and the value of intangibles (that can be magically shifted elsewhere with a push of a button) play an important role. Industries' tax burdens are affected, among other reasons, by the types of assets they use and their operating structures.

For 2010, the U.S. retail industry carried an average effective tax burden of almost 26%. The pharmaceutical industry, on the other hand, carried a burden of a mere 6.72%. The ETR for the private equity sector, where business entities are usually formed as partnerships, was 0.43%(!). The argument is clear: when we say that the U.S. corporate tax system is uncompetitive, we must ask, “for whom?” Obviously, any comparison would have to ask a similar question with respect to the compared jurisdictions. Not all industries in each country suffer the same burden of corporate tax, which may be the result of the comparative advantage of specific industries in specific jurisdictions or simply a reflection of local preference for a specific industry. Simply comparing “companies” misses the mark.

This leads to another point regarding the incidence of corporate tax rates. As mentioned above, many commentators note that corporations do not pay taxes, people do. A further assertion is that labor carries most of the burden. If this assertion is correct, an employee of the retail industry probably carries a much higher burden than an employee in a pharmaceutical company. If a comparison is made to support the easing of such burdens, it should question which employees in the foreign jurisdiction carry what burden in order to make the comparison convincing. Also important to note in this respect is a fact that participants in the discourse frequently cite: most of the labor force in the United States is employed by non-corporate entities. Under this logic, the benefit of corporate tax rate reductions

234 The CEO of Wal-Mart, Mike Duke, eloquently exemplified those differences in recent testimony before the Finance Committee: “Last year in the U.S., Walmart paid $1.25 billion in state and local property tax. We paid $630 million in state corporate income tax. We collected and remitted $13.8 billion in sales tax. And we paid $4.7 billion in corporate taxes in the U.S., which was about 3% of all corporate income taxes that were collected by the U.S. Treasury. Our effective corporate tax rate last year was 32.2%. Many companies that testify before you theoretically face similar tax rates; we actually pay them.” Finance July 27 Hearing, supra note 51, at 1.

235 CRS 2007 REPORT, supra note 103, at 21.

236 Professor Aswath Damodaran from NYU Stern School of Business reports the effective tax rates of different U.S. industries at the end of each year. His recent report is available at: Aswath Damodaran, Tax Policy, MUSINGS ON MARKETS (Jan. 28, 2011), http://aswathdamodaran.blogspot.com/2011/01/tax-policy.html.
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abroad may have been shared by much of the labor force. However, rate reduction here (to the extent it affects wages) will profit a rather narrow sector of employees — those employed by publicly traded companies (because, under the logic of the corporate tax incidence argument, non-corporate employees will remain unaffected).

In addition, the argument that corporations do not pay taxes, people do, even though true, stands in sharp contrast to another argument sometimes made in the context of current debate: countries do not compete, companies do. Business entities are abstract legal creations and, as such, are not interested in the rate of return of an investment. Their equity owners and managers are. In other words, I assert the companies do not compete; people do. But participants, when discussing competition, many times stop at comparing corporate taxes and completely neglect the comparison of individual income taxes and the way they integrate with corporate-level taxes. This is wrong because the boundaries of competitiveness obviously do not correlate to the boundaries of corporate taxes if individuals are the ones paying the taxes and are the ones competing for investment returns. I did not explore the issue of corporate-shareholder integration in this article, and this is indeed an important issue. In the current discourse, however, most participants do not address this issue comparatively, a fact that seriously cripples any comparative competitiveness argument.

Finally, it is not necessarily clear that countries do not compete. Countries may compete implicitly and explicitly. It is not unreasonable to expect that countries will reform their tax systems to improve the status of their own industries well beyond global neutrality and thus implicitly compete with other countries. Moreover, in today’s global markets, it is hard to ignore the explicit role played by national governments. Some of the largest equity investors in the world are sovereign wealth funds owned and operated by national governments. The assets under management in such funds are in fact “larger than the total assets under management in hedge funds.”

Gravelle, supra note 52, at 474.

238 The argument that countries do not compete rests on an assumption that the perfect international tax system is based on a norm that maximizes “global, rather than national welfare.” However, “[a]s a guide to national policy, such global altruism may be morally admirable, but it is more than we might really expect. Nations, no less than individuals, typically act, at least within broad limits, to advance their own interests rather than those of everyone in the world.” Daniel Shaviro, The Rising Tax- Electivity of U.S. Corporate Residence, 64 Tax L. Rev. 377, 386–87 (2011).
funds or private equity funds. So, when we say competition and compare competitors, the possibility of real national-government-level competition must be taken into account. In the current discourse, this issue is simply ignored.

E. The Technique of Comparison:

1. How Corporate Tax Models Operate

Comparison itself is an in-depth look into how law really operates, which is another place where participants in the discourse frequently fail. I discuss only two major examples that underlie the very basics of the competitiveness argument.

What almost all participants compare (with a few notable exceptions, most obvious being Knoll) is the corporate taxes countries impose on their domestic MNCs. When doing so, participants in the discourse ignore significant factional differences in how different jurisdictions define what a “corporation” is and what “domestic” means for tax purposes.

“A basic structural decision in the design of corporate tax is the determination of which entities or organizations should be subject to the tax.” Unfortunately, participants in the discourse largely ignore this basic issue. This is a meaningful failure because the United States is probably the only country in the world that allows most of its business entities to effectively elect whether to be taxed as a corporation or not. As noted above, under the “check-the-box” regulations, a business entity, whether domestic or foreign, is not taxed at the entity level unless it is specifically referenced in the regulations as an entity that is to be treated as a per-se corporation, or otherwise elects to be taxed as a corporation. The effect of the regulations is that in the United States practically only publicly traded corporations are subject to entity-level tax. As noted above, however, most business income in the United States is earned by unincorporated business and hence not subject to entity-level taxes.

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The situation in many (if not most) other industrialized jurisdictions is completely different. While an owner of a limited liability company (LLC) in the United States can have it treated as fiscally transparent for tax purposes, in Germany, the functional equivalent of an LLC (Gesellschaft mit beschränkter Haftung, or GmbH) is subject to corporate taxes. In France, not only the equivalent of an LLC (Société à Responsabilité Limitée, or S.à.R.L.) is subject to corporate taxes but also any profits of the French equivalent of a limited liability partnership, or LLP (Société en Commandite Simple), that are attributable to the holdings of any limited partners. The same is true for Japan, where, simply put, a Japanese LLP (Goshi Kaisha) is subject to corporate taxes. Unlike in the United States, the price that an investor in frequently compared-to jurisdictions has to pay for limited liability is corporate tax.

When the United States does not subject to corporate taxes entities that are functionally equivalent to entities that are subject to corporate taxes in many other countries, the comparison of corporate tax rates and corporate tax burdens becomes nothing more than a crude juxtaposition of words in texts of different tax codes (the words being “corporate taxes”). For example, of all the different indicators of corporate tax burden, corporate-tax-cut proponents disrespect the most the one that measures the share of corporate tax revenue in proportion to GDP. However, the corporate tax collection to GDP ratio is the only measurement that takes the entity classification difference into account. When this ratio is measured in France, the “revenue collection” numerator includes corporate taxes collected from LLPs and LLCs, which is not the case in the United States. This means that the argument that revenue collection in the United States is poor compared to other countries due to the uncompetitive tax environment in the United States is, at the least, questionable. It is at least as conceivable that revenue collection compares poorly to other jurisdictions because such jurisdictions collect revenue from business entities that the United States does not. In the current version of the debate, the competitiveness argument does not stretch beyond the competitiveness of U.S. publicly traded MNCs.

Knoll’s analysis of competition is so important because he is almost the only commentator who analyzes competitiveness based on business segments (or, in his words, “industries”) rather than by comparing “corporations.” When industries are compared, the tax

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burden would take into account the way in which the industry operates, including whether it is subject to industry-level taxes. For example, we could logically assume that the private equity industry in the United States is far more competitive (tax-wise) than the Japanese one since a private equity fund in Japan would be subject to entity-level tax, while in the United States it would not.

A second example of the technical failure of the comparison is that commentators almost always fail to define what a domestic corporation is, which is important to do because participants in the discourse pose the competition argument as being a dichotomy, differentiating between U.S. corporations and non-U.S. corporations. The competition is between “our” corporations and “theirs.” How we define our corporations and how they define theirs is significant. Interestingly, critical analysis of comparative law provides a useful insight here, as it puts in doubt such dichotomies as an operating assumption.

Here as well, the United States stands in sharp contrast to many other jurisdictions. Section 7701(a)(4) of the Code defines a corporation as “domestic” formalistically, by reference to the place of incorporation. The place of incorporation, however, says nothing about who the owners or the managers of the corporations are. Thus, a corporation incorporated in Delaware wholly owned by a French individual would be a U.S. corporation for federal income tax purposes. On the other hand, a corporation in the Cayman Islands wholly owned by a U.S. individual would be treated as a foreign corporation for federal income tax purposes.

Most other jurisdictions employ some version of a more substantive rule for corporate residency, known as the “place of effective management” (POEM). The OECD defines the place of effective management as “the place where key management and commercial decisions that are necessary for the conduct of the entity’s business as a whole are in substance made.”

Obviously, such a difference may be of great significance when considering who is competing against whom. A German-controlled corporation incorporated in the United States will be defined as a German corporation (under the POEM test) for German tax purposes but as a U.S. corporation for U.S. tax purposes (under the place of incorporation test). In this case, “ours” is also “theirs.” On the other hand, a corporation that is wholly owned by U.K. shareholders,

incorporated in the Cayman Islands but managed by an American CEO, is effectively “residentless.” It is not resident in the United Kingdom because it is managed from the United States. It is not domiciled in the United States because it is incorporated in the Cayman Islands. It is not taxed in the Cayman Islands because, well, the Cayman Islands simply does not impose tax on foreign-owned corporations. In other words, in competitive terms, for tax purposes, this corporation is neither “ours” nor “theirs.” Such corporations are simply nonexistent for purposes of the competitiveness argument.

Given that U.S. investors frequently facilitate foreign investments by using offshore corporations, the result is that corporations that are owned, managed by and create financial benefits to U.S. residents are excluded from the discourse. If we accept my assertion that individuals, not corporations, compete, such corporations must be considered functionally “ours” when we discuss international competition.

To summarize this part, ignorance of how corporate tax law actually works here and elsewhere produces comparative results with unclear value. If “corporate” here and “corporate” elsewhere mean different things for tax purposes, the comparison is essentially one of apples and oranges.

2. Methodological and Ideological Disengagement

Another failure of participants in the discourse in the execution of comparisons is incoherency. It seems that participants tend to use comparisons when convenient and dismiss comparisons when they are not. Participants also frequently employ methods of comparison inconsistently, rejecting them and adopting them carelessly, shifting randomly from one form of analysis to another.

For example, many participants in the discourse who advocate rate reductions to improve competitiveness (a) point to rate reductions widely adopted elsewhere and (b) dismiss as inappropriate the measurement of tax burden by the collection-to-GDP ratio (which usually implies that the United States is not uncompetitive). However, the same participants many times reject the adoption of VAT (a) even though it is widely adopted elsewhere and (b) use the collection-to-GDP ratio method (the same method that they sometimes dismiss) to explain why VAT is such a bad idea.

The other side of the aisle is also at fault. Proponents of worldwide consolidation usually reject territoriality although it is widely adopted; taking a difference-oriented approach to comparison,
they note many unique differences between the United States and countries that adopted territoriality. On the other hand, many of the same participants are also advocating VAT, supporting their arguments by pointing to the similarity of models adopted elsewhere, frequently ignoring contextual differences, such as the VAT base and VAT preferences in each jurisdiction.

This incoherence is a result of misunderstanding of what comparison is. Instead of using the comparison to coherently promote a defined agenda, participants simply seek jurisdictions that adopted models they wish to adopt and point to such jurisdictions in support of their argument. Unfortunately, the same jurisdictions may also have adopted other models that such commentators do not wish to adopt. This forces them to take an incoherent approach, adopting comparisons when convenient, ignoring them when they are not.

This practice presents a limited view of legal comparison as a tool for legal reform. The fact that something is “there” is of little meaning. Yet, this can easily be fixed by harnessing comparison to promote a specific agenda. Participants in the discourse, I believe, wrongly view comparison as some objective picture of reality. However, comparison is hardly free of political agendas, and clear agendas may make comparison more coherent. For example, when objections to VAT are made because VAT creates bigger government, it makes perfect sense to argue against its adoption if we take this ideological view even though it is adopted elsewhere (assuming we believe the comparative studies according to which VAT really increases the size of governments). The same ideological position would also support territoriality and rate cuts, particularly because it is adopted elsewhere (because we need to remain competitive). Similarly, an argument according to which only rich publicly traded corporations would benefit from rate cuts (unlike in other jurisdictions) would go ideologically hand in hand with a comparative argument according to which we should not adopt rate cuts coupled with territoriality (even though adopted elsewhere) but should adopt VAT (like in other countries). In such cases, comparative arguments that approve some models adopted elsewhere but reject others are rational because they support a coherent ideological view.

VI. CONCLUSION

This article observed how the vibrant debate in corporate tax reform in the United States is dominated by comparative arguments.
This is generally a welcome phenomenon. Tax writers have much to learn from the experience of other taxing jurisdictions. However, as much as a comparative approach is desirable, it is also dangerous if ill executed. Bad comparisons produce inaccurate guidance that may not bring about the desired results of tax reform.

Most participants simply juxtapose laws. To start, they do not define the purposes of comparison well. The result is comparative arguments that are sometimes based on comparisons with jurisdictions that actually failed to achieve the same competitiveness and simplicity aims that we seek to achieve. Participants also fail to properly consider which jurisdictions are appropriate candidates for comparison, and the result is comparative research that includes jurisdictions that are simply irrelevant for competitiveness arguments. Participants also fail to properly define the legal models compared, falling into the trap of ultra-specificity, on the one hand, and overgeneralization on the other. Finally, they fail to observe how corporate tax laws actually operate in real life in the jurisdictions compared. This raises the question of what relevant guidance can be produced, when the compared models are treated as similar even though they are very different.

Several themes that emerge may hint to the underlying circumstances of such failures. First, and the most important one, is the utter disregard of any coherent process of comparison. Comparisons are made in an almost random manner rather than as a rigorous methodical endeavor. Second, there is an overreliance on comparative finance to make legal arguments. While comparative finance may prove helpful, it must rely on some real understanding of the functionality of tax rules. It is questionable whether this is the case in the context of tax reform discourse. Third, participants disengage the process of comparison from any identified ideological stance. To be sure, the ideological positions of participants in the discourse are usually well defined. However, comparison is wrongly perceived to be an objective endeavor. This creates an eclectic, uncommitted, sometimes contradictory approach to comparisons, shifting from functional to cultural analysis almost unconsciously.

Within the context of the corporate tax reform debate, the comparative process is currently harnessed by participants of the discourse to explain why their ideologies and beliefs are superior. This undermines the benefits of the comparative process by forcing it into an intractable political disagreement. Instead, participants should acknowledge their ideological agenda, and harness comparison to support the formulation of policies that efficiently execute such
agenda. Comparative tax law holds much promise for the process of corporate tax reform in the United States. To fulfill this promise, participants in the corporate tax reform discourse must take a more engaged and serious view of comparative tax law and the process of comparison.