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Income Taxation of Corporations in the United States

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Income Taxation of Large Corporations in the U.S.

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Introduction

Taxes affect everyone. Public infrastructure, education, healthcare, social security, public safety, and national defense are just some of the services provided for U.S. Citizens and residents through tax revenue. As taxes pay for these services, it is often a topic of discussion in the media. Though there are varying opinions about taxes and our tax system, there is one quote from Benjamin Franklin that everyone can agree upon: "Our new Constitution is now established, everything seems to promise it will be durable; but, in this world, nothing is certain except death and taxes."

While Franklin's statement about death and taxes continues to hold true for many Americans, one "person(s)" that has been able to avoid taxes, and in some cases, death itself, is the U.S. corporate entity. This paper analyzes three key questions addressing corporate tax avoidance: How are companies avoiding taxes, why has the U.S. government not put a stop to corporate income tax avoidance, and what can be done to ensure corporations are paying their fair share of income tax in the future?

The first piece of this paper is designed to lay the foundation for the subsequent discussions of how companies avoid paying tax and possible solutions. Additionally, it will provide both background and clarification for a system that many refer to as complex and confusing. The topics are divided into eight parts to provide clarification: Tax avoidance vs. tax evasion, marginal tax rates, employment taxes, international tax issues, tax treaties, structuring, case examples, and the amount of money the U.S. has lost from corporate income tax avoidance.

Literature Review

Tax Avoidance vs. Tax Evasion

Former UK chancellor of the Exchequer (head of the U.K. treasury) once said, "The difference between tax avoidance and tax evasion is the thickness of the prison walls." While tax avoidance is legal, tax evasion is not and can result in penalties and prison if the evasion is egregious enough. This analogy for the difference between avoidance and evasion is one that seems simple, but it is often complex. The difference between avoidance and evasion tows a fine line and is up to our government to decide what is classified as evasion and avoidance.

The Internal Revenue Manuel (IRM), which is a guide provided by the government for U.S. taxpayers, provides definitions of avoidance and evasion. IRM § 25.1.1.3.3 states that avoidance of tax is not a criminal offense. Taxpayers have the right to reduce, avoid, or minimize their taxes by legitimate means. Evasion on the other hand involves affirmative acts to evade or defeat a tax, or payment of tax. Examples of affirmative acts are deceit, subterfuge, camouflage, concealment, attempts to color or obscure events, or make things seem other than they are. This is how the U.S. government defines avoidance vs. evasion, and one thing is clear through this definition. Affirmative acts or intent is the main driving point by the government of defining avoidance vs. evasion.

Research from the "Journal of Economic Behavior & Organization" shows that the more money one pays to avoid taxes, the less likely one will be considered a tax evader by the government.[1] When one spends money to avoid paying taxes, they are often paying tax

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[1] Gamannossi, Duccio and Levaggi, Rosella and Menoncin, Francesco, Tax avoidance and evasion in a dynamic setting, Journal of Economic Behavior & Organization, Pages 443-456, December 2022

professionals, lawyers, or lobbyists who understand how to lower tax liabilities in a legal way. These professionals are not cheap. Though tax avoidance is legal, it is still questioned ethically[2]. People continue to question how companies lower their tax rate and why they do not pay heavily in taxes. Companies do face backlash from the public at times for tax avoidance practice because of this, however, tax avoidance will continue to be used unless there are changes in how the government defines avoidance and evasion.

Marginal Tax Rates

A marginal tax rate is the rate one pays on their highest dollar of income. For U.S. taxpayers, this rate increases as taxable income increases. This makes the U.S. tax structure a progressive one. Throughout the last four decades there has been a shift to lower marginal tax rates worldwide. Economic analyses from East Asia, Ireland, Russia, and India show economic growth from lower marginal tax rates.[3] In 1980 the average worldwide corporate marginal tax rate for the highest income earners was 40.11 percent, however, this number has decreased to 23.37 percent in 2022.[4] Currently the U.S. marginal tax rate for corporations in the U.S. is set at a flat rate of 21 percent. This rate was enacted in the 2017 Tax Cuts and Jobs Act or TCJA. Before TCJA, the corporate tax rate was a progressive structure based on the actual amount of taxable income. The first $50,000 of income was subject to a 15% tax rate and this continually increased up to 35% for any income over $10,000,000. See figure 1 below for full details.

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[2] Hall, Kenneth S., The Ethics of Tax Avoidance and Tax Evasion, 2015
[3] Reynolds, Alan, Marginal Tax Rates, Economic History, Government Policy, Taxes, March 2008
[4] Enache, Christina, Corporate Tax Rates around the World, 2022, Tax Foundation, December 2022

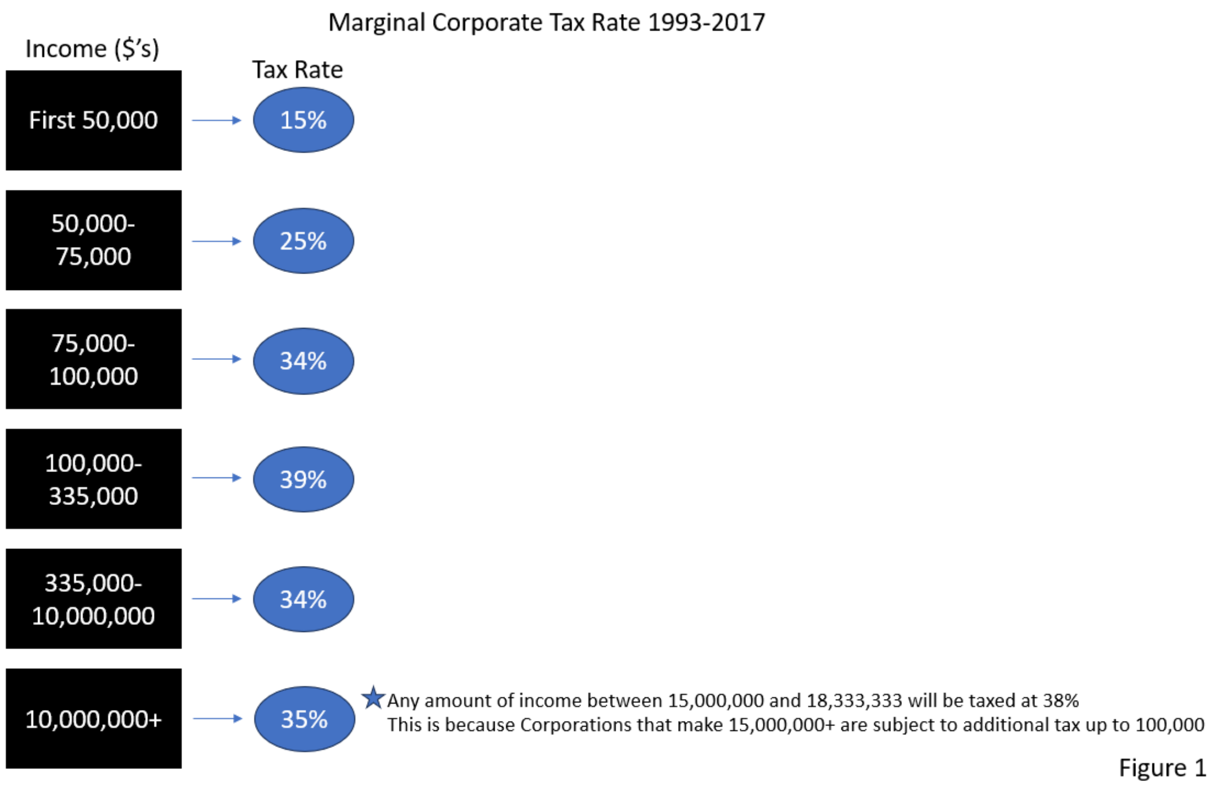

Figure 1

Even though marginal tax rates are decreasing worldwide, it is important to note that the marginal tax rate is not the actual rate corporations pay on their income.

The effective tax rate is the percentage of tax a corporation actually pays on their income. Corporations can lower their effective tax rate through tax avoidance strategies. In some cases, as shown in the research in this paper, the effective tax rate of corporations can be as low as 0 percent.

Since the real measure of revenue generated is the effective tax rate, it is important to ask whether increasing or reducing marginal tax rates for corporations actually helps increase tax revenue, or if there is another solution that should be considered to make sure corporations are paying their fair share of income tax. The research in this paper compares the effective tax rate before TCJA when the marginal tax was higher, and after TCJA when it has been lowered to a flat rate. Considering that marginal tax rates are continuously discussed by politicians and citizens alike, the research that has been done is important to show if shifting corporate marginal tax rates impacts the amount of tax corporations pay.

Employment Taxes

Corporations do pay taxes other than income and one form of tax they pay heavily is employment tax. Employment taxes date back to 1935 with the Federal Insurance Contribution act or FICA, which was the start of Social Security. The government first began to collect FICA payroll taxes in 1937 and in 1939 they further added the Federal Unemployment Tax Act or FUTA, which was set as unemployment insurance for those who lost their jobs. Since the first FICA tax of Social Security in 1935, an additional Medicare tax was also added in 1965.[5] These taxes have continuously increased since their founding and the U.S. has become increasingly reliant on these payments. For example, in 2009 payroll taxes accounted for more than six times that of the rest of the tax revenue of the federal government.[6] It is important to know the distinction between these taxes as it will allow us to compare how much employment tax is paid by employees and employers.

IRS Publication 15, (Circular E), Employer's Tax Guide shows that social security is taxed at a rate of 6.2% for employers and 6.2% for employees depending on the wage of the employee. There is one stipulation with Social Security tax and that is the maximum amount of wage that can be taxed is $160,200 for 2023. It should be noted that employers usually withhold the 6.2% of tax on wages owed by employees and pay these taxes over to the IRS on behalf of

[5] NCPSSM, History of the Federal Income Contribution Act (FICA), August 2021
[6] Hur, Johnson, History of Payroll Taxes, BeBusinessed, 2019

the employee. This burden is taken on by the employer, and thereby removes the administrative burden for the employee.

IRS Publication 15, (Circular E), Employer's Tax Guide also shows how Medicare is taxed. Medicare is taxed at a rate of 1.45% for employers and 1.45% for employees depending on the wage of the employee. There is an additional Medicare Tax for employees who earn over $200,000 a year. This additional tax is only paid by the employee. As with the employee's portion of Social Security, the employer takes on the burden of withholding and paying over the employee's share.

Unemployment taxes are levied at both the federal and state level. I.R.C. § 3301 provides that Federal unemployment tax is at a flat rate of 6% for the first $7,000 of wages paid to an employee. This 6% is only paid by the employer and the rate can be reduced to 0.6% if the employer also paid state unemployment taxes I.R.C. § 3305. This is to prevent double taxation for businesses as some states require unemployment tax payments, while others do not. As this is the case, total employment tax remains at around a total of 6% when accounting for both federal and state unemployment taxes together.

According to the U.S. fiscal projections, the U.S. government has estimated tax revenue from employment taxes of $4.71 trillion for 2023. Of the $4.71 trillion, $1.1 trillion will come from Social Security Tax, $342 billion will come from Medicare tax, and $55 billion will come from Federal unemployment tax. Considering at least half of Medicare and Social Security Tax will come from employees, it is calculated that businesses are projected to pay $776 billion in federal employment taxes for 2023. This will account for 16.5% of U.S. revenue in 2023.

International Issue

Before discussing how U.S. corporations structure transactions to avoid tax, it is first important to understand the uniqueness of the U.S. tax system in terms of taxation for income earned abroad.

Before the 2017 TCJA, the U.S. operated on a worldwide tax system. This is unique because only four other countries operate on a worldwide tax system. These countries are Chile, Israel, Korea, and Mexico.[7] A worldwide tax system is a system in which corporations are required to pay U.S. income taxes on profits earned overseas. This would apply to any income that was not taxed at the previous highest U.S. tax rate for corporations of 35%.[8] For example, if a corporation was taxed at 20% in another country, they would be taxed an additional 15% when income was brought back to the U.S. This system discouraged corporations from bringing foreign income back to the U.S. because they did not want to pay additional taxes on foreign income. The other tax system used is a territorial system. A territorial system does not tax profits abroad. Instead, corporations pay taxes only in the jurisdiction of operation. The current U.S. tax system is a mix between territorial and a worldwide system.[9]

The current system is territorial for tangible assets. This includes assets such as property, plant, and equipment. When corporations make profits from these assets, they are not taxed on profits when returning money to the U.S. For example, if a corporation were to open a factory in Vietnam, they would not be taxed in the U.S. on the profits made from producing products there.

[7] Tax Foundation, Worldwide Tax System, Tax EDU, October 2021
[8] Bunn, Daniel, U.S. Cross-border Tax Reform and the Cautionary Tale of GILTI, Tax Foundation, February 2021
[9] Tax Policy Center Briefing Book, Key Elements of the U.S. Tax System, What is a territorial tax and does the United States have one now?, May 2022

This incentivizes companies to contract production of physical products internationally.

The new system is a worldwide system for intangible assets. This includes assets such as patents, trademarks, copyrights, and trade secrets. When corporations make profits from these assets, they are taxed on profits when returning money to the U.S. This tax is the tax on global intangible low-taxed income or GILTI. Currently the tax on GILTI ranges from 10.5% to 13.125%.[10] The goal of this tax is to incentivize companies to bring foreign profits earned on intangible assets back to the U.S. This is why this tax rate is lower than the current U.S. corporate tax rate of 21%.

Along with the tax on GILTI, Subpart F income is also taxed. Subpart F income is defined as passive income U.S. citizens make from pro rata shares of controlled foreign corporations. Controlled foreign corporations are defined as non-U.S. corporations in which 50% of the voting stock is owned by U.S. citizens. I.R.C. § 952. Whether or not profits from these corporations are brought back, taxes will still be levied at the ordinary U.S. income tax rate for royalties, interest, dividends, rent, and annuities held abroad.

These two foreign tax law adjustments made under the 2017 TCJA changed how corporations are taxed on foreign income. To transition to this new system, the TCJA also allowed for a one-time 15.5% repatriation tax on cash held abroad. There was also an 8% tax on illiquid assets brought back to the U.S.[11] This was done to incentivize companies to bring cash and other assets that was sitting abroad back to the U.S.

[10] Tax Foundation, Global Intangible Low-Taxed Income (GILTI), TaxEDU, December 2021
[11] Tax Foundation, Reptatriation, TaxEDU, November 2023

The incentives given to corporations to bring money back to the U.S. are clear to see under the TCJA. To do this, the overall U.S. corporate tax rate was decreased. This is shown through the low tax rates on GILTI and the one-time repatriation tax. It could be argued that this system was put into place to bring U.S. in conformity with other countries. The previous U.S. tax system taxed corporations at a rate much higher than other countries. The world average corporate tax rate in 2022 was 23.37%. Comparing this to the previously highest 35% rate of which corporations were taxed; it seems reasonable to lower the tax rate. Though this is a valid point, there are countries where the corporate tax rate is substantially less than the world average. There are even some countries that have no corporate tax. [12] Countries that have a corporate tax rate substantially less than the world average, or no corporate tax are often referred to as tax havens.

Structuring

The Congressional Research, which is a public policy research institute of the United States Congress had this to say on tax havens, “There is no precise definition of a tax haven. The OECD initially defined the following features of tax havens: no or low taxes, lack of effective exchange of information, lack of transparency, and no requirement of substantial activity.”[13] The OECD or Organization for Economic Cooperation and Development is a global organization comprising of 38 countries that is committed helping the world economy through equality, opportunity, and well-being for all.[14] The OECD has brought up the use of tax havens as an

[12] Enache, Cristina, Corporate Income Tax Rates around the World, 2022, Tax Foundation, December 2022
[13] Gravelle, Jane G., Tax Havens: International Tax Avoidance and Evasion, Congressional Research Service, January 2022
[14] Bardoloi, Yashvardhan, What is the OECD, and what does it do?, February 2018

argument that double taxation is necessary, as in some countries, corporations can pay little or even no income tax.

A counter argument to this would be that corporations should not be penalized for acting in a jurisdiction where tax rates are low because they are required to do business in these areas. This could be because of the production capability of the country or because there are certain resources available in the country that are not available elsewhere. While this point is one that could be argued, in different cases, we see how companies structure their business in tax havens to avoid paying taxes. Structuring in tax havens is something we see internationally, as well as, in the U.S., which is why it is important to examine how companies' structure to avoid paying taxes.

Companies will often structure their business around tax havens to reduce their tax liability. Companies can do this in a variety of ways, and one of these ways is known as transfer pricing.

I.R.C. § 482 refers to transfer pricing as the practice of pricing transactions between and within enterprises under common ownership and control. Simply put, transfer pricing involves the use of related business transactions within the same company for a set price. The company often sets these prices, and this is where the avoidance strategy lies. Take the scenario portrayed in the next two paragraphs as an example of transfer pricing in action.

A company operates in the U.S., but has subsidiary companies in Brazil, Ireland, and Germany which produce and sell products to the public. The marginal tax rates for these countries are as follows: Brazil 34%, Ireland 12.5%, and Germany 21.5%. As Ireland has the lowest tax rate, the company wants to funnel profits through Ireland.

The company will do this by using transfer pricing. In this scenario, Brazil produces a product at $10 and sells it to another subsidiary in Ireland for $12. Ireland then spends $3 to finalize production and sells it to the subsidiary in Germany for $45. The German subsidiary then sells to the public at $48. In this scenario, $2 of income is taxed in Brazil, $30 of income is taxed in Ireland, and $3 of income is taxed in Germany. This leads to a total income tax of $5.08 for the company, which is only a total effective tax rate of 14.5% based on the total profit of $35. See figure 3 below for a visual example of the scenario.

Transfer Pricing Example

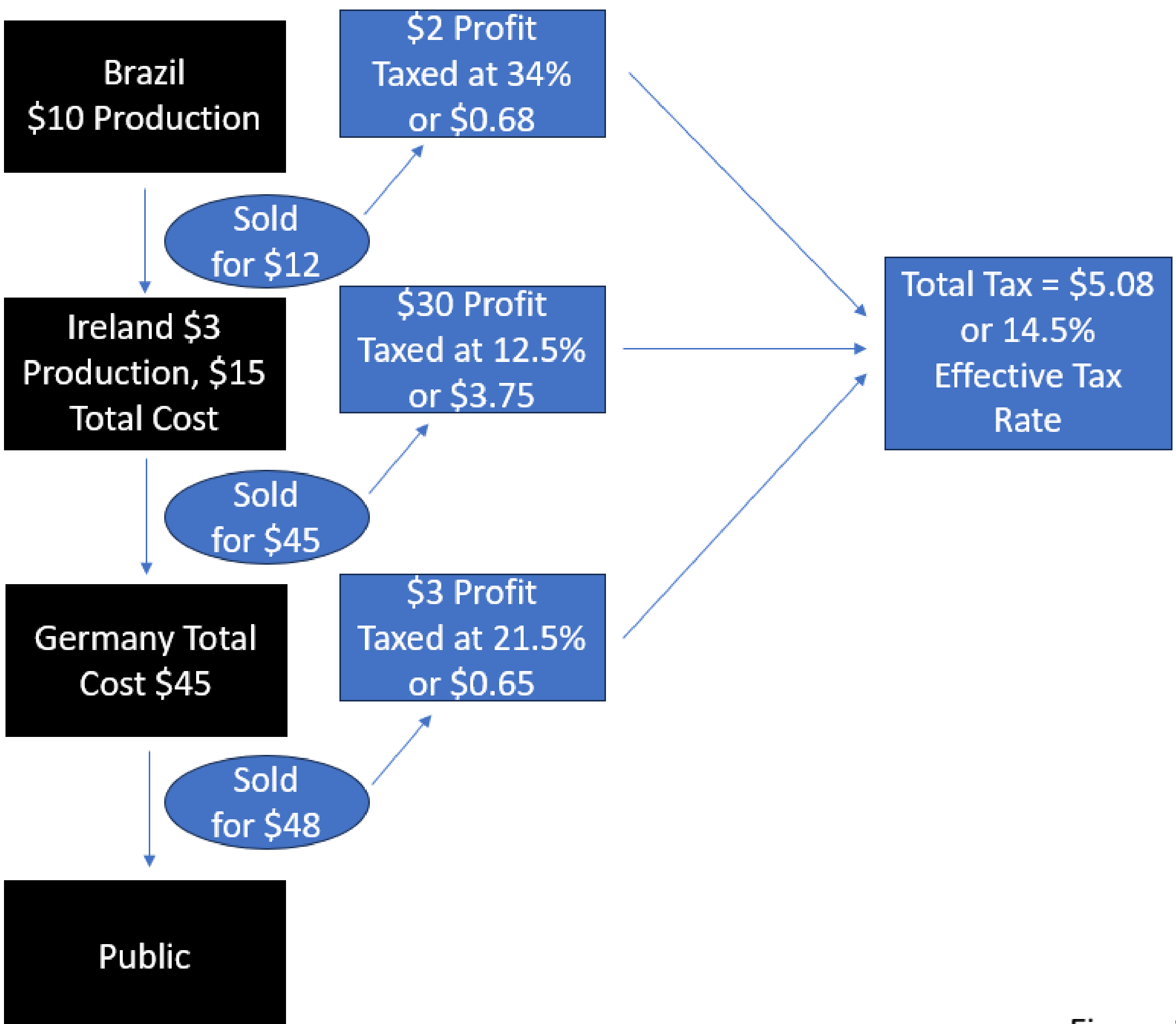

Figure 3

This is one example of transfer pricing and shows how corporations' structure in tax havens to avoid paying taxes on income earned abroad. Considering the corporation can then repatriate the income back to the U.S. at no cost because of the DRD law referenced earlier, it gives reasons for why the OECD continues to bring up the issue of tax havens. The example above shows how corporations' structure to avoid taxes through countries that have low tax rates. Countries often have incentives to lower tax rates for large corporations.

Tax havens are usually smaller countries and gain revenue they would've otherwise not received through allowing corporations to operate in their country at low tax rates. Tax revenue from these corporations can often make up large portions of a smaller country's GDP, though it would be a drop in the bucket for a larger country.[15] Drops may not be noticed by a larger country at first, but when the bucket begins to leak, we see countries begin to raise concerns.

Specific Cases

The United States and the European Union have questioned the use of tax havens by large corporations in recent years based on tax avoidance vs. tax evasion. These jurisdictions have claimed that some large corporations have evaded taxes through structuring in tax havens. One example can be seen through a court hearing in the United States over Microsoft's use of Puerto Rico to shift profits.

In 2012, the IRS launched the largest audit in history and accused Microsoft of structuring to avoid taxes through selling their intellectual property in 2005 to a Puerto Rican owned facility. Intellectual property is the patents, trademarks, copyrights, and trade secrets a company owns. Though these are the official names of intellectual property, Michael A. Mann,

[15] Palan, Ronen and Murphy, Richard and Chavagneux, Christian, Tax Havens: How Globalization Really Works, 2010

an intellectual property attorney, defines intellectual property as "know-how, message, innovation, and reputation". Know-how is the training and workforce of a company that makes it succeed. Message is the content and information a company knows conveys, like the knowledge of their market and how they should advertise. Innovation is what a company has that is unique that is better than someone else's product, whether it be price or quality. Finally, reputation is what a company has built up to earn respect for their name, which in term makes their product or service worth more. Each of these intellectual properties make up every business, and Mann suggests that studies show 80% of the value of a typical business is intellectual property.[16] As such, Microsoft had the incentive and motive to structure to avoid paying taxes.

To avoid paying taxes, Microsoft sold Microsoft Office and Windows to a Puerto Rican owned subsidiary. In 2022, Microsoft Office and Windows accounted for $69.7 billion in revenue for Microsoft.[17] As the Puerto Rican subsidiary "owned" the rights to Microsoft Office and Windows, every sale of either service went through Puerto Rico where they burned the software onto CDs to account for sales. Since Microsoft had a deal with the Puerto Rican government, they paid taxes at a rate that was virtually 0%.[18]

The IRS audited the transaction Microsoft made with its subsidiary in Puerto Rico under suspicion that the transaction was not made at arms-length. IRC § 482 states that an arms-length transaction is an agreement made by two uncontrolled parties freely and independently of each other, and if the two parties are related, the transfer price of the item must be a controlled transaction. A controlled transaction as defined in IRC § 482 is any transaction that if occurred

[16] Mann, Michael A., Intellectual property is 80% of the value of a business, July 2011
[17] Franek, Kamil, Microsoft Revenue Breakdown by Product, Segment, and Country, 2023
[18] Kiel, Paul, How a Maneuver in Puerto Rico Led to a $29 Billion Tax Bill for Microsoft, ProPublica, October 2023

on the open market with unrelated parties, would be the same price as the transaction between related parties.

The IRS concluded that the software rights sold to the Puerto Rican subsidiary were well-below market price, thus not meeting the controlled transaction requirement, and in turn evading billions of dollars in taxes. On October 11, 2023, the IRS handed down a bill of $28.9 billion to Microsoft due to tax evasion as a result of the transaction.[19] Microsoft does not agree, and a legal battle is set to ensue between the IRS and Microsoft in the foreseeable future. Though it seems as if it is just a battle between the IRS and Microsoft, it is also a battle to stop companies from using tax havens. Other corporations are sure to linger in the background wondering if they are next.

Though this example shows the U.S. coming for tax havens, there are examples abroad of countries coming for tax havens as well. One example of this is the European Union's investigation into Apple's tax practices in Ireland.

On August 29, 2016, after a two-year investigation, the European Commission, which is the principal executive body of the European Union, ruled that Ireland granted illegal tax benefits to Apple from 2003-2014 that allowed them to drop their tax rate in the country to as low as 0.005% by 2014. The European Union ordered them to pay €13 billion plus penalties due to unpaid taxes from 2004-14.[20]

Apple was able to funnel profits through Ireland through manufacturing, even though a majority of Apple products are assembled in China and Vietnam. Apple would assemble, but not

[19] Salmon, Felix, Why Microsoft owes the IRS $29 billion in taxes, Axios, October 2023
[20] Moscaritolo, Angela, EU: Ireland Gave Apple $14.5B in Illegal Tax Benefits, August 2016

completely manufacture products in China and Vietnam and transfer them to Ireland at low profits. Ireland would then finish production of the products in their Cork manufacturing plant before selling the products to Apple Stores across Europe at a substantial profit, leaving little to no profit for the retail stores selling the products. Apple would do this to funnel almost all of the profits in Europe through Ireland where they had a "sweetheart" deal with the Irish government that allowed them to have virtually no income tax due to the importance of the company's operations in the country.[21] Considering Apple employs 6,000 employees in Ireland, which is second only to Google, it is easy to see why Ireland would give a tax break to Apple. They bring in jobs, and jobs bring in employment and income tax from wages.

The European Union asserts that the practices Ireland and Apple are legal and ordered Apple to pay $14.5 billion plus penalties in back taxes. The EU stated that the deal was illegal under competition rules in the EU that protect free competition. By having a tax deal that was different than other companies received, Apple therefore had an unfair advantage under EU law.[22] Apple disagreed with the EU's assessment and took them to court.

In July of 2020, the EU's general court rejected the order that Apple would have to pay the $14.5 billion in back taxes as the European Commission "did not succeed" in proving that Apple had been given special treatment by Ireland.[23] The EU has appealed the decision and it is set to go to the European Union's highest court in early 2024.[24]

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[21] Holtzblatt, Mark A., Geekie, John, Tschakert, Norbert, Should U.S. and Global Regulators Take a Bigger Tax Bite Out of Technology Companies? A Case on Apple's International Tax Minimization and Reporting Strategies, Issues in Accounting Education, February 2016

[22] europa.eu, Competition rules in the EU, July 2022

[23] Vega, Nicolas, Apple wins landmark battle with EU over $15 billion tax bill, New York Times, July 2020

[24] Chee, Foo Yun, EU seeks top court backing $14 billion tax fight against Apple, Reuters, May 2023

Considering the length of time the European Commission and the IRS have spent in dealing with these cases, with no definitive outcome, the fight against tax havens is difficult, with no easy solutions.

The Revenue the U.S. has lost due to Corporate Income Tax Avoidance

Studies suggest that the U.S. misses out on $90 billion per year in tax revenue from corporations that avoid taxes through tax havens.[25] When considering the U.S. tax revenue from corporate income tax is expected to be $420 billion for 2023[26], it can be calculated that an extra $90 billion in tax revenue would account for 17.6% of all income tax from corporations. This number is significant and shows that corporations avoid substantial amounts of income taxes. Though this $90 billion is the amount the U.S. misses out on yearly due to structuring of U.S. companies in tax havens, we must also think about how much money in profits is still floating abroad in tax havens.

Studies showed in 2015 that the 500 largest U.S. companies hold $2.1 trillion in profits offshore.[27] This money had not been repatriated into the U.S. and therefore, has not been taxed. If the money were to be repatriated into the U.S. and taxed, it would gain an estimated $620 billion in U.S. taxes. These numbers are large and show that the U.S. continues to miss out on revenue from corporations.

[25] Americans For Tax Fairness, Offshore Corporate Tax Loopholes, Tax Fairness Breifing Booklet, 2014
[26] U.S. Treasury Department, How much revenue has the U.S. collected this year?, Fiscal Data, October 2023
[27] Reuters, Big U.S. firms hold $2.1 trillion overseas to avoid taxes: study, October 2015

Research

Basis of Research

Ten large U.S. corporations listed on the New York Stock Exchange are examined in the research section of this paper. The corporations chosen are all U.S. based, have international reach, and have a top fifty market cap. Market cap is the total value of all outstanding shares of stock. The ten corporations that fit this description and were chosen for research were Apple, Microsoft, Walmart, Google, Visa, Facebook, Procter & Gamble, Tesla, Amazon, and Exxon Mobile. The effective tax rate for each of these corporations will be compared from the years 2016-2017 to 2018-2022. The highest marginal tax rate from 2016-2017 was 35% while from 2018-2022 it was 21%.

This comparison is important because the TCJA expires on January 1, 2026.[28] This research can be used to analyze the impact on corporate tax revenue generation of raising and lowering marginal rates.

Analyzing the Effective Tax Rate of Ten Large U.S. Corporations

Apple

Apple Inc is the second largest corporation in the U.S. listed on Stock Analysis as of 2024. This ranking is based on market cap. Apple's main revenue source is electronics. Devices such as the iPhone, iPad, Apple Watch, and MacBook make up most of their revenue. Apple also has services such as Apple TV+, Apple Fitness+, and Apple Music which earn small percentages of digital revenue. Apple has services available in 175 countries.[29]

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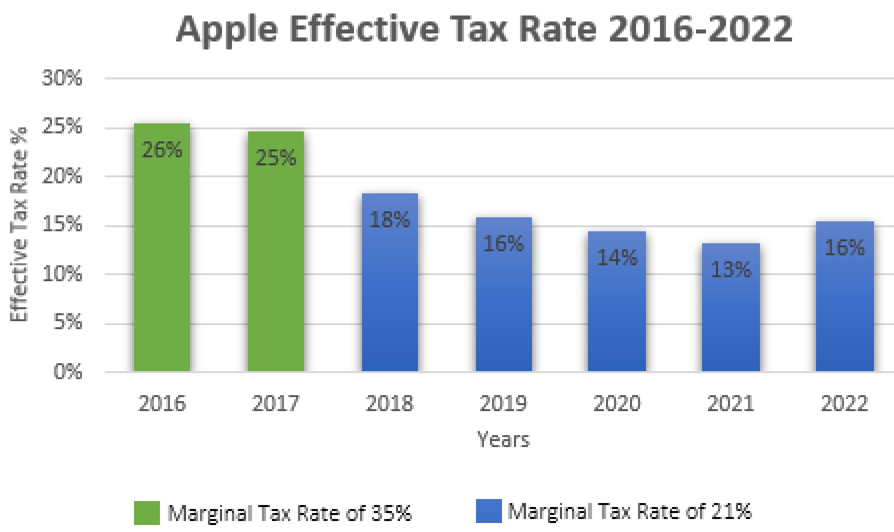
[28] Peterson, Noah, Parts of the TCJA Are Expiring Soon, Tax Foundation, December 2023
[29] Pereira, Daniel, Apple Business Model, The Business Model Analyst, April 2023



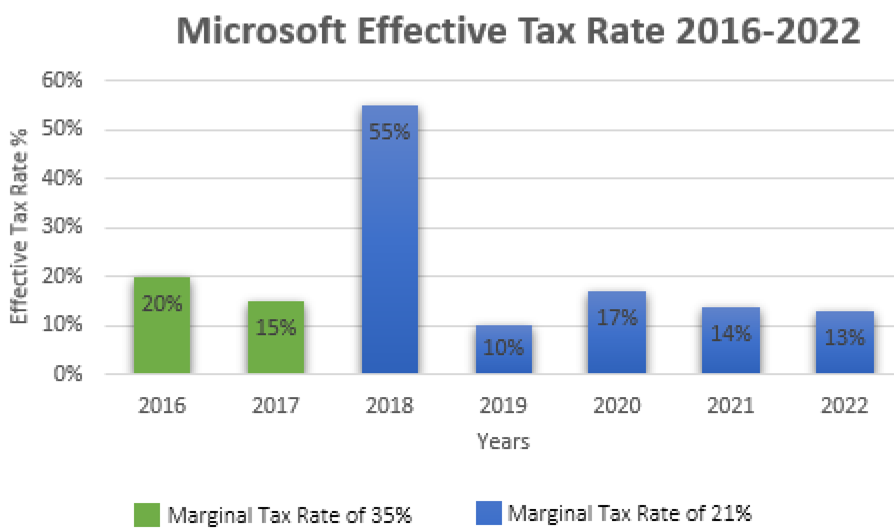
Data from macrotrends.net

From this graph, it is shown that Apple had a relatively lower effective tax rate from 2018-2022 compared to 2016-2017. There was an overall decrease year over year from 2016-2021 before a slight increase in 2022. This graph shows that every year, Apple paid taxes less than the marginal tax rate. The average effective tax rate from 2016-2017 was 25.5% while from 2018-2022 it was 15.4%. There are no outliers in any of the years, and overall Apple has a relatively consistent trend of taxes for the marginal tax rate periods from 2016-2017 and 2018-2022.

Microsoft

Microsoft Corporation is the largest corporation in the U.S. listed on Stock Analysis as of March 2024. This ranking is based on the market cap. Microsoft's main revenue sources are Microsoft Office, Azure Cloud Services, Windows, and Server Products.[30] Microsoft operates its business worldwide.

[30] Franek, Kamil, Microsoft Revenue Breakdown by Product, Segment and Country, Kamil Franek, September 2022



Data from macrotrends.net

From this graph, it is shown that Microsoft has had a relatively consistent tax rate from 2016-2022 other than in 2018. The reason Microsoft's effective tax rate was so high in 2018 is because they brough back $138.5 billion dollars in cash held abroad during this year.[31] They did this is because of the TCJA one-time 15.5% repatriation tax on cash held abroad. This rate is lower than both the marginal tax rate from 2016-17 and 2018-2022. As this percentage is an outlier, it is not included in the overall average effective tax rate. The average effective tax rate from 2016-2017 was 17.5% while from 2019-2022 the average rate was 13.5%. This is a 4% difference, and it shows that for Microsoft, lower marginal tax rates did decrease their effective tax rate. Future research could look at years prior to 2016 to get a more accurate comparison.

Walmart

Walmart Inc. is the fifteenth largest corporation in the U.S. listed on Stock Analysis as of March 2024. This ranking is based on the market cap. Walmart's main revenue source is retail sales.

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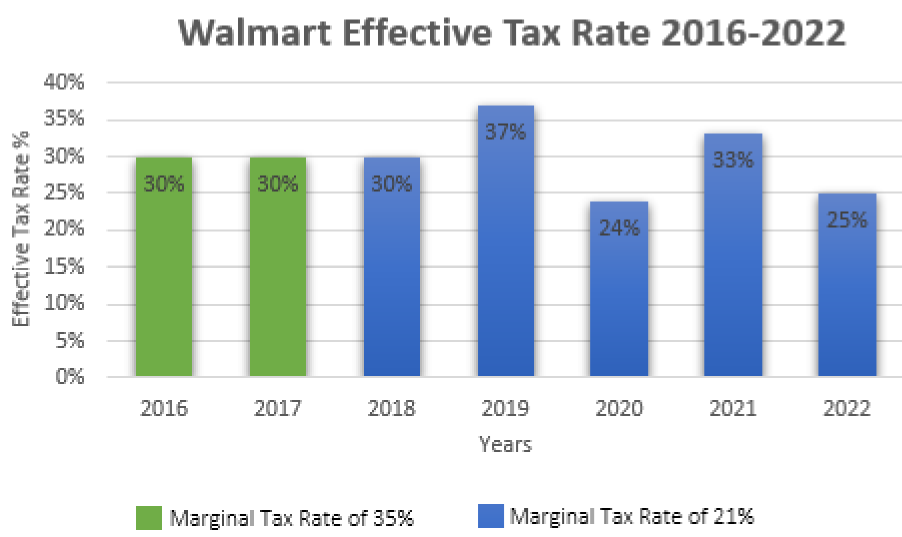
[31] Fiegerman, Seth, Microsoft takes $13.8 billion charge from tax bill, CNN Business, January 2018

Walmart operates 11,000 stores in 27 countries. It is important to note that around 41% of these stores are located in the U.S. Other than these physical locations, Walmart also has a gains revenue through e-commerce. [32]



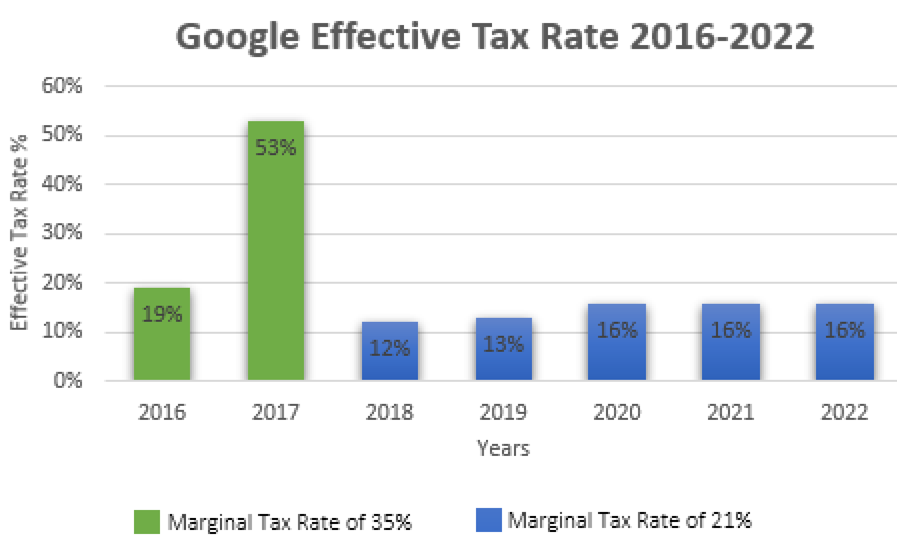
Data from macrotrends.net

Walmart has a relatively flat effective tax that hovers around 30%. There is some fluctuation from 2019-2022, however, the average effective tax rate from 2018-2022 is 30%. This is the same from 2016-2017. This graph also shows no decrease in tax due to the reduction of marginal tax rate in 2018. Walmart's large physical retail presence in the U.S. is probably reason for this. It is difficult for a company like Walmart to engage in transfer pricing because their sales are predominately in the U.S. Also, most of their revenue is through physical retail stores, which also makes it difficult to avoid taxes. Overall, Walmart pays taxes at an effective rate of 30% year-over-year regardless of the marginal tax rate.

[32] Visnji, Margaret, How Walmart Makes Money? Understanding Walmart Business Model, R&P, January 2019

Google

Alphabet Inc., known mainly as Google is the fifth largest corporation in the U.S. listed on Stock Analysis as of March 2024. This ranking is based on the market cap. Google's main revenue source is running ads. Google gets ad revenue from companies who want their website at the top of the page of the search engine. This revenue source accounts for over half of Google's revenue. They also run ads on YouTube, which is another revenue source. Their final main revenue source comes from cloud services such as storing data. Google does business in 219 countries and territories.[33]



Data from macrotrends.net

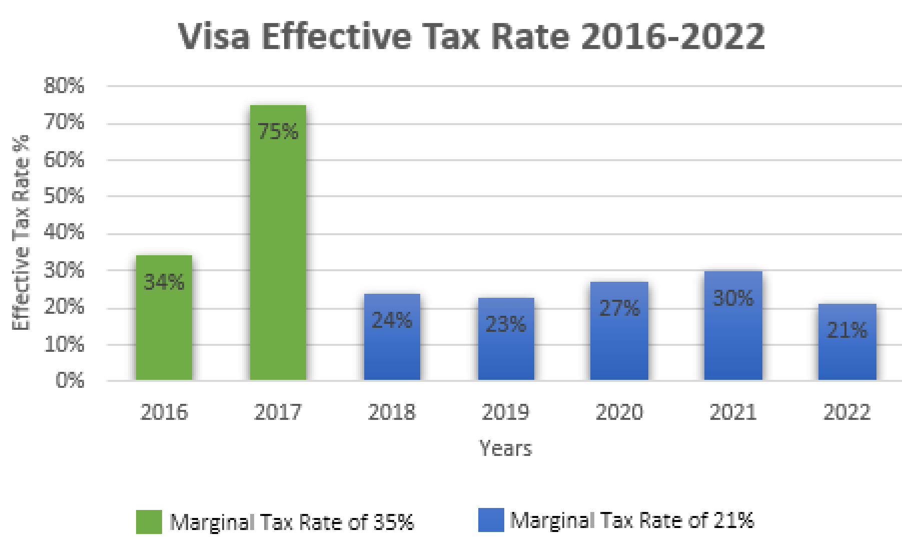
Looking at the effective tax rate of Google from 2016-2022, it is shown that Google mainly stays around an effective tax rate of 16%. This does not apply to 2017 where there is an outlier. This outlier is due to the one-time repatriation tax of 15.5% passed in the TCJA. Much like Microsoft, Google repatriated income held abroad because of this lower tax rate. The only

[33] Cuofano, Gennaro, Google Revenue Breakdown, FourWeekMBA, February 2024

difference in this case is the timing. Google decided to repatriate their income at the end of 2017 when TCJA was passed, while Microsoft opted to wait until 2018. As this percentage is an outlier, it is not included in the overall average effective tax rate discussed later in this paper. Google had an effective tax rate of 19% in 2016 compared to the average rate of 14.6% from 2018-2022. This 4.4% difference shows that Google did see a decrease in their effective tax rate due to lower marginal tax rates. Future research could look at years prior to 2016 to get a more accurate comparison.

Visa

Visa Inc. is the eleventh largest corporation in the U.S. listed on Stock Analysis as of March 2024. This ranking is based on the market cap. Visa's main revenue source is through credit card fees. Visa has over 2.5 billion credit cards issued worldwide across 200 countries.[34] As payments shift towards e-commerce, Visa continues to grow in the U.S. and internationally.



Data from macrotrends.net

[34] Sheth, Nikita, How does Visa make money?, Finty, August 2023

From this graph, it is shown that Visa is much like Google. There is an outlier in 2017 once again due to the company completing a reorganization of Visa Europe and other legal entities. As a result of this reorganization, the company recorded a $1.5 billion non-recurring income tax provision.[35] This caused the deferred federal income tax for Visa to spike in 2017. Other than this outlier, the tax rates of Visa have fluctuated from 2018-2022. The average effective tax rate from 2018-2022 was 25% while the 2016 rate was 34%. This shows an overall decrease in effective tax rate for Visa when the marginal tax rate was lowered. Future research could look at years prior to 2016 to get a more accurate comparison.

Meta

Meta Platforms, Inc., formerly known as Facebook, is the fifth largest corporation in the U.S. listed on Stock Analysis as of March 2024. This ranking is based on the market cap. Meta's main revenue source is advertising. Advertising on their platforms such as Facebook, Instagram, Messenger, and WhatsApp accounts for virtually all revenue. [36] These platforms are available in over 160 countries, which makes Meta a global corporation.

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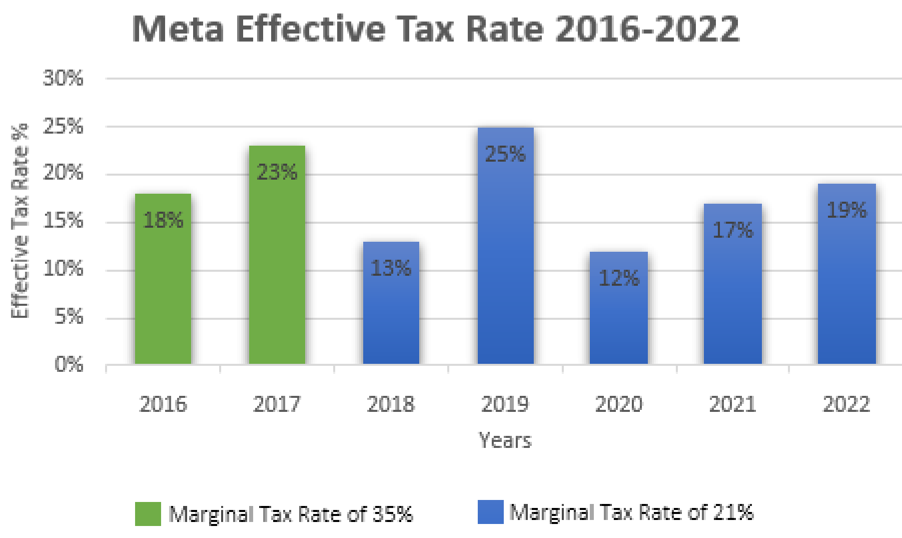
[35] Visa Inc., Form 10-K, November 2017

[36] Goel, Shikhar, How does Facebook (Meta) make money: Business Model Analysis, The Strategy Story, January 2023



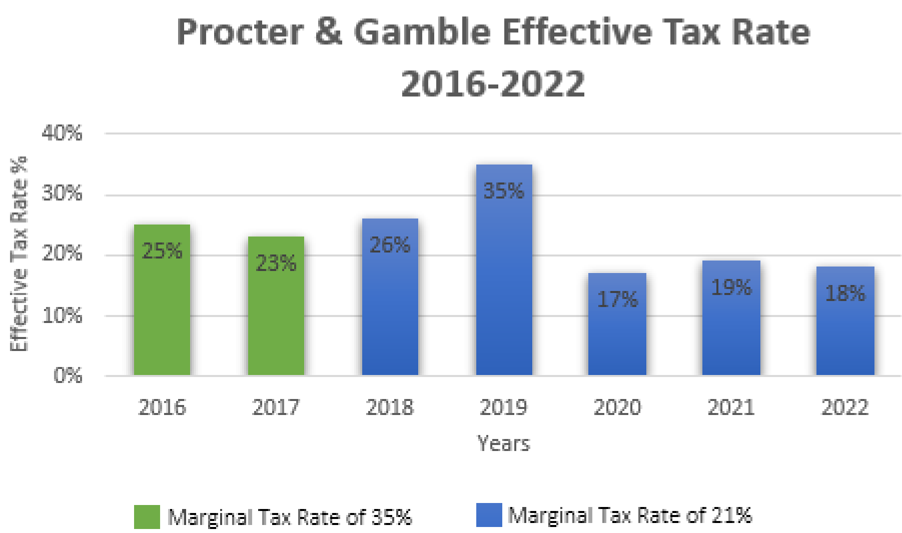
Data from macrotrends.net

Looking at this graph, it is shown that Meta's effective tax rate fluctuates. There is no consistency in the graph other than 2021-2022 being close. It could be argued that TCJA has caused a slight decrease in the effective tax rate for Meta as in 2016-2017 the average effective tax rate was 20.5% while from 2018-2022 it was 17.2%. Future research could see if Meta's effective tax rate continues to increase as it has done since 2020. This could even this number out. Overall, Meta has a fluctuating effective tax rate, and it could be argued that the TCJA lowered the effective tax rate slightly in this example.

Procter & Gamble

The Procter & Gamble Company or P&G is the twenty-first largest corporation in the U.S. listed on Stock Analysis as of March 2024. This ranking is based on the market cap. P&G's main revenue source is the production of consumer goods. They own consumer brands such as

Gillette, Crest, Pampers, and Tide among many other brands. These products are sold in more than 180 countries around the world.[37]



Data from macrotrends.net

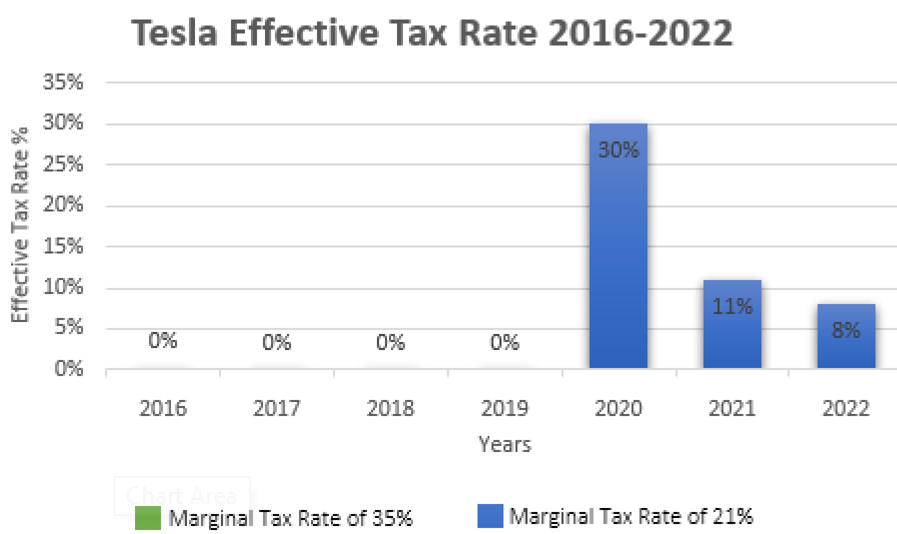
This graph shows relatively higher rates of effective tax from 2016-2019 with lower rates from 2020-2022. The highest tax rate in 2019 was due to the restructuring of their Gillette business. The restructuring of the business made the company's tax bill higher in 2019.[38] As the value of the business was decreased due to this restructuring, it also caused the tax bill to be less in future years. This is part of the reason why there was an overall decrease in the effective tax rate of P&G after 2019. The average of tax rates from 2016-2017 was 24% while from 2018-2022 it was 23%. Overall, there is no evidence of change in effective tax rates due to the TCJA in this scenario, the main cause for higher and lower tax rates for P&G is due to the company restructuring part of their business.

[37] Ramirez, Matthew, Procter & Gamble: Business Model, SWOT Analysis, and Competitors 2023, Pitchgrade, March 2023

[38] Naidu, Richa and Soundarya J, P&G posts strong sales, takes $8 bln Gillette writedown, Reuters, July 2019

Tesla

Tesla, Inc. is the fourteenth largest corporation in the U.S. listed on Stock Analysis as of March 2024. This ranking is based on the market cap. Tesla's main revenue source is the production of electric vehicles. They also have small revenue streams through the production of solar panels and other energy storage products. Tesla sells these products directly to consumers internationally. They also have dealerships and service centers across the globe.[39]



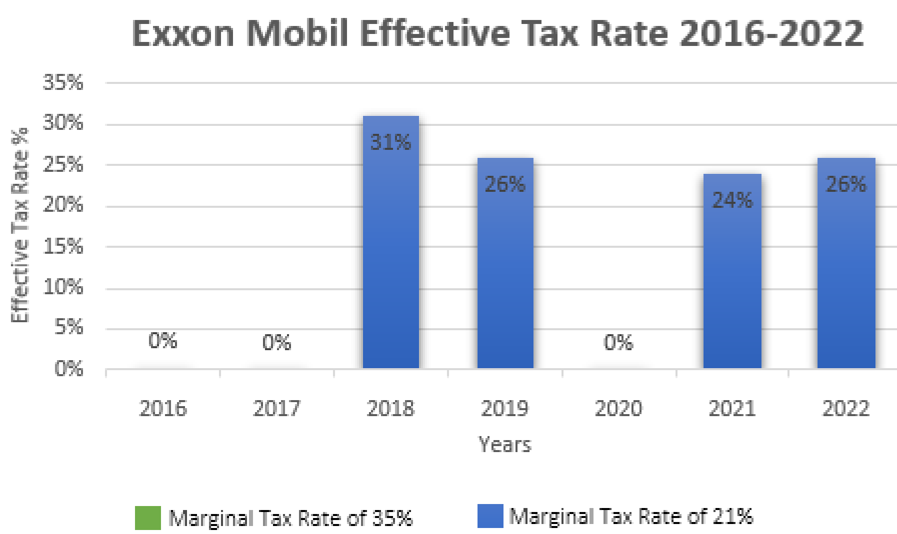
Data from macrotrends.net

This graph is unique in comparison to the other graphs in this research. This is because from 2016-2019, Tesla had an effective tax rate of 0%. The reason for this is because Tesla had a net operating loss in these years. Tesla's effective tax rate does go up substantially in 2020 to 30%, however, it then drops back down to relatively low rates in 2021 and 2022. Overall, it is hard to compare how the marginal tax rates affected the effective tax rates in this scenario because Tesla had a net operating loss in some of the years chosen for research.

[39] Goel, Shikhar, How does Tesla make money: Business Model & Supply Chain Analysis, The Strategy Story, November 2022

Exxon Mobil

Exxon Mobil Corporation is the eighteenth largest corporation in the U.S. listed on Stock Analysis as of March 2024. This ranking is based on the market cap. Exxon Mobil's main revenue source is oil. This oil is usually refined and turned into lubricant, plastic, or gasoline. They produce oil in 36 different countries and sell their products worldwide.[40]



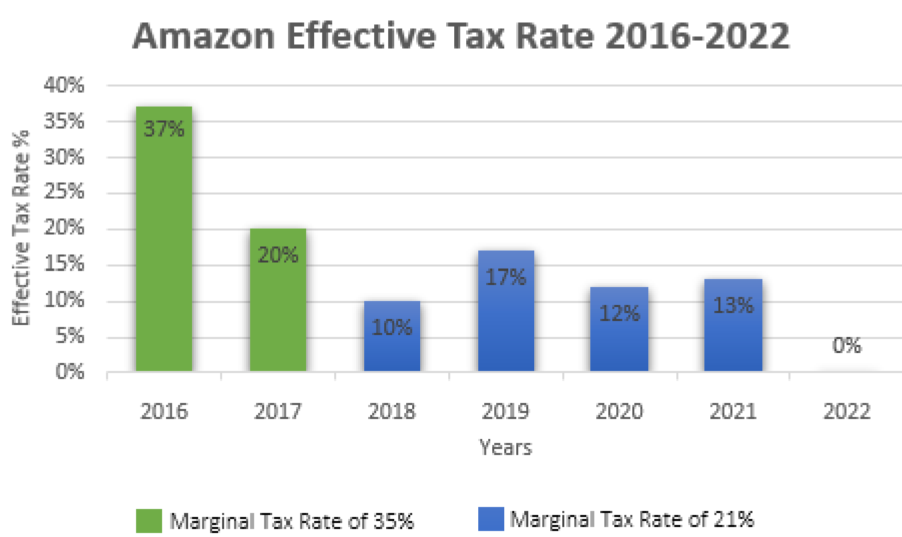
Data from macrotrends.net

Looking at this graph, it is shown that Exxon Mobil had a 0% effective tax rate in 2016, 2017, and 2020. This is because the company had a net operating loss during these years. Much like Tesla's graph, it is hard to compare the effect of the TCJA on the effective tax rate in this example. It is interesting to note that Exxon Mobil did have relatively higher effective tax rates from 2018-2022 than the marginal tax rate of 21%. The only year this did not apply was in 2020 when it was 19%.

[40] Visnji, Margaret, How ExxonMobil Makes Money? Understanding ExxonMobil Business Model, R&P, February 2019

Amazon

Amazon.com, Inc. is the fourth largest corporation in the U.S. listed on Stock Analysis as of March 2024. This ranking is based on the market cap. Amazon's main revenue source is e-commerce. Amazon dominates the e-commerce space as it is larger than the next 15 largest U.S. e-commerce retailers combined.[41] Amazon also operates in over 50 countries worldwide.



Data from macrotrends.net

Looking at Amazon's effective tax rates from 2016-2022, it is shown that there is a lot of fluctuation. Amazon had the highest effective tax rate in 2016 of any company researched in this paper. However, they also had an effective tax rate of 0% in 2022 due to a net operating loss during the year. It should also be noted that Amazon did have a decrease in its effective tax rate from 2016-2017 when the average rate was 28.5% compared to 2018-2022 when it was 10.4%. One could argue this could be due to the lower marginal tax rates in these years. Overall,

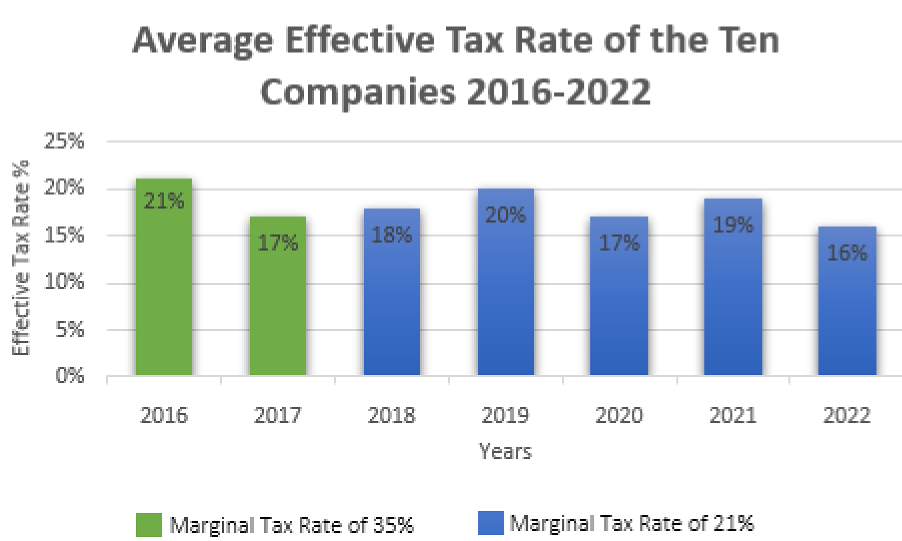
[41] Feger, Arielle, A guide to Amazon: A powerhouse of retail, advertising, and technology, EMarketer, January 2024

Amazon has a fluctuating effective tax rate, and it does seem they have a lower effective tax rate in the years with a lower marginal tax rate.

Conclusion

Average Effective Tax Rate of the Ten Corporations

Now that the effective tax rates of the ten companies from 2016-2022 have been analyzed and discussed, it is important to see the overall average. This is important because it paints the overall picture of whether the change in marginal tax rate due to the TCJA affected the overall effective tax of large corporations. It is important to note that outlier percentages discussed in individual company analysis have been removed from this average. The outliers discussed were Visa's 75% effective tax rate in 2017, Microsoft's 55% effective tax rate in 2018, and Google's 53% effective tax rate in 2017. By removing these outliers, it removes possible skews in the overall average.



By looking at the graph, it is shown that the trend of effective tax rate is fairly linear from 2016-2022. There are slight fluctuations, however, overall, it remains constant. From 2016-2017 the average effective tax rate was 19% while from 2018-2022 it was 18%. That is a very minimal overall change when comparing the marginal tax rate difference of 14% in these time periods. Overall, this graph shows that the marginal tax rate being changed from 35% to 21% had relatively no impact on the effective tax rate corporations actually pay.

Improvements to Research

There are steps that could be taken to improve the research shown in this paper. The research could be improved by adding additional companies to get more precise data. Also, more years of research before 2016 could be used to get a better measurement of tax rates before the TCJA. In addition to looking at more years before TCJA, in the future, more years could be looked at that include the TCJA rate. It has been discussed in this paper that the TCJA goes until January 1, 2026. This means that 2023, 2024, and 2025 tax rates could be looked at in the future to improve the overall data. Research could be improved in these three ways, however, with the research currently done, the conclusion is that the marginal tax rate being changed from 35% to 21% had little impact on the effective tax rate large corporations pay.

Reflection and Evaluation

Solutions

The research shows that large corporations will continue to use tax avoidance strategies under the current and previous systems of law. The research done is important as it informs people that raising taxes may sound like an easy solution, however, getting large corporations to pay income tax is not that simple. To build on this research, other solutions to solving corporate income tax avoidance are discussed in this section.

Research on solutions will be broken into four parts. The first part will explain the solution. This will include the history and specific details of the solution. The second part will look at implementation. This will measure how the solution can be implemented and if it is feasible. The third part will examine how enforceable the solution is. If it is not enforceable, it may not be a viable option. The fourth and last part will discuss public opinion. No policies can be passed without public support and this part will see what the public thinks of the solution.

After the four parts of the solution are discussed, there will be a final section for each solution. This section will reflect on each question that is answered and piece together each answer. This will allow for an impartial discussion on whether the solution is viable. If the solution is viable, it is important to be discussed as it could solve the problem of corporate income tax avoidance. If it is not viable, it is important to research how the solution can be improved or if there are any other options.

Based on the outline for research, this paper will focus on three proposed solutions. These three solutions are transparency, funding the IRS and collection of repatriation taxes. Each of these solutions provides a unique angle at solving the problem of corporate income tax avoidance. The first solution that will be evaluated is transparency.

Transparency

Transparency in a tax sense deals with the disclosure of tax information by companies to the public. If a company is transparent with their tax structure, it is easier to understand what a company may be doing to avoid taxes. If this is the case, it is easier for the government to know what companies are doing to avoid taxes. This would allow government to make policy changes that could plug avoidance strategies, thus increasing the amount of tax revenue from corporate income tax.[42] Though tax transparency is mainly in the public sphere of influence, rather than government influence, the concept has begun to gain steam in corporations recently.

Corporations have begun to be more transparent with their tax practices. This is being done to provide an understanding to shareholders, and the public, of what they are investing in. This concept has been discussed since the early 2000's and companies have begun to implement tax transparency practices throughout their business in recent years.[43] Companies appear to be providing more transparency with their tax practices. In reality, much of what corporations share is difficult to understand for the average person.

Too much information never seems like a bad thing in the eyes of the public. This changes when thinking about how difficult it may be for a company to be investigated. By providing an overwhelming amount of information, not all of which is needed, what is really going on can unclear. In this situation, underlying tax avoidance practices are hidden under a vast array of information that is difficult to find.[44] After all, IRS resources are finite. The government does not have the time, nor the resources to look at every detail of a company's tax dealings, even if they are transparent. What is the point of having a bunch of information if no one understands it? This is where implementation of policy in the government regarding transparency can play a role in making information clearer to both the public and government.

Implementation of policies regarding tax transparency have been discussed both nationally and internationally in recent years. The main policy that has been discussed is the policy of country-by-country reporting.

[42] Blank, Joshua D., The Timing of Tax Transparency,
[43] Alexander, Raquel Meyer, Tax transparency, Business Horizons Volume 56, Issue 5, Pages 543-549, October 2013
[44] Stohl, Cynthia and Stohl, Michael and Leonardi, Paul M., Information Visibility and the Paradox of Transparency in the Digital Age, International Journal of Communication, 2016

Country-by-country reporting is an effort to increase the transparency of multinational enterprises' global operations and economic footprint.[45] This policy is a law requiring multinational enterprises to separately state each major component of income tax subject to federal income tax, foreign income tax, and other income tax. Also, these enterprises must identify the components of income before tax as either foreign or domestic. 17 CFR § 210.4-08. This is the US law regarding country-by-country reporting. This is part of the framework to stop base erosion and profit shifting first implemented by the OECD in 2017.[46]

This framework circles back to the international issue of tax transparency, and country by country reporting is a solution the OECD brough forth as a solution to international corporate tax avoidance. Though US implementation has been discussed, it is important to note that 110 countries and jurisdictions have implemented country-by-country reporting as of February 2024.[47] This number of countries implementing laws requiring country-by-country reporting is a major step toward tax transparency internationally. However, even if a policy is implemented, the next step is making sure the policy is enforced.

Enforceability of country-by-country reporting is important. If there are no penalties for large corporations that violate laws regarding country-by-country reporting, then it really does not matter if it is implemented. In the United States, there are penalties in the form of a fine for not filing form 8975. This form is a country-by-country reporting form required for multinational enterprises with revenue of 850,000,000 or more. 26 CFR § 1.6038-4(h). The filing of this form is required by the IRS. If a company does not file this form, they will face penalties and fines.

[45] DerOhanesian, John and Tanguay, Brittany Hardin, What is Country by Country Reporting?, KPMG, February 2022
[46] Barter, Sarah, BEPSA Action of Country by Country Reporting, Policy Commons, July 2018
[47] Country-specific information on Country-by-Country reporting implementation, OECD, February 2024

These penalties and fines apply to any taxpayer that does not file correct information on returns or does not file the form at all. If any person fails to file form 8975, they will pay a penalty of $10,000 for each period they do not file the form. IRC § 6038(b)(1). This fine is increased when the taxpayer fails to pay this fine within 90 days. After 90 days of not paying this initial penalty, the United States can reduce the amount of foreign taxes paid by 10% by reducing the foreign tax credit companies can claim. IRC § 6038(c)(1)(A). This will increase the taxes companies will pay as it limits their credit claim. This percentage is also increased by 5% for every 90 days the penalty is not paid. IRC § 6038(c)(1)(B). Companies are also not able to file tax returns in subsequent years of not filing a return. Overall, form 8975 acts as enforcement of country-by-country reporting requirements. This is how country-by-country reporting is enforced, and now it is important to see what the public thinks of increasing tax transparency.

Public opinion on tax transparency goes hand in hand with the ESG rating. ESG rating measures a company's exposure to long-term environmental, social, and governance risks.[48] The component of ESG rating that coincides with tax transparency is governance. ESG rating is affected by tax transparency. ESG rating has been increasingly important to investors in recent years.

Investors tend to look at ESG ratings before investing, and data suggests that the value investors place on ESG has increased three times over from 2019 to 2022. Investors are willing to pay $20 more for stocks in companies with higher ESG ratings.[49] Though tax transparency is just a part of the ESG rating, the public still likes when companies are transparent with their taxes. This is because increasing tax transparency allows investors to gain knowledge of a

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[48] Plaut, Alison, What Is an ESG Rating, The Motley Fool, October 2023

[49] Baker, Malcolm and Egan, Mark L. and Sarkar, Sarkar, Suproteem K., How Do Investors Value ESG?, NBER Working Paper Series, December 2022

company's performance in a way that was not previously available.[50] It is no surprise that public investors like knowing the business practices of the companies they are investing in. This is a good public opinion of tax transparency, but are there any negative viewpoints?

Some argue that by forcing companies to furnish tax data in public, tax secrecy is at risk for companies. This would harm competitiveness in business as companies can look at each other's tax practice and copy what they are doing.[51] People argue that tax returns are private. Allowing any tax return information into the public view could create problems for businesses that have unique tax strategies. Another argument against tax transparency is the costs outweigh the benefits.

The costs of tax transparency for businesses are not cheap. Businesses must alter their existing systems to comply with the processes of country-by-country reporting. This leads to corporate shift from tax havens. Studies suggest that this causes businesses taxable income to decrease, thus lowering the amount of tax a government can collect. The overall effect of country-by-country reporting on the growth rate of tax payments is insignificant because of this.[52] This is why people argue that country-by-country reporting and other tax transparency policies are not necessary.

Tax transparency discloses private tax structuring practices by businesses and brings them into public view. This allows both the public and government to view the inner workings of tax structures. It has been implemented through country-by-country reporting and is enforced by

[50] Sherwood, Parker, Country-by-Country Reporting and Tax Transparency, ESG Reporting Hub, March 2023
[51] Evers, Maria Theresia and Meier, Ina and Spengel, Christoph, Country-by-Country Reporting: Tension between Transparency and Tax Planning, Centre for European Economic Research, November 2016
[52] Hugger, Felix, The Impact of Country-by-Country Reporting on Corporate Tax Avoidance, Leibniz Institute for Economic Research at the University of Munich, 2019

governments. In the US specifically it is enforced by form 8975, which requires multinational enterprises to comply with country-by-country reporting requirements. Public perception of this policy is that it is overall good to be able to see what businesses are doing, however, costs of implementing tax transparency policies may outweigh the gains.

Tax transparency is practical, enforceable, and the public likes when companies are transparent with their tax practices.

Fund the IRS

IRS funding is a topic often discussed as a solution to tax avoidance on a business scale and individual scale. It has been discussed in this paper how much money the US misses out on due to tax avoidance by both businesses and individuals. Funding the IRS has been posed as a solution to stop this problem.

To stop the problem of tax avoidance, funding the IRS would allow for an increase in the tax collection capacity. This capacity is increased because with an increase in resources, the IRS can fight tax avoiders and evaders more effectively.[53] In 2022, the IRS was given funding of $80 billion over a ten-year period to increase these resources. IRS resources include hiring agents, upgrading information technology, and taxpayer services.[54] Each of these resources play a vital role in the posed solution to tax avoidance, starting with an increase in agents.

An increase in agents includes an increase in accountants, lawyers, criminal investigators, information technologists, and customer service representatives.[55] Accountants, lawyers, and criminal investigators play an active role in nullifying tax avoidance while customer service

[53] Osofsky, Leigh, Estimating the Return on Investment in the IRS, The Journal of Things We Like, November 2023
[54] Temkin, Jeremy, The Reality of Increased IRS Funding, The Insider, October 2022
[55] Corbin, Ken, The Timing is Right to Consider a Career at the IRS, IRS, March 2022

representatives play a passive role. By increasing funding to hire these professionals, the U.S. can increase tax revenues. In February 2024, the U.S. Treasury estimated that the IRS will yield up to $561 billion in additional revenue over the next ten years due to an additional $80 billion in funding from the 2022 Inflation Reduction Act.[56]

This increase in budget not only helps with hiring agents, but also applies to the overall increase in upgrading information technology. The IRS relies heavily on information technology to process tax returns, collect taxes, and distribute tax refunds. This comes as the IRS continues to modernize their tax processing system through information technology.[57] This modernization can improve the taxpayer experience as returns are processed quicker leading to more transparency when filing a return. Also, modernization can lead to impartiality when the IRS looks at a return.

Impartiality with regards to tax returns deals with scenarios when the IRS does decide to investigate a tax return for malpractice. With the increase of technology, the IRS can optimize systems to create ways to examine tax returns through unbiased, artificial methods. This optimization is unbiased and provides better experience for the taxpayers.[58] This passive implementation of a system provided by an increase in funding toward information technologists and overall information technology allows for active resources to narrow their scope. This narrowing of scope allows these active resources to be used effectively in focusing on taxpayers that abuse the tax system. Being able to impartially and effectively focus on taxpayers that abuse

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[56] Lawder, David, US Treasury estimates higher IRS revenue gains from modernization funding, Reuters, February 2024

[57] U.S. Government Accountability Office, IRS's Efforts to Modernize 60-year-old Tax Processing System Is Almost a Decade Away, November 2021

[58] Kaufman, Brian and Kaschit, Pandya, IRS and TEI Working Coordinates Efforts to Optimize IRS Technology, Tax Executive, Vol. 74, Issue 4, Pages 18-27, July/August 2022

the tax system is the role that an increase in information technology plays in stopping tax avoidance, and another way to stop this through IRS funding is taxpayer services.

Taxpayer services are any service that improves the taxpayer experience. Taxpayer experience is improved through an increase in customer service. Customer service representatives, taxpayer assistance centers, and the taxpayer advocate service all improve the taxpayer experience.[59] Through increased funding, these services are enhanced. Enhancing these services increases the taxpayer's experience when filing taxes, but how does this impact tax avoidance?

Tax transparency is increased when customer service is increased. It has been discussed in this paper the importance of tax transparency to the public. When increasing taxpayer services, taxpayers and tax preparers have an instant hotline that they can use for tax questions or tax issues. This provides taxpayers and tax preparers with a clear understanding of how taxes should be prepared, what resources are available, and how certain elements of tax are defined. This overall transparency leads to more compliance.[60] An increase in taxpayer services is another resource of IRS funding that can limit tax avoidance.

Resources of IRS funding can limit income tax avoidance as is seen through an increase of agents, better information technology, and better taxpayer services. These three resources play active and passive roles in countering income tax avoidance overall. Though this is the case, it is important to discuss the implementation of funding the IRS.

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[59] Luscombe, Mark A., Is the IRS Starting an Upturn in Enforcement and Customer Service?, Tax Trends, October 2019

[60] Olson,Nina E., Taxpayer Rights, Customer Service, and Compliance: A Three-Legged Stool, 51 U. Kan. L. Rev. 1239, 2002

The implementation of funding the IRS is important because to sustain the resources available to combat income tax avoidance, funding must also remain constant. As the IRS is a government agency, implementation of funding is dependent on the government budget. The government budget for 2023 was $5.72 trillion, $15.2 billion or 0.27% of which went to funding the IRS.[61] It has been discussed in this paper that the IRS has been given a budget increase of $80 billion for 10 years from 2022. This shows that the government has the resources to fund the IRS and implementation is possible. The implementation of IRS funding is shown through the example of funding in 2022, however it is also important to ask if that is enforceable.

Enforceability of IRS funding comes down to the government. This is because government changes lead to new policy. This new policy could cause IRS funding to be cut or increased more. Government budgets are changed often, and the IRS is no exception.

The IRS has been shifted and altered dramatically since its formation in 1862. Research shows that various factors have altered IRS budgets throughout history. While times of war and reform led to increased IRS spending, times of budgetary constraints, corruption, and shifts away from IRS input on issues have led to decreased spending.[62] The IRS budget is something that lacks sustainability without bipartisan support or set limits that can not be altered. It also does not help that the IRS faces constant pressure from congress.

When congress enacts new policy regarding taxes, it adds to the burden faced by the IRS to enforce and implement these changes. These changes in policy alter the tax code. This in turn

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[61]IRS Fiscal Year 2023 Congressional Budget Justification & Annual Performance Report and Plan, U.S. Treasury, 2023

[62] Thorndike, Joseph J., Reforming the Internal Revenue Service: A Comparative History, 53 Admin. L. Rev. 717, 2001

alters the way IRS enforces policy causing the IRS to have an increased burden.[63] This burden causes the need for an increase in the resources of the IRS because they have more to deal with. With constant changes to budget, and with the continued need for increase in resources, the enforceability of IRS funding is unclear, which is an issue.

Public attitude toward the IRS from its inception has mainly been negative. After all, paying taxes is not something that is enjoyed. Research also shows that federal income tax is generally disliked by the public.[64] This opinion hasn't changed much in the history of the tax as survey from 1978 found that most taxpayers thought that federal income tax is the least fair tax.[65] Considering public opinion of income taxes is not good, it is no surprise that people generally do not like funding IRS.

The public does not agree with funding the IRS. This is because of three main reasons. These three reasons are framing efforts, not understanding the IRS, and the human element of the IRS. Each of these three reasons are why people do not like the IRS, and before there is any public support for IRS spending, these issues must be resolved starting with framing efforts.

Framing efforts by media outlets and government officials can sway public opinion on issues. It has been shown that attitudes regarding the IRS have been shaped through framing efforts.[66] If media outlets portray the IRS in a more positive manner, then public perception could be improved. Following this, people do not understand what the IRS does because taxes are confusing. The IRS can establish educational and media programs to increase public

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[63] Koskinen, John A., The Challenges Facing the IRS of the Future, Ohio Northern University Law Review Vol. 45, 2019

[64] Shaw, Greg M., and Gaffey, Laura, Trends: American Public Opinion on Economic Inequality, Taxes, and Mobility: 1990-2011, Public Opinion Quarterly, Volume 76, Issue 3, Fall 2012, Pages 576-596, September 2012

[65] Song, Youn-dahl and Yarbrough, Tinsley E., Tax Ethics and Taxpayer Attitudes: A Survey,

[66] Anson, Ian G. and Kane, John V., Ought It Aduit? Information, Values, and Public Support for the Internal Revenue Service, Cambridge University Press, November 2022

understanding of taxes.[67] Finally, the human element of the IRS is an easy target for people to question. Funding technology resources should be the number one concern for any funding the IRS gets because increases in information technology can increase the public trust of government entities, including the IRS.[68]

If the IRS wants to increase public opinion, and gain support for funding, it must look to solve these issues that have been discussed. If not, then the IRS will continue to face public backlash, which will not help in receiving funding, and solving the overall issue discussed in this paper of corporate income tax avoidance.

Implementation is possible, and research shows that an increase in budget leads to a decrease in corporate income tax avoidance. However, for the IRS to use funding as a solution to corporate income tax avoidance, it must first find a way to gain constant funding through increasing public opinion. If the IRS were to increase public opinion, government officials would be more inclined to fund the IRS as it would be something the public wants. The issues of IRS funding in enforceability and public opinion must be solved before IRS funding can be seen as a consistent solution to corporate income tax avoidance.

Collection of Taxes from Corporations Using Safe Havens

International tax safe havens are where large multinational corporations avoid store income through transfer pricing. Putting pressure on these countries is a way the U.S. can work internationally to collect tax. One way to do this is through sanctions.

[67] Kornhauser, Marjorie E., A Tax Morale Approach To Compliance: Recommendations For The IRS, Florida Tax Review, 2007
[68] Moon, M.J., Can IT help government to restore public trust? Declining public trust and potential prospects of IT in the public sector, 36th Annual Hawaii International Conference on System Sciences, 2003

Sanctions on tax havens could force the country to comply with the U.S., but also, could pressure corporations to repatriate income. Research shows that foreign subsidiaries of U.S. multinational corporations tend to repatriate more earning to the parent company when the country has a volatile exchange rate and a higher risk of expropriation.[69] Though these two factors affect repatriation of income, it is important to examine whether the U.S. can affect these factors through sanctions, starting with exchange rate volatility.

Exchange rate volatility is the unexpected fluctuation of one currency relative to another that causes appreciation or depreciation. This fluctuation of value can negatively affect investor confidence in the currency, which can cause an overall decrease in investment.[70] As this is the case, companies will often set up in tax havens that tend to be less volatile. However, research shows that economic sanctions significantly influence exchange rate volatility.[71] If the U.S. were to impose economic sanctions, it could cause large multinational corporations to repatriate income. Exchange rate volatility can be affected through economic sanctions, and now expropriation will be looked at.

Expropriation is the seizing of private property by the government for the purpose of public benefit. This is known as eminent domain in the U.S. As this is done a country-by-country basis, it is hard for the U.S. to intervene. The only time the U.S. will intervene on such an issue is if a person with assets abroad has a warrant for arrest.[72] In this case, the U.S. does have the

[69] Tahir, Muhammmad and Ibrahim, Haslindar and Khan, Badal and Ahmed, Riaz, Foreign earnings repatriation: the effect of exchange rate volatility and the risk of expropriation, Journal of Economic and Administrative Sciences, November 2022

[70] Devereux, Michael B. and Engel, Charles, Exchange rate pass-through, exchange rate volatility, and exchange rate disconnect, Journal of Monetary Economic Volume 49, Issue 5, Pages 913-940, July 2002

[71] Wang, Yiwei and Wang, Ke and Chang, Chun-Ping, The impacts of economic sanctions on exchange rate volatility, Economic Modelling Volume 82, Pages 58-65, November 2019

[72] May, Colin, Asset Seizure and Forfeiture: A Basic Guide, LEB, August 2016

power to seize assets abroad, however, for the context of this paper, this situation is unlikely to come up. As it is unlikely that the U.S. can play a role in heightening the risk expropriation through sanctions, exchange rate volatility will be highlighted going forward.

Though this is an international solution, domestic solutions also need to be posed collecting foreign income taxes. One way this has been done is through combined reporting. Combined reporting requires corporations with subsidiaries to list their total global profits and compare this to the overall business in each jurisdiction.[73] This comparison will determine the overall tax bill rather than limiting the tax bill to domestic profits. For example, if a state accounts for 20% of the corporation's overall sales, 20% of its global profit will be taxed. This solution allows states to fight tax havens domestically as corporations must list their entire global income, rather than limiting their taxable income as solely domestic. This is one solution domestically to collecting taxes from corporations who operate in tax havens.

Whether looking at international or domestic solutions to tax safe havens, implementation must be discussed to ensure the solution is viable. International sanctions against tax havens to increase pressure on large multinational corporations to repatriate income can be done by levying taxes on any financial transactions that occur from the U.S. to that country. This is shown to work as in 2010 the Foreign Account Tax Compliance Act or FATCA forced the automatic exchange of data between foreign banks and the IRS. This forced financial institutions worldwide to identify clients who were American and what income they had earned. IRC § 1472(b). Any institution that does not apply this is taxed 30% on all dividends and interest

[73] Phillips, Richard, A Simple Fix for a $17 billion Loophole: How States Can Reclaim Revenue Lost to Tax Havens, ITEP, January 2019

income paid to the institution for any dealings in the U.S. IRC § 1472(a)(2). Implementation of sanctions such as this on foreign banks and countries are proven to work.

Research shows that FATCA had a fundamental impact on tax havens such as Switzerland. This research highlighted the importance of FATCA in closing of Switzerland's oldest bank, Wegelin.[74] It has been posed in research that the U.S. could impose similar sanctions seen in FATCA on countries, rather than just banks. This proposition suggests imposing taxes on financial transactions with uncooperative tax havens similar to FATCA.[75] By doing this, economic pressure is put on these countries to cooperate. It also could cause exchange rate volatility in the country as the demand to invest in the country decreases with heightened taxes. An increase in exchange rate volatility could pressure large multinational corporations to repatriate money as has been discussed in this paper.

Domestically, combined reporting has been implemented by 28 states. In the states where it has been implemented, there have been examples of bipartisan support for it because it has been proven to increase tax revenues while not changing the state's overall tax rate for non-corporations.[76] Implementation of combined reporting is possible for every state dependent on state legislature. This is not easy, however, implementation of combined reporting is reasonable considering states such as Kentucky, New Jersey, and New Mexico have passed combined reporting requirements in the past 5 years.

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[74] Song, Jane G., The End of Secret Swiss Accounts?: The Impact of the U.S. Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts, Northwestern Journal of International Law & Business, 2015

[75] Clasuing, Kimberly and Saez, Emmaneul and Zucman, Gabriel, Ending Corporate Tax Avoidance and Tax Competition: A Plan to Collect the Tax Deficit of Multinationals, January 2021

[76] Mazerov, Michael, States Can Fight Corporate Tax Avoidance by Requiring Worldwide Combined Reporting, Center on Budget and Policy Priorities, March 2024

Following implementation, enforcement of international or domestic policy to combat tax safe havens is important to look at. Internationally, enforcement that involves sanctions on other countries needs the backing of the international community. Opponents of FATCA highlighted the drastic change to American foreign tax policy, which in turn may cause foreign governments and banks to lobby for its repeal.[77] This is a valid argument. If foreign governments and banks reverse the pressure of sanctions on the U.S., then the U.S. may have to succumb to international pressure and repeal the change. Though FATCA has achieved international success through the OECD's Common Reporting Standards, which is similar to FATCA, it serves as a warning. This warning is that international U.S. tax policy can only be enforced if it has international backing.[78]

Domestically, combined reporting is required for companies when the law is passed. However, it has been shown that corporations can change the law surrounding combined reporting. In Oregon, the legislature felt pressure from large corporations to scrap combined reporting. Combining this with lobbying efforts and threats from corporations to take the matter to court, combined reporting was scrapped in Oregon.[79] This shows how any law can be changed at any given time. Just because combined reporting is put into place does not mean it will last forever. Given the fact that corporations can use their economic weight on state governments, domestic enforceability can be questioned.

Public opinion on international sanctions and domestic combined reporting is the final part to be looked at. Public opinion on international sanctions is determined by who the sanction impacts and how well the sanction works.[80] Who the sanction impacts is important to

[77] Behrens, Frederic, Using a Sledgehammer to Crack A Nut: Why FACTA Will Not Stand, Wis. L. Rev. 205, 2013
[78] Paul, John, The Future of FATCA: Concerns and Issues, North East Journal of Legal Studies, 2018
[79] OCPP, Legislature leaves Oregon largely defenseless against corporate abuse of tax havens, June 2018
[80] McLean, Elena V. and Roblyer, Dwight A., Public Support for Economic Sanctions: An Experimental Analysis, Foreign Policy Analysis, April 2016

determining public opinion on the sanction because people are less likely to support a sanction if it affects individuals in the country, rather than institutions or leadership. In this case, economic sanctions on tax safe havens aim to target multinational corporations, which would receive public support. The other element of public opinion on sanctions is how well the sanction works.

How well the sanction works builds off the enforceability. Considering any economic sanction on a tax haven is enforceable with international support as discussed before, it is reasonable to assume public opinion would be positive.

Compared to opinions on international sanctions, public opinion on domestic combined reporting is mixed. On one hand, the public seems to support combined reporting because it levels the playing field for small businesses.[81] This is because small businesses do not have the ability to use tax havens and shift profits like large corporations do. By implementing combined reporting, corporations are taxed at a fairer rate when compared to small businesses. This allows small businesses to stay in business longer and compete against corporate giants.

On the other hand, some people think combined reporting will push business out of state. This is because some states do not require combined reporting. If a company were to be taxed more because of combined reporting, it could cause the corporation to leave the state completely.[82] This would decrease jobs in the state and lower the taxes because without corporate income in the state, there would be nothing to tax. This shows opinions on combined reporting are mixed.

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[81] Wodicka, Chris and Worthington, Flora, Combined Reporting: A Widely Used Tool to Counter Corporate Tax Avoidance, The Commonwealth Institute, March 2021

[82] Callaghan, Peter, What the heck is 'worldwide combined reporting' and why do DFLers think it can raise hundreds of millions?, MinnPost, April 2023

Public opinion, enforceability, and public opinion have now been discussed for international sanctions and domestic combined reporting. Internationally, public opinion of sanctions will be positive if the sanction mainly impacts multinational corporations and is enforceable. Enforceability is met if the sanction has backing from the international community. Without this, enforcement is not possible. Finally, implementation of sanctions can be done through policy similar to FATCA, which is a proven to work policy in combating income tax avoidance. If sanctions meet the criteria of each of these viewpoints, it can act as a viable solution to corporate income tax avoidance by corporations through tax safe havens.

Domestically, public opinion of combined reporting is mixed. Bipartisan may be difficult in some situations, however, there have been examples of bipartisan support. Enforceability is possible when law is passed, however, there are questions as to whether large corporations can alter state legislature opinion. Any combined reporting law must deter the influence of corporate pressure to be enforceable. Lastly, implementation of combined reporting is possible and is shown through 28 states passing combined reporting laws. Overall, if states can gain bipartisan support and limit the influence of corporations on legislature, it is possible for combined reporting to be an effective way to collect taxes from corporations using tax safe havens.