Reenacting the Repatriation Holiday: Can I.R.C. § 965 Incentivize Green Investment?

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I. INTRODUCTION

Environmental concerns, particularly those associated with climate change, are arguably the most pressing issues facing the world, and President Obama has made addressing these concerns a top priority of his second term in office.[1] Legislators have proposed various approaches to regulate causes of climate change, including enacting cap-and-trade

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1. Richard W. Stevenson & John M. Broder, *Speech Gives Climate Goals Center Stage*, N.Y. TIMES, Jan. 22, 2013, at A1.

systems or carbon taxes,[2] enacting command-and-control legislation, passing subsidies or tax expenditures for energy efficient behavior, and revising emissions standards.

The reform of corporate tax policy is a hot-button issue in American politics.[3] Some argue that the worldwide tax system[4] should be abandoned for a territorial system, while others suggest a worldwide minimum tax system.[5] Currently, U.S. corporate tax rates are some of the highest in the world.[6] Despite the high marginal tax rates, the nation's mounting debt is currently in excess of $16 trillion.[7] The wider economic picture of the country is just as bleak—characterized by high unemployment,[8] stagnant growth or decline in various economic indicators,[9] and a decades-long trend of decreasing domestic manufacturing.[10]

In light of these daunting environmental and economic issues, one would hope that the U.S. government was responding with fresh and creative solutions. However, this is unfortunately not the case. The current legislative environment is, instead, one characterized by

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2. *See* John M. Broder, *House Bill for a Carbon Tax To Cut Emissions Faces a Steep Climb*, N.Y. TIMES, Mar. 7, 2009, at A13; Thomas L. Friedman, Op-Ed., *Show Us the Ball*, N.Y. TIMES, Apr. 8, 2009, at A25.

3. *See* Peter Baker, *Obama Appeals to Business for Support on Tax Plan*, N.Y. TIMES, Dec. 6, 2012, at A22; Editorial, *Reform and Corporate Taxes: The Obama Framework Is a Start to a Long Overdue Debate*, N.Y. TIMES, Feb. 23, 2012, at A26.

4. The United States currently employs a system of taxation where income earned by a U.S.-based taxpayer is generally subject to U.S. income tax regardless of where that income is earned. *See infra* Part II.

5. Editorial, *Permanent Tax Holiday: President Obama Takes Aim at Mr. Romney's Corporate Tax Plan*, N.Y. TIMES, July 19, 2012, at A28; Jia Lynn Yang & Suzy Khimm, *Companies Quietly Push for Tax Break on Foreign Profits in 'Fiscal Cliff' Debate*, WASHINGTON POST (Nov. 29, 2012), http://articles.washingtonpost.com/2012-11-29/business/35585702_1_tax-code-corporate-tax-edward-d-kleinbard.

6. The United States' highest marginal rate of 35% is the highest among its main trading partners; however, corporations pay effective rates that are much lower, on average closer to 20%. Victor Fleischer, *Not All Companies Would Welcome a Lower Tax Rate*, N.Y. TIMES, Dec. 12, 2012, at F16.

7. David Malpass, *The U.S. Needs To Win the Battle To Limit Government Now*, FORBES (Jan. 23, 2013), http://www.forbes.com/sites/currentevents/2013/01/23/the-u-s-needs-to-win-the-battle-to-limit-government-now/.

8. Though unemployment rates have been improving since 2008, they remain higher than any other period since 1992. *Household Data Annual Averages*, BUREAU OF LABOR STATISTICS, http://www.bls.gov/cps/cpsaat01.pdf (last visited Mar. 17, 2013).

9. *See U.S. Economic Statistics—Monthly Data*, TREASURY.GOV (Jan. 22, 2013), http://www.treasury.gov/resource-center/data-chart-center/monitoring-the-economy/Documents/monthly%20ECONOMIC%20DATA%20TABLES.pdf.

10. Michele Nash-Hoff, *What's Happening to U.S. Manufacturing?*, HUFFINGTON POST (Aug. 10, 2011, 2:34 PM), http://www.huffingtonpost.com/michele-nashhoff/us-manufacturing-crisis_b_922889.html?view=screen.

inactivity, partisanship, and brinksmanship.[11] In this political environment, traditional approaches to environmental legislation and efforts to pass comprehensive climate change legislation are unlikely to be successful.[12] Legislative leaders will likely have to adopt unconventional approaches for progress to be made in the area of environmental regulation. This Comment explores whether one such unconventional approach—reenacting a repatriation tax holiday with an incremental environmental investment requirement—can increase federal revenues, encourage environmentally beneficial behavior, and stimulate the economy. This proposal is not meant to serve as a substitute for broad greenhouse gas (GHG) regulation or tax reform. It is intended to be a short-term measure designed to provide an environmental and economic incentive in response to a legislature that has proven to be disinclined to pass comprehensive legislation in either arena.[13] Part II of this Comment briefly explores the U.S. system of taxation of foreign income and the history, goals, and effects of I.R.C. § 965.[14] In Part III, the Comment proposes a reenactment of the repatriation holiday with environmental restrictions, and it attempts to outline steps to ensure that the beneficial goals of enacting the holiday are more likely to be met in Part IV. Finally, Part V presents the motivations behind using the tax code to incentivize such environmental investment and discusses some of the alternative means of addressing GHG emissions.

II. U.S. TAXATION OF FOREIGN INCOME AND THE REPATRIATION TAX HOLIDAY

This Part first provides a brief background of the U.S. system of taxation of foreign income and the history of the repatriation tax holiday. It then turns to the goals and effects of enacting § 965 and the likely reasons why it failed to achieve those goals when previously enacted.

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11. *See* Editorial, *Fiscal Endgame: If Congressional Republicans Would Only Act Sensibly, a Sensible Deal Could Be Reached*, N.Y. TIMES, Dec. 27, 2012, at A26; Jennifer Steinhauer, *Congress Nearing End of Session Where Partisan Input Impeded Output*, N.Y. TIMES, Sept. 19, 2012, at A21; Jennifer Steinhauer, *Debt Bill Signed, Ending Crisis and Fractious Battle: Obama Says the Troubles Were Avoidable*, N.Y. TIMES, Aug. 3, 2011, at A1.

12. *See* John M. Broder, *Director of Policy on Climate Will Leave*, N.Y. TIMES, Jan. 25, 2011, at A15.

13. *See id.*

14. The last repatriation tax holiday was enacted in 2004 and was codified in I.R.C. § 965. *See* American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 422, 118 Stat. 1418, 1514-19; *infra* Part II.

A. U.S. Taxation of Foreign Income

The United States currently employs a system of worldwide taxation in which income earned by a U.S. resident (and by extension, a U.S.-based corporation) is subject to U.S. federal income tax regardless of where that income is earned.[15] The Internal Revenue Service (IRS) employs a mechanism known as the foreign income tax credit to ensure that this income is not subject to double taxation in the United States and the jurisdiction where the income is earned.[16] Additionally, much income earned by controlled foreign corporations[17] (CFCs) is not taxable in the United States until the income is repatriated to the United States, typically as a dividend paid by the CFC to the U.S.-based entity.[18] U.S.-based multinational corporations go to great lengths to minimize their overall tax liability[19] and to defer taxes through transfer pricing and storing foreign business income in CFCs.[20] It is estimated that U.S.-based corporations have deferred paying income tax to the U.S. government on over $1.7 trillion of CFC income.[21] In many cases, these profits will likely remain offshore and untaxed until corporations have some incentive to bring them back to the United States and subject them to domestic tax.[22] While there is currently debate in Washington over whether to overhaul the corporate tax system completely,[23] Congress provided a temporary incentive for domestic corporations to repatriate

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15. Craig M. Boise, *Breaking Open Offshore Piggybanks: Deferral and the Utility of Amnesty*, 14 GEO. MASON L. REV. 667, 670 (2007).

16. David. L. Cameron & Philip F. Postlewaite, *Incremental International Tax Reform: A Review of Selected Proposals*, 30 NW. J. INT'L L. & BUS. 565, 587 (2010); I.R.C. § 901 (West 2012).

17. The term "controlled foreign corporation"

> means any foreign corporation if more than 50 percent of (1) the total combined voting power of all classes of stock of such corporation entitled to vote, or (2) the total value of the stock of such corporation, is owned . . . by United States shareholders on any day during the taxable year of such foreign corporation.

I.R.C. § 957(a).

18. Boise, *supra* note 15, at 667-70; Cameron & Postlewaite, *supra* note 16, at 565.

19. *See generally* Cameron & Postlewaite, *supra* note 16.

20. Boise, *supra* note 15, at 667, 677-79; Rodney P. Mock & Andreas Simon, *Permanently Reinvested Earnings: Priceless*, 121 TAX NOTES 835, 837-38 (2008).

21. Editorial, *Say No to a Corporate Territorial Tax*, SF GATE (Dec. 15, 2012), http://www.sfgate.com/default/article/say-no-to-a-corporate-territorial-tax-4121161.php; Yang & Khimm, *supra* note 5.

22. *See* Richard Rubin, *Offshore Cash Hoard Expands by $183 Billion at Companies*, BLOOMBERG.COM (Mar. 8, 2013, 4:10 PM), http://www.bloomberg.com/news/2013-03-08/offshore-cash-hoard-expands-by-183-billion-at-companies.html.

23. Peter Baker, *Obama Appeals to Business for Support on Tax Plan*, N.Y. TIMES, Dec. 6, 2012, at A22; Editorial, *Reform and Corporate Taxes: The Obama Framework Is a Start to a Long Overdue Debate*, N.Y. TIMES, Feb. 23, 2012, at A26.

foreign income with the enactment of the American Jobs Creation Act of 2004 (Jobs Act).[24] With the inclusion of a provision that became I.R.C. § 965, the Jobs Act created a temporary, one-time repatriation tax holiday, allowing dividends paid by CFCs to U.S.-based corporations to be taxed at a much more favorable effective tax rate of 5.25%.[25] U.S. corporations took advantage of this provision and repatriated $315 billion of eligible dividends, which provided over $16 billion of revenue for the IRS in 2005.[26]

B. The Repatriation Tax Holiday Under I.R.C. § 965

The Jobs Act included a provision that became I.R.C. § 965.[27] Section 965 allowed domestic corporations with shares in CFC subsidiaries to take a one-time deduction for 85% of eligible dividends received from those subsidiaries.[28] This deduction allowed corporations to be taxed at an effective tax rate of 5.25% for dividends qualifying under § 965.[29] For a dividend to qualify under § 965, the dividend must have been a cash dividend paid by a CFC to a "United States shareholder" (USS).[30] Section 965 also laid out several limitations on the amount[31] and character[32] of the dividends and offset the amount of

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24. Boise, *supra* note 15, at 669; *see* American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 422, 118 Stat. 1418, 1514-19.

25. I.R.C. § 965(a)(1) (West 2012); American Jobs Creation Act § 422; *see infra* Part II.B. Some scholars disagree on the effective rate that corporations actually paid, with some contending that the effective rate was in fact less than 5.25%. Mock & Simon, *supra* note 20, at 836.

26. Lee A. Sheppard & Martin A. Sullivan, *Repatriation Aid for the Financial Crisis?*, 53 TAX NOTES INT'L 275, 276, 283 (2009).

27. American Jobs Creation Act § 422.

28. I.R.C. § 965(a)(1).

29. *See* M. Mendel Pinson & Melanie Shanley, *Effects of 2004 Int'l Tax Holiday, Recommendations Going Forward*, 132 TAX NOTES 845, 845 (2011) (citing DELOITTE TAX LLP/CFO RESEARCH SERVS., THE BROAD IMPLICATIONS OF SECTION 965 REPATRIATION (2005)). The repatriation tax holiday provided that "there shall be allowed as a deduction an amount equal to 85 percent of the cash dividends which are received during [the] taxable year by [the] shareholder from controlled foreign corporations." I.R.C. § 965(a)(1). For example, if a U.S.-based corporation received $100 of dividends during the year from a CFC, that corporation would be able to deduct $85 of those dividends which would subject $15 of dividends to taxation at the corporation's marginal tax rate. Assuming the highest marginal corporate tax rate of 35%, the tax liability for the $100 in dividends received would be $5.25, or 5.25%. Boise, *supra* note 15, at 690.

30. I.R.C. § 965(a)(1). "[T]he term 'United States shareholder' means, with respect to any foreign corporation, a United States person [including corporations] . . . who owns . . . 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation." *Id.* § 951(b).

31. *Id.* § 965(b)(1). Repatriations were limited to

> the greater of—(A) $500,000,000, (B) the amount shown on the applicable financial statement as earnings permanently reinvested outside the United States, or (C) in the case of

otherwise qualifying dividends by any increase in related party borrowing.[33] Additionally, § 965 contained restrictions requiring that the dividend proceeds be invested in the United States as part of a domestic reinvestment plan (DRIP) in order to qualify for the deduction.[34]

C. The Goals of Enacting I.R.C. § 965 and the Effects

The goals of enacting § 965 in the Jobs Act were largely indicated by the limitations discussed above, particularly the extraordinary dividend limitation and the DRIP requirement.[35] With the extraordinary dividend limitation, legislators intended to encourage repatriations in excess of historical levels.[36] Additionally, the DRIP requirement was included to increase domestic investment in order to stimulate economic growth and job creation.[37]

First, legislators sought to reduce the tremendous backlog of unremitted earnings stored in CFCs by allowing only those dividends in excess of average historical repatriated earnings paid by CFCs to USSs over the base period to be eligible for the holiday.[38] These amounts in excess of average base period dividends were considered to be earnings that would otherwise have been permanently retained in the CFCs.[39] By

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> an applicable financial statement which fails to show a specific amount of earnings permanently reinvested outside the United States and which shows a specific amount of tax liability attributable to such earnings, the amount equal to the amount of such liability divided by 0.35.

Id. Many of the corporations that participated in the holiday were not limited by § 965(b)(1)(A) but were limited by either (B) or (C). Boise, *supra* note 15, at 691 ("[M]ost U.S. corporations that took advantage of section 965 repatriated amounts far in excess of the $500 million limit.").

32. I.R.C. § 965(b)(2). "Only 'extraordinary dividends'—those exceeding the annual average repatriation level over a specified base period—were eligible for the dividend deduction." Boise, *supra* note 15, at 690.

33. I.R.C. § 965(b)(3). A party is a

> related person with respect to a controlled foreign corporation, if—(A) such person is an individual, corporation, partnership, trust, or estate which controls, or is controlled by, the controlled foreign corporation, or (B) such person is a corporation, partnership, trust, or estate which is controlled by the same person or persons which control the controlled foreign corporation.

Id. § 954(d)(3). This reduction in benefits for related person borrowing essentially prevented corporations from borrowing cash from themselves to repatriate to the United States at the favorable rate.

34. *Id.* § 965(b)(4).

35. *See* Boise, *supra* note 15, at 689-92; Mock & Simon, *supra* note 20, at 836-37; *supra* Part II.B.

36. Boise, *supra* note 15, at 690.

37. Mock & Simon, *supra* note 20, at 843 (citing H.R. REP. NO. 108-755, at 256 (2004)).

38. Boise, *supra* note 15, at 690.

39. *Id.*

providing an incentive through the greatly reduced effective tax rate on these earnings, legislators sought to encourage corporations to repatriate the earnings, which would create revenue for the federal government that it would likely not have received otherwise.[40] The holiday was successful in incentivizing corporations to repatriate earnings. Approximately $315 billion of eligible dividends were repatriated, providing over $16 billion in revenue for the IRS.[41] Empirical studies showed a significant increase in repatriation during the holiday as compared to other years, indicating that the holiday did in fact significantly incentivize corporations to repatriate earnings that otherwise would not have been repatriated.[42] Additionally, corporate interests have been lobbying for a reenactment of § 965 for the past several years,[43] which suggests that corporations were quite fond of the provision and that a future reenactment would lead to similar results.

By including the DRIP requirement, Congress sought to carry out the namesake of the Jobs Act, which was to create jobs in America through increased investment in domestic projects.[44] Section 965 established limits on the qualifying uses of repatriated earnings, requiring that they be reinvested "in the United States (other than as payment for executive compensation), including as a source for the funding of worker hiring and training, infrastructure, research and development, capital investments, or the financial stabilization of the corporation for the purposes of job retention or creation."[45] In addition, "[i]nvestments such as executive compensation, intercompany distributions, shareholder dividends, stock redemptions, portfolio investments, acquisition of debt instruments, and the payment of taxes on shareholder dividends were expressly prohibited."[46] Congress's intent was to spur economic and job growth through increased investment and not to provide corporations with a bonus supply of cash from which to pay executives and shareholders.

When § 965 was enacted, proponents forecasted that the repatriation holiday would trigger $400 billion of repatriations and possibly create

40. Pinson & Shanley, *supra* note 28, at 847.

41. Sheppard & Sullivan, *supra* note 26.

42. DONALD J. MARPLES & JANE G. GRAVELLE, CONG. RESEARCH SERV., R40178, TAX CUTS ON REPATRIATION EARNINGS AS ECONOMIC STIMULUS: AN ECONOMIC ANALYSIS 4 (2011) ("U.S. multinationals increased their repatriations by approximately 266% from the prior year.").

43. Eric Kroh, *Repatriation Holiday Advocacy Group Says It's Still Active*, 135 TAX NOTES 554, 554 (2012).

44. Mock & Simon, *supra* note 20, at 843 (citing H.R. Rep. No. 108-755, at 256 (2004)).

45. I.R.C. § 965(b)(4)(B) (West 2012).

46. Mock & Simon, *supra* note 20, at 843-44 (citing I.R.S. Notice 2005-10, 2005-6 I.R.B. 474 (2005)).

over 600,000 jobs.[47] After the dust settled involving the repatriations, researchers found that even with the DRIP requirements and the large amount of repatriated profits, there were no indications that § 965 contributed positively to job creation or domestic investment.[48] Empirical studies have indicated that, despite legislative and corporate projections to the contrary, repatriation did not increase domestic investment, employment, or research and development.[49] In fact, many of the largest corporate participants ended up laying off workers soon after the repatriation, while also engaging in large share buybacks and other activities that were specifically listed as nonqualifying activities under § 965.[50]

D. Why Did § 965 Fail To Achieve Its DRIP Goals?

While § 965 included some restrictions on uses of the repatriated earnings through the DRIP requirements, the congressional intent to create jobs and stimulate the economy was not achieved.[51] There are at least two explanations for this failure. First, the language of the provision allowed for ambiguity in how the repatriated earnings were required to be spent. Second, the provision did not include a tracing requirement, and because money is fungible, the corporations were able to use the repatriated earnings for non-DRIP purposes.

The provision included "the financial stabilization of the corporation for the purposes of job retention or creation" as a permitted use of repatriated dividends.[52] The IRS attempted to clarify what kinds of investments would be considered "financial stabilization" investments by issuing a notice.[53] It included in this category repayment of debt and a catch-all "other" provision that allowed spending to qualify generally under the DRIP requirements as long as it financially stabilized the corporation and was approved by the high-level management of the corporation.[54] According to the notice, certain uses did not qualify as "investments in the United States pursuant to section 965(b)(4),"

47. Roy Clemons & Michael R. Kinney, *An Analysis of the Tax Holiday for Repatriation Under the Jobs Act*, 120 TAX NOTES 759, 760 (2008) (quoting Rep. Phil English, R-Pa., a member of the House Ways and Means Committee, who drafted the bill).

48. MARPLES & GRAVELLE, *supra* note 42, at 3; Pinson & Shanley, *supra* note 29, at 847-48.

49. *See, e.g.*, Dhammika Dharmapala et al., *Watch What I Do, Not What I Say: The Unintended Consequences of the Homeland Investment Act*, 66 J. FIN. 753, 782-83 (2011).

50. *See* Pinson & Shanley, *supra* note 29, at 847-48.

51. *Id.* at 846-48.

52. I.R.C. § 965(b)(4)(B) (West 2012).

53. I.R.S. Notice 2005-10, 2005-6 I.R.B. 474 (2005).

54. *Id.* at 478-79.

including executive compensation, dividends and other distributions with respect to stock, and stock redemptions.[55] Despite this guidance, some of the largest corporate participants were still able to engage in such nonqualifying activities.[56]

More importantly, the notice specifically provided that the "taxpayer is not required to trace or segregate the specific dividend proceeds it receives to demonstrate that it has properly invested the amount of the dividend in the United States pursuant to the domestic reinvestment plan."[57] This absence of a tracing requirement likely contributed to the lack of incremental increases in domestic investment and job creation following the spike in repatriation.[58] Additionally, researchers point out that the lack of a tracing requirement and the wide array of options for qualifying investment under the DRIP requirements, combined with the fungible nature of money, allowed corporations to use investment activity that would have been undertaken absent the repatriation holiday to satisfy the DRIP requirement.[59] These corporations, based on the lack of an incremental investment requirement, were then able to engage in significant share repurchases and other non-DRIP financial activity with the resulting glut of cash from repatriations.[60]

III. REENACTING THE REPATRIATION HOLIDAY AND ARMING § 965 WITH AN ENVIRONMENTAL REQUIREMENT

This Comment proposes that the repatriation holiday be reenacted. The proposed holiday would require that all repatriated earnings be used for energy efficient or environmentally desirable investment, particularly modernization of manufacturing facilities that would reduce costs and potentially make domestic manufacturing more viable in relation to cheaper offshore manufacturing.[61] Industrial sources contribute significantly to GHG emissions.[62] Some point to outdated, inefficient

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55. *Id.* at 480.
56. Pinson & Shanley, *supra* note 29, at 846-47.
57. I.R.S. Notice 2005-10, 2005-6 I.R.B. 477 (2005).
58. *See* Pinson & Shanley, *supra* note 29, at 846-50.
59. Dharmapala et al., *supra* note 49, at 782-83.
60. *Id.*; Pinson & Shanley, *supra* note 29, at 847, 850.
61. *See* STEVEN NADEL & R. NEAL ELLIOTT, AM. COUNCIL FOR AN ENERGY-EFFICIENT ECON., ENCOURAGING MODERNIZATION OF THE INDUSTRIAL SECTOR AND OTHER ENERGY-SAVING CAPITAL INVESTMENTS THROUGH TAX REFORM (2012), *available at* http://aceee.org/files/pdf/white-paper/encouraging-modernization.pdf.
62. *See Sources of Greenhouse Gas Emissions*, EPA, http://www.epa.gov/climatechange/ghgemissions/sources.html (last visited Feb. 7, 2013) (indicating that industry sources contributed 20% of total U.S. greenhouse gas emissions in 2010).

manufacturing equipment and processes as a contributing factor to U.S. industry's GHG emissions.[63] With industry's large contribution to overall GHG emissions and the fact that a portion of that share is due to outdated manufacturing equipment, modernization of domestic manufacturing could make a significant impact in reducing energy consumption and GHG emissions. Although industrial sources contribute significantly to GHG emissions, transportation and electricity production contribute over half of the GHG emissions in the United States.[64] This Comment focuses on manufacturing because transportation and electricity production sources are less likely to be impacted by changes to the system of taxation of foreign sourced income.[65] Accordingly, transportation and electricity generation sources are likely better regulated through emissions standards and broad systems of regulating GHG emissions like cap-and-trade or carbon taxes.[66]

The proposed reenactment of the repatriation holiday should be substantially similar to § 965 as included in the Jobs Act. However, it should include some key differences particularly aimed at incentivizing environmentally beneficial investment. In order to accomplish this, the DRIP requirements, as previously enacted in § 965, must be revised to include a narrower and more specific class of reinvestment options that are eligible for favorable taxation.[67] These reinvestment options should not allow for share repurchase or other activity that would not further the goals of increasing environmentally beneficial investment.[68] The new environmental dividend reinvestment program (EDRIP) requirements should be loosely based on the previously enacted structure.[69]

The EDRIP requirements should require a program to be approved by senior corporate leadership (e.g., the chief executive officer), as was

63. *See* Nadel & Elliott, *supra* note 61, at 1; *Methane Emissions*, EPA, http://www.epa.gov/climatechange/ghgemissions/gases/ch4.html (last visited Mar. 15, 2013) (describing how upgrading industrial equipment can reduce emissions of the greenhouse gas methane).

64. *Sources of Greenhouse Gas Emissions*, *supra* note 62 (indicating that transportation and electricity production sources contributed 27% and 34% of GHG emissions in 2010, respectively).

65. Over half of the transportation-related GHG emissions come from passenger cars and light-duty trucks. *Transportation Sector Emissions*, EPA, http://www.epa.gov/climatechange/ghgemissions/sources/transportation.html (last visited Feb. 8, 2013).

66. *See generally* Reuven S. Avi-Yonah & David M. Uhlmann, *Combating Global Climate Change: Why a Carbon Tax Is a Better Response to Global Warming Than Cap and Trade*, 28 STAN. ENVTL. L.J. 3 (2009); Robert R. Nordhaus & Kyle W. Danish, *Assessing the Options for Designing a Mandatory U.S. Greenhouse Gas Reduction Program*, 32 B.C. ENVTL. AFF. L. REV. 97 (2005).

67. *See supra* Part II.D.

68. *See supra* Part II.D.

69. *See* I.R.C. § 965(b)(4) (West 2012).

required previously.[70] Additionally, the EDRIP should require companies to invest in specific categories of energy efficient or other environmentally beneficial capital improvements. Over the past decade, Congress has adopted several tax credits in an effort to incentivize energy efficient and environmentally desirable capital improvements and other behavior.[71] These credits have included very specific lists of eligible investments. The new EDRIP requirements, perhaps through supplemental guidance from the IRS, should include a similar specific list of eligible investment activity. The new EDRIP limitations on eligible investment should not overlap with existing credits, but should provide incentive to invest in other environmentally beneficial ways. Allowing investments for which the tax code already provides a credit to satisfy the EDRIP requirements would be duplicative. However, if Congress were to decide, based on evaluating the effects of existing credits and the proposed repatriation holiday, that certain investments are so worthy as to warrant both measures, then those investments should be included as a qualifying investment in the EDRIP requirements. Therefore, for any investment eligible for an investment credit,[72] the amount of such investment allowed to also be included in an EDRIP should be reduced by the amount of the credit. This would provide additional incentive for categories of investment that are deemed highly desirable and would also avoid duplicative benefits.

Congress has implemented measures aimed at modernizing the nation's production facilities in the past, including the investment tax credit.[73] Though largely repealed in 1986, the investment credit still applies in some form to investments in certain types of property, including property aimed at increasing energy efficiency.[74] As some of the credits currently exist to encourage environmentally beneficial investment, an exploration of the investment credit and its impacts is useful in examining any tax measures aimed at encouraging modernization and energy efficiency. Additionally, taking into account

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70. *Id.*

71. *See, e.g.*, *id.* § 30B (the alternative motor vehicle credit); *id.* § 45 (the renewable electricity production credit); *id.* § 45L (the energy efficient home credit); *id.* § 45M (the energy efficient appliance credit); *id.* § 48 (the energy credit).

72. *See infra* notes 73-87 and accompanying text.

73. *See* S. REP. NO. 87-1881, at 1 (1962). The investment credit was first enacted in 1962 and was aimed at encouraging investment and modernizing the production facilities of the United States. *Id.* at 10-11; Thomas W. Giegerich, *The Monetization of Business Tax Credits*, 12 FLA. TAX REV. 709, 720-21 (2012). Between 1962 and 1986, the investment credit was alternately expanded, suspended, repealed and reenacted based on the economic conditions and the whims of the legislature at the time until it was repealed by the Tax Reform Act of 1986. Giegerich, *supra.*

74. I.R.C. § 48; *see* Giegerich, *supra* note 73, at 721.

some of the energy efficient investment activities for which credits exist would be helpful in defining the qualifying EDRIP activities.

Currently, enacted investment tax credits are available for capital expenditures in many types of property and include the rehabilitation credit,[75] energy credit,[76] advanced coal project credit,[77] gasification project credit,[78] advanced energy project credit,[79] and the therapeutic discovery project credit.[80] Because this Comment proposes the inclusion of an EDRIP requirement focused on encouraging energy efficient investment, a brief exploration of the currently enacted energy tax credit is useful to serve as an example of the specific behaviors that could be included in the EDRIP requirements to incentivize energy efficiency.

The energy credit provides a tax credit of either 10% or 30% of the cost of the eligible energy property.[81] Energy property includes any equipment that uses solar energy,[82] equipment that produces, distributes, or uses energy from a geothermal deposit,[83] fuel cells or microturbines,[84] combined heat and power systems,[85] small wind energy property,[86] and property that uses the ground or groundwater as a thermal heat sink or energy source.[87]

These credits do not contain provisions requiring incremental investment[88] for eligibility. In the early 1990s, President Clinton supported measures to enact an incremental investment credit.[89] Though these measures were not enacted, many scholars analyzed the proposals and their potential benefits and administrative difficulties, and their analyses inform this discussion.[90]

An incremental investment tax credit differs from a regular or flat credit in that the amount of the credit is based on the amount of

75. I.R.C. § 47.
76. *Id.* § 48.
77. *Id.* § 48A.
78. *Id.* § 48B.
79. *Id.* § 48C.
80. *Id.* § 48D.
81. *Id.* § 48(a)(2)(A). The credit is 30% for qualifying fuel cell, solar, and small wind power property. *Id.* The credit is 10% for all other qualifying energy credit property. *Id.*
82. *Id.* § 48(a)(3)(A)(i)-(ii).
83. *Id.* § 48(a)(3)(A)(iii).
84. *Id.* § 48(a)(3)(A)(iv).
85. *Id.* § 48(a)(3)(A)(v).
86. *Id.* § 48(a)(3)(A)(vi).
87. *Id.* § 48(a)(3)(A)(vii).
88. *See infra* text accompanying notes 91-96.
89. Stephen R. Corrick & Martin A. Sullivan, *An Incremental Investment Tax Credit: Can It Deliver on Its Promise?*, 58 TAX NOTES 209, 210 (1993).
90. *See generally id.*; Jane G. Gravelle, *Incremental Tax Subsidies for Investment*, 55 TAX NOTES 1691 (1992).

qualifying capital expenditures that exceed a base amount, such as the average of qualified expenditures from an earlier period.[91] This means that flat credits kick in for the first dollar of qualifying investment activity, whereas an incremental credit would require that a taxpayer expend in excess of its historical average spending in qualifying investments to activate the credit. One of the most important advantages of an incremental tax credit as compared to a regular credit is that the incremental credit "has the potential to provide an investment incentive of the same order of magnitude as a regular investment tax credit, but at a fraction of the revenue cost."[92] However, an incremental credit is far more complicated and difficult to administer than a regular or flat credit.[93] Because an incremental credit employs a base period threshold, there is an increased accounting burden to document past qualifying investment over the base period.[94] Additionally, the incremental credit inherently excludes large populations of taxpayers who are unable or unwilling to make qualifying investments in the tax year in excess of the base period threshold, which leads to an undesirable lack of neutrality in the tax code.[95] However, many tax provisions currently exist that are nonneutral and encourage specific behaviors over others.[96]

IV. REMEDIATING THE FAILURES OF § 965 TO ENSURE THE ENVIRONMENTAL AND ECONOMIC BENEFITS

As discussed, Congress authorized a repatriation holiday with the inclusion of § 965 in the Jobs Act, which triggered substantial repatriation activity but did not incentivize the desired domestic investment or trigger the job growth that Congress had intended.[97] Why, then, should we even consider reenacting a provision that failed to achieve its stated goals? This Part argues that, in addition to the inclusion of environmentally specific investment requirements, the shortcomings that contributed to the failures during the last repatriation holiday can be remedied to help ensure that the goals of the provision are accomplished.

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91. Corrick & Sullivan, *supra* note 89, at 212.
92. *Id.* at 210.
93. *See id.* at 211.
94. *Id.*
95. *Id.*
96. For example, home ownership is rewarded more than renting by the mortgage interest deduction. Viral V. Acharya et al., Op-Ed., *White Picket Fence? Not So Fast*, N.Y. TIMES, Aug. 17, 2011, at A23.
97. *See supra* Part II.C.

Based on § 965's failure to incrementally increase domestic investment, employment, or research and development, reenacting a similar provision would require some important changes. First, the DRIP requirements must be revised to be much more specific, limiting qualifying investments to a narrow class of environmentally beneficial investment activities, as discussed above.[98] Second, to encourage incremental investment activity, eligibility for favorable tax treatment must be dependent on qualifying investment in excess of average historical investment over a base period. Third, a tracing requirement should be included to ensure that repatriated earnings are in fact put towards acceptable incremental reinvestment activities. This Part also includes a brief discussion of the possible effects of these proposed limitations.

A. *Including an Incremental Investment Requirement*

In addition to more narrow and targeted EDRIP requirements, the new repatriation holiday should include a requirement that investment be higher than the company's average historical investment in the same categories over a specified base period. Similar to the requirement included in § 965, that repatriated income exceed historical average repatriations over a five-year base period[99] in order to incentivize CFCs to repatriate income that likely would not have been repatriated but for the holiday, an incremental requirement based on the eligible EDRIP investment would allow only excess investment to be taxed at the reduced rate and, therefore, likely succeed in promoting the economic goals of § 965 as originally intended.[100] In addition to the economic goals, incremental investment in environmentally desirable or energy efficient capital improvements will likely achieve the goal of improving energy efficiency and reducing GHG emissions.[101] The definition of the base period in an incremental tax expenditure is the most important feature of the provision.[102] The baseline should be established by evaluating historical qualifying investment based on the EDRIP criteria. By setting taxpayer-specific baselines calculated from historical spending, the

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98. *See supra* Part III.

99. *See* I.R.C. § 965(b)(2), (c)(2) (West 2012). The base period calculates average historical repatriations over three of the past five years, disregarding the two years in which the taxpayer repatriated its highest and lowest amounts. *Id.* § 965(c)(2).

100. *See id.* § 965(b)(2); Corrick & Sullivan, *supra* note 89; Gravelle, *supra* note 90; *supra* Part II.C.

101. *See* Nadel & Elliott, *supra* note 61, at 1-3; *Methane Emissions*, *supra* note 63.

102. Corrick & Sullivan, *supra* note 89, at 212 (discussing incremental investment tax credits as opposed to a tax deduction based on incremental qualifying activity).

provision would more likely ensure that each participant in the holiday commits to meaningful investments that will increase energy efficiency and decrease GHG emissions. Based on prior criticisms of previously proposed incremental investment incentives, controls should be included to avoid potential administrative pitfalls and loopholes in the base period requirement.[103]

B. Including a Tracing Requirement

A reenacted repatriation holiday should also include a tracing requirement to discourage corporations from using repatriated income for nonqualifying investments or financing activities. Several potential difficulties exist in regards to the inclusion of a tracing requirement. First, tracing requirements associated with other tax provisions have proven burdensome and difficult to administer. Second, a tracing requirement presents issues having to do with the timing of repatriations and qualifying reinvestment that would require additional consideration of the specifics of the EDRIP limitations, including the length of time over which the qualifying investments could take place.

Tracing requirements add complexity and administrative difficulty to a tax provision. Since 1986, the interest deduction has included a tracing requirement.[104] In general, interest expense is deductible based on whether the loan proceeds that cause the incurrence of interest expense are used for an allowable purpose.[105] This requirement forces taxpayers in most cases to trace the use of loan proceeds in order to demonstrate the deductibility of associated interest expenses. The tracing rules present difficulties for the taxpayer when loan proceeds are commingled with other funds or used for different purposes, particularly when the multipurpose use is for both deductible and nondeductible expenditures.[106] Complex allocations must be performed to trace the use of loan proceeds and to determine the proper treatment of associated interest for tax purposes.[107]

When § 965 was previously enacted, DRIPs often involved investments that stretched over multiple years.[108] Though any reenactment of a repatriation holiday with reinvestment requirements undoubtedly needs

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103. *See generally id.*; Gravelle, *supra* note 90, at 1693.
104. *See generally* I.R.C. § 163; Treas. Reg., 26 C.F.R. § 1.163-8T (2012).
105. *See id.* § 1.163-8T(a)(3).
106. *See generally* Martin J. McMahon Jr., *Simplifying the Interest Deduction for Individual Taxpayers*, 91 TAX NOTES 1371 (2001).
107. *Id.* at 1372-76.
108. *See* Mock & Simon, *supra* note 20, at 845.

to allow investments in projects that span more than one year, such long-term investments present additional questions and difficulties for designing and implementing a tracing requirement. Would the EDRIP requirements include a limitation on the eligible time period for completing EDRIP investments? If, as in the interest tracing rules, taxpayers are required to trace the use of repatriated funds to eligible EDRIP expenditures, at what point in the investment process are funds "used?" That is, does the money have to actually be spent, or will a binding commitment suffice? Would amendments to EDRIPs be allowed, and if so, how will corporations be required to document that actual investments meet the EDRIP requirements? Additionally, if qualifying funds are not put to qualifying use in later years, how will the past beneficial tax treatment be rectified?

As applied to a repatriation tax holiday, a tracing requirement will undoubtedly present challenges in the form of both administrative burdens and difficulties in identifying qualifying EDRIP investments. These burdens and difficulties must be balanced against possible gains in order to ensure the beneficial economic and environmental investment effects.

C. *Potential Effects of Remediating § 965*

The proposed limitations on a reenacted repatriation tax holiday outlined above could discourage corporations from repatriating income to the levels seen with the original § 965 in the mid-2000s. Some corporations might be hard-pressed to find enough qualifying investment opportunities based on the narrower EDRIP requirement to participate in the holiday. Others may have made such large investments in qualifying activities in prior years that their base period average investment prevents them from participating. Still others may not be willing to invest in the United States for other unrelated reasons that outweigh the benefit of reduced repatriation tax rates. Though some of this dampening effect is unavoidable due to heightened limitations and administrative burdens on taxpayers, the possibility of actually achieving the desired increase in domestic investment, along with the environmental benefits, is arguably worth the potentially diminished tax revenues as compared to the original participation in the § 965 holiday.

Some tax scholars have contended that temporary repatriation holidays have failed to incrementally improve domestic employment, investment, or research and development because the economic and tax environment in the United States is less competitive generally than in other countries.[109] High tax rates here affect future long-term strategic decisions of firms, often steering U.S-based multinational corporations to look elsewhere for investment opportunities.[110] Either a territorial tax overhaul or a decrease in corporate tax rates could be necessary to properly incentivize investment here without temporarily distorting incentives.[111] That is, even with a repatriation tax holiday, corporations may be unlikely to invest in a jurisdiction with a less favorable tax system and higher costs of manufacturing.[112] However, decreases in the cost of natural gas and other fuel sources combined with other nontax conditions could make the United States a more attractive economic environment for manufacturing in the future.[113] These economic counterbalances may lead companies to participate in a repatriation holiday with more strict investment requirements and therefore would impact the success of the measure.

V. WHY THE TAX CODE?

In this legislative and economic environment, any changes in tax policy likely must be at least revenue-neutral (and more likely revenue-generating) for there to be any hope of a measure being passed. They also likely must have some positive economic outcome—such as job creation.[114] This makes typical measures to mandate environmental standards or incentivize environmentally desirable behavior much more difficult. This Part briefly examines the concept of tax expenditures and their associated costs. Additionally, it contrasts some of the possible impacts of the proposed reenactment of the repatriation holiday with other legislative programs.

Attempts to incentivize certain behavior through beneficial tax treatment are often classified as tax expenditures.[115] Tax expenditures are "revenue losses attributable to provisions of the Federal tax laws which

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109. *See* Pinson & Shanley, *supra* note 29, at 851. *See generally* Conrad de Aenlle, *The Push To Trim Corporate Tax Rates*, N.Y. TIMES, Feb. 13, 2011, at I2 (discussing the implications of having one of the highest corporate effective tax rates in the world).

110. Pinson & Shanley, *supra* note 29, at 851.

111. *Id.*

112. *Id.*

113. *See* Nadel & Elliott, *supra* note 61, at 1.

114. *See* Michael A. Fletcher & Jia Lynn Yang, *A Push To Bring Foreign Profits Home: $1 Trillion To Recoup*, WASH. POST, Sept. 25, 2010, at A8 (noting that many of the tax policies of the Obama administration have faced criticism as being antibusiness).

115. Rosanne Altshuler & Robert Dietz, *Reconsidering Tax Expenditure Estimation*, 64 NAT'L TAX J. 459, 459-61 (2011) (defining tax expenditures); *see* Roberta F. Mann, *Back to the Future: Recommendations and Predictions for Greener Tax Policy*, 88 OR. L. REV. 355, 358-60 (2009).

allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."[116] A repatriation holiday likely fits within this definition as a deduction that provides a preferential rate of tax; however, determining whether a provision is a tax expenditure requires a more thorough analysis.[117] Analysis and measurement of the costs and impacts of tax expenditures are complex and dependent on several inputs, including the baseline from which the "normal" treatment is derived, tax rates, and changes in tax laws.[118] Through a highly simplified tax expenditure analysis of § 965 as previously enacted, the provision could be said to have cost upwards of $94 billion in lost revenue.[119] This assumes, however, that the repatriated amounts would have been repatriated in the same tax year even absent the § 965 holiday, which has been shown to be unlikely.[120] The lost revenue is not the only cost consideration for a tax expenditure. Tax expenditures also impose administrative costs on corporations and the IRS as well as economic efficiency costs due to the altered economic behaviors of participants.[121]

Many contend that environmental concerns, particularly those related to climate change, are important enough to require stronger mandates for reducing GHG emissions.[122] There is a longstanding policy debate amongst environmental law scholars regarding the enactment of command-and-control legislation versus the incentivization of behavior through various incentive or subsidy programs to address pollution and other environmental issues.[123] The proposed reenactment of a repatriation tax holiday is merely a temporary incentive and does not require any GHG emitters to reduce emissions. A carbon tax system could create a strong incentive to reduce GHG emissions and also encourage

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116. Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93-344, § 3(a)(3), 88 Stat. 297, 299.

117. At least one scholar has viewed § 965 as being more like a tax amnesty. *See* Boise, *supra* note 15.

118. THOMAS L. HUNGERFORD, CONG. RESEARCH SERV., RL34622, TAX EXPENDITURES AND THE FEDERAL BUDGET 5-7 (2011); *see* Altshuler & Dietz, *supra* note 115, at 462-80.

119. Assuming the highest corporate tax rate of 35%, $315 billion in repatriations would normally have led to approximately $110 billion of income tax. Under the holiday, the repatriations led to approximately $16 billion of tax revenues.

120. *See* MARPLES & GRAVELLE, *supra* note 42, at 4.

121. *See* Eric T. Laity, *The Corporation as Administrative Agency: Tax Expenditures and Institutional Design*, 28 VA. TAX REV. 411, 424-25, 428 (2008).

122. *See, e.g.*, Avi-Yonah & Uhlmann, *supra* note 66.

123. *See* David M. Driesen, *Is Emissions Trading an Economic Incentive Program?: Replacing the Command and Control/Economic Incentive Dichotomy*, 55 WASH. & LEE L. REV. 289, 290-91 (1998).

continuous improvement in emissions while the tax is in force.[124] Command-and-control legislation and broad emissions systems like cap-and-trade would include more of a mandate to reduce GHG emissions. Therefore, a cap-and-trade system could have a much more significant impact on lowering GHG emissions and has potential support from liberals, conservatives, environmentalists, and corporate interests alike.[125] However, federal legislators have not passed a cap-and-trade system despite the support for one over the past decade. The proposed repatriation holiday is not a substitute for broad GHG regulation, irrespective of the form of such regulation. The value in such a proposal is the combination of possible environmental benefits through energy efficiency and decreased GHG emissions, increased revenues for the treasury, and direct financial benefits for corporations.

Additionally, scholars have identified and supported measures that attempt to "green" the tax code.[126] The National Academy of Sciences is working on a carbon audit of the tax code, as mandated by the Energy Improvement and Extension Act of 2008, which is expected to be released soon.[127] Enacting a provision to incentivize energy efficient or environmentally desirable investment through a repatriation holiday is another step toward "greening" the tax code.

VI. CONCLUSION

The repatriation tax holiday included in the Jobs Act encouraged significant dividend repatriations but served more as a gift to large multinational corporations because it allowed them to engage in significant share repurchases as opposed to creating jobs or stimulating the economy. By learning from what contributed to the failure of § 965 to achieve its domestic reinvestment goals, Congress can amend the provision to protect against similar failure in the future. Additionally, by including requirements that the repatriated earnings be incrementally invested in energy efficient or environmentally desirable capital expenditures, a newly reenacted holiday could help reduce industrial GHG emissions. In the absence of wholesale cap-and-trade or carbon

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124. *Id.* at 339-42.

125. Avi-Yonah & Uhlmann, *supra* note 66, at 4-6.

126. *See* Mann, *supra* note 115, at 356-58 (citing CRAIG HANSON & DAVID SANDALOW, THE BROOKINGS INST. & WORLD RES. INST., GREENING THE TAX CODE 1 (2006), *available at* http://pdf.wri.org/greening_the_tax_code.pdf).

127. Energy Improvement and Extension Act of 2008, Pub. L. No. 110-343, Div. B, § 117, 122 Stat. 3807, 3831; *see* Mann, *supra* note 115, at 356-58; Bill Becker, *We Need To De-Carbonize Our Tax System*, THINKPROGRESS (Oct. 30, 2012, 3:30 PM), http://thinkprogress.org/climate/2012/10/30/1099391/we-need-to-de-carbonize-our-tax-system/.

tax legislation to regulate climate-change-causing GHGs or an overhaul of the corporate tax system, a repatriation tax holiday with an environmental requirement is a step in the right direction. In this highly partisan and obstructionist political climate, unconventional approaches and small-scale efforts to regulate GHGs are required to advance the fight against climate change.