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A Securities Tax and the Problems of Taxing Global Capital

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1. Introduction

In an earlier paper I proposed a new approach to taxing capital that is owned by U.S. households and nonprofits.[1] The cornerstone of the new approach would be a flat annual tax on the market value of U.S. publicly traded securities. I estimate that a tax rate of around .8 percent (80 basis points) would roughly approximate the average tax

[1] Mark P. Gergen, How to Tax Capital, 70 Tax L. Rev. 1 (2016).

burden on capital income in the U.S. under the existing patchwork system for taxing capital income.[2] A security issuer would remit the tax based on the market value of its securities. A security issuer would receive a credit for U.S. publicly traded securities it holds so that wealth that is represented by a string of publicly traded securities would be taxed once. For example, a mutual fund would remit the tax based on the market value of interests in the fund and it would receive a credit based on the market value of publicly traded securities it holds.

Income producing capital that is not subject to the securities tax, such as an interest in a closely held business or an interest in a private equity fund, would be covered by a complementary tax that would be at the same rate as the securities tax. The complementary tax would be based on the estimated value of an asset.[3] An entity would be required to remit the tax on the estimated value of all interests in the entity that are held by a person subject to the complementary tax. These principally would be U.S. residents and U.S. nonprofits.[4] I estimate the securities tax would cover around 80 percent of the income-producing wealth of U.S. households and nonprofit excluding owner-occupied housing. The complementary tax would cover the rest.

The securities tax is designed to tax wealth at the first point in a wealth chain where wealth is represented by a publicly traded security. The complementary tax is designed to tax wealth at a point where capital is held by a household or nonprofit in the form of a claim against a business entity or in the form of a claim on a real asset. Both taxes require business entities that use capital and financial entities that intermediate capital to remit the tax rather than collecting the tax from capital owners (households and nonprofits). This would significantly reduce public enforcement and private compliance costs and increase the rate of compliance.

The securities tax and the complementary tax are intended to replace the entire existing patchwork system for taxing capital income in the U.S. This includes the corporate income tax; the individual income tax on all income from securities, including interest, dividends, and capital gains; and the individual income tax on all other investment or business income, including income from partnerships and sole

[2] If the normal rate of return on capital is 4 percent, then this is equivalent to an income tax on the normal rate at a tax rate of 25 percent. 70 Tax L. Rev. at 4.

[3] The complementary tax would be based on the estimated value of an asset—and not the actual value of an asset—to prevent taxpayers from avoiding tax by under-reporting asset value. This eliminates the Achilles Heel of a wealth tax, which is determining the value of assets that do not have an observable market price. Asset value would be estimated under a rule that assumes all investments yield a normal return, which would be specified by law. The specified normal return should be around 3.5 percent to 4.5 percent per year plus the rate of inflation. 70 Tax L. Rev at 38-42. Importantly, an entity like a private investment fund in which persons subject to the complementary tax hold an interest would be required to revalue all interests of a type in an entity if any interest of a type was redeemed, acquired, or transferred in an arm's-length transaction. The revaluation rule would bring the expected tax burden of the securities tax and the complementary tax into line for assets like interests in hedge funds that are fairly liquid and so that are likely to be revalued periodically. 70 Tax L. Rev. at 46-49.

[4] The complementary tax would also be paid if an interest were held by a defined benefit pension fund, a family trust, and a closely held entity that was not engaged in an active trade or business. 70 Tax L. Rev. at 48-50.

proprietorships and income from real estate. The securities tax and the complementary tax would eliminate many of the distortionary features of the existing U.S. system for taxing capital income, including the realization requirement, the distinction between debt and equity, and the double-taxation of corporate income.[5] The taxes are designed to work alongside a tax on labor income. Ideally the labor income tax would be in the form of a cash-flow consumption tax or a value added tax, because these forms of a labor income tax would largely eliminate the need to distinguish labor income and capital income, unlike a wage tax.[6] Existing tax preferences that reduce capital income taxes on capital owned by nonprofits and on capital owned by households that represents savings for retirement could be preserved by rebating part of the tax to nonprofits and to households on retirement savings.[7]

This paper examines how the securities tax would function in a global context.[8] If other nations do not change their approaches to taxing cross border investment, then it

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[5] 70 Tax L. Rev. at 28-30. The securities tax and the complementary tax do not cure the so-called double distortion on the choice between labor and leisure and the choice between consumption of earnings and saving that is associated with any tax on capital. Id. at 14-15. The taxes eliminate most distortions within capital markets. In the domestic context the principal distortion remaining under the two taxes is in the choice between liquid and illiquid assets by persons who are subject to the complementary tax (e.g., individuals, nonprofits, and defined benefit pension plans) and in the management of illiquid investments. The timing option and the availability of value-erasing strategies would create a distortion in favor of illiquid assets over liquid assets in investment choice. In the earlier paper I argued that this distortion should be fairly small because of the low tax rate and because the illiquidity of an asset makes it costly for persons subject to the complementary tax to dispose of assets that are over-valued for purposes of the complementary tax. The largest source of distortion would likely result from under-valuation of illiquid assets that have a better than normal return. This would create a lock-in effect similar to the lock-in effect that is created by the realization requirement under existing tax law. This effect could be quite significant with respect to some asset classes held by wealthy households, such as directly owned real estate and equity in closely held businesses. Id. at 42-48.

[6] 70 Tax L. Rev. at 61-72.

[7] An alternative is to bifurcate the securities tax into two taxes: one paid by issuers of securities and the other paid by individuals who hold publicly traded securities outside of tax-deferred accounts. The dual tax structure would eliminate the need to rebate part of the tax to nonprofits, individuals who hold securities in tax deferred accounts, and foreign investors. But this would compromise the effectiveness of the securities tax as a mechanism to combat tax havens and hidden wealth.

[8] This paper compares the securities tax to the status quo with respect to taxing global capital. It does not compare the securities tax to other proposals to reform the corporate income tax. The securities tax most closely resembles a Comprehensive Business Income Tax ("CBIT") in being a single tax on capital used by business entities that is remitted by a business entity. Since a CBIT is an income tax it reduces the problems created by a securities tax with respect to BEPS activities by multinational corporations that are addressed in Section 2. A CBIT and a securities tax raise similar issues with respect to cross-border portfolio investment because both taxes would increase the tax burden on foreign portfolio investment in the U.S., if the tax is not partially rebated to foreign investors.

The securities tax bears some resemblance to Eric Toder and Alan Viard's proposal to replace the corporate income tax with a shareholder-level mark-to-market income tax on corporate equity. See Eric Toder and Alan D. Virad, Replacing Corporate Tax Revenues with a Mark-to-Market Tax on Shareholder Income, 69 National Tax Journal 701 (2016); Eric Toder and Alan D. Virad, A Proposal to Reform the Taxation of Corporate Income, Tax Policy Center (June 2016); Eric Toder and Alan D. Viard, Major Surgery Needed: A Call for Reform of the U.S. Corporate Income Tax, SSRN Abstract 2426657 (2014). Toder and Viard originally proposed to eliminate the corporate income tax entirely, which would have imposed no U.S. tax burden on foreign direct (active) investment in the U.S. and no U.S. tax burden on foreign indirect (passive) investment in the U.S. It also would have encouraged MNCs to engage in BEPS would be necessary to modify the securities tax in several major respects to avoid dealing what could be a killing blow to the existing international tax system, and to comply with the existing international norm on the taxation of passive investment income. The modifications create complexity and new distortions but on the whole the modified securities tax would be no worse, and may be modestly superior, to the status quo with respect to taxing cross border investment, both nationally and globally. Perhaps the most significant benefits with respect to the taxation of cross border investment is global and would be realized by other nations because the securities tax and complementary tax, as withholding taxes, lend themselves to being implemented in a way that would make the U.S. unattractive as a tax haven for foreign wealth owners, without the U.S. having to join in the Common Reporting Standard, and with the U.S. remaining a haven for hidden wealth. There might be some benefit to the U.S. in this policy as well for it would make it extremely difficult for a U.S. wealth owner to avoid U.S. taxes by "round tripping" an investment in the U.S. through a foreign tax haven.

Section 2 addresses the taxation of Multinational corporations ("MNCs"). The unmodified securities tax could deal a killing blow to the existing international system for taxing MNCs. If the U.S. eliminated the corporate income tax, then MNCs would respond by shifting reported income to the U.S. This would significantly decrease global tax revenues and might prompt other nations to take retaliatory measures, dealing what could be a killing blow to the existing international system for taxing MNCs. To avoid this the U.S. could give a U.S. MNC a partial credit against its remittance obligation under the securities tax based on the share of a MNC's consolidated global income that is reported as foreign source income, and the U.S. could retain a corporate income tax on U.S. source income of a foreign MNC. This would preserve something close to the status quo with respect to the taxation of MNCs.

Section 3 addresses cross-border portfolio investment, focusing on investment in publicly traded securities. The securities tax integrates the corporate income tax and individual income taxes on interest, dividends, and capital into a single tax that is paid by a securities issuer. To the extent the securities tax replaces individual income taxes on passive investment income, it would violate the norm that a wealth owner's home nation has primary jurisdiction to tax passive investment income. To comply with this norm the U.S. could rebate a significant part of the securities tax to a foreign holder of a U.S. security. Section 3 explains other reasons why it probably is in the interest of the U.S. to rebate a significant part of the securities tax to a foreign holder of a U.S. security. It also explains the structure of a rebate, the need for and structure of anti-arbitrage rules, and the interaction of the rebate with giving a U.S. MNC a credit against the securities tax for foreign taxes paid on foreign source income.

Section 4 addresses the problem of determining the tax home of a MNC and the definition of a U.S. security for purposes of the securities tax. The existing U.S. system of taxing the global income of a U.S. corporation gives U.S. MNCs a tax incentive to move their tax home offshore. I explain that the securities tax coupled with the credit and

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activities to shift reported income to the U.S. In the most recent papers, Todar and Viard revise their proposal to preserve a corporate income tax at a 15 percent rate.

the rebate would flip this and create a strong tax incentive for a business that has substantial U.S. source income and substantial U.S. ownership to choose a U.S. tax home. If this tax bias in favor of a U.S. tax home is thought to be problematic, then the tax disadvantage to a business of having a foreign tax home can be reduced by allowing a foreign MNC to issue a special class of U.S. securities, on which it would pay the securities tax and which would carry some of the tax benefits of having a U.S. tax home.

Section 5 addresses the problem of global tax havens and hidden wealth. It explains how a rebate could be integrated into the CRS and FATCA information reporting systems to deter U.S. wealth owners from evading U.S. capital taxes by "round tripping" an investment in U.S. securities through a foreign tax haven. This strategy would also would make the U.S. unattractive as a tax haven for foreign wealth owners, without the U.S. having to join CRS, and without requiring U.S. financial institutions to report foreign-owned accounts and assets. Basically people would have the option of holding wealth secretly in the U.S. but this wealth would bear the burden of U.S. capital taxes.

2. Multinational corporations

If the U.S. adopted the securities tax and eliminated the corporate income tax, then this would significantly reduce global tax revenues as a result of U.S. and foreign multinational corporations ("MNCs") shifting reported income to the U.S. This could well provoke retaliatory measures by other nations. This Section proposes two modifications to the securities tax that are intended to preserve something like the status quo with respect to the taxation of cross-border direct investment by MNCs. I begin with some with background. [9]

a) The current landscape

Publicly traded securities issued by MNCs represent a large fraction of the world's wealth.[10] A MNC typically has a simple external capital structure and a very complicated internal capital structure. A parent corporation's external capital structure is likely to involve a single class of common stock and multiple classes of fixed income-

[9] Much of the literature on international tax debates the relative merits of the competing principles of capital export neutrality, capital import neutrality, or capital ownership neutrality, and advocates for policies that conform to whichever principle the author prefers. Under the principle of capital export neutrality an investor should face the same tax burden when it is comparing investment opportunities in its home nation and investment opportunities abroad. Under the principle of capital import neutrality all inbound investments into a nation should bear the same tax burden. Under the principle of capital ownership neutrality the international tax regime should not distort the ownership of capital assets. It will become apparent that I do not use these principles as policy guides. For a critique of the principles see Daniel Shaviro, Fixing U.S. International Taxation (2014); Daniel Shaviro, The Crossroads versus the SeeSaw: Getting a Fix on Recent International Tax Policy Judgments, N.Y.U. School of Law, Public Law and Legal Theory Research Paper Series, Working Paper No. 15-20 (2015); Michael J. Graetz, Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies, 54 Tax. L. Rev. 272 (2001).

[10] Multinational corporate stock is estimated to account for 40% of the value of the West's stock markets. See Multinationals: the retreat of the global economy, The Economist (Jan. 28, 2017).

securities, which may include preferred stock and long- and short-term debt. The internal capital structure of a large MNC is likely to include hundreds of affiliates that are established in scores of nations. Some affiliates will conduct business operations while others will be passive intermediaries. Affiliates will hold each other's debt and equity. And affiliates will engage in business transactions with each other. Typically, a parent corporation will hold 100 percent of the equity and long-term debt of an affiliate, either directly or indirectly through other affiliates. It is very unusual for a parent corporation to hold less than 50 percent of an affiliate's equity.[11] When a MNC owns less than 100 percent of an affiliate it often is because an affiliate is a joint venture between two or more MNCs.

Cross-border investment by an MNC is described as direct investment. To be more precise, when an entity established in Nation A owns a controlling interest (typically defined as 10 percent or more)[12] in an entity established in Nation B the investment in the entity in Nation B is defined as foreign direct investment.[13] The U.S. had $6,978 billion outbound foreign direct investment and $6,544 billion inbound foreign direct investment in the fourth quarter of 2015.[14] Much of this investment is by large MNCs. Outbound U.S. foreign direct investment was equal to approximately 7% of the assets of the U.S. households and 9% of the net worth of U.S. households in the same quarter.[15] The quantity of outbound foreign direct investment provides a very rough sense[16] of the share of the wealth of U.S. households that is represented by foreign investment through U.S. companies. By comparison, U.S. outbound portfolio investment

[11] United Nations Conference on Trade and Development ("UNCTAD"), World Investment Report 2016, Investor Nationality: Policy Challenges, esp. pp. 135-136.

[12] The technical definition of direct investment is holding sufficient voting stock (or its equivalent) in a foreign business entity to be able to exercise substantial influence over the entity's business decisions. In the US this is defined as at least 10% of the voting stock. See Graetz & Grinberg, 56 Tax L. Rev. at 538-539.

[13] Foreign direct investment can be by an individual as well as an entity. And foreign direct investment can take the form of ownership of real assets as well as ownership of an entity.

[14] The data is from the Bureau of Economic Analysis report of the Net International Investment Position and is from the fourth quarter of 2015.

[15] U.S. households were estimated to hold assets worth $101,696.8 billion and to have a net worth of $87,118 billion. Board of Governors of the Federal Reserve System, Financial Accounts of the United Nations, Third Quarter 2016 (Dec. 8, 2016). Table B.101.

[16] This point should be underscored. The system of accounting for cross-border investment can obscure the ultimate owners and users of capital. Corporate inversions illustrate. A MNC ("MNC") is treated as a resident of the nation in which it is legally established. Thus a U.S. MNC's investment in foreign operations is accounted for as outbound direct investment. In an inversion a U.S. MNC becomes a subsidiary of a newly established foreign parent corporation. This erases the outbound direct investment. After the inversion holdings by U.S. persons of the foreign parent's debt and equity are accounted for as outbound portfolio investment, while the investment by the foreign parent in its U.S. subsidiary is accounted for as inbound direct investment. The inversion does not change who owns the capital in the MNC or the location of its real assets or operations, both of which are likely to be centered in the U.S. But the inversion makes the investment of U.S. wealth holders in the U.S. assets and operations of the MNC appear to be cross border investments.

was $9,606 billion in the fourth quarter of 2015.[17] Much of this is foreign investment through foreign companies.

The existing system of taxing cross-border investment is based on a consensus "that active business income should be taxed in the country in which it originates (the source country) and passive income should be taxed in the country in which the recipient of the income resides (the residence country)."[18] The distinction between active business income and passive income roughly corresponds with the distinction between foreign direct investment (which generates active income) and foreign portfolio investment (which generates passive income).[19] The upshot of the consensus that active business income should be taxed at its source is that a MNC generally pays the corporate income tax to every nation in which it has a corporate affiliate on the income that is reported by an affiliate as having its source in that nation. The U.S. is somewhat of an exception to the norm for the U.S. taxes the global income of a U.S. corporation, much as it taxes the global income of a U.S. citizen or U.S. resident. But it would be an overstatement to say that the U.S. taxes the global income of a U.S. MNC. The U.S. does not a require a U.S. parent corporation to pay tax on the income of a foreign subsidiary until the income is repatriated to the parent, and a U.S. parent corporation is given a credit against its U.S. tax liability for foreign taxes a foreign subsidiary pays on foreign source income.[20]

MNCs often arrange their global operations to shift reported income to affiliates in nations that tax corporate income at a low rate in order to reduce the company's global tax burden. The acronym BEPS—"base erosion and profit shifting"—refers to these activities. A common BEPS strategy is to strip earnings from a "high tax" affiliate (i.e., an affiliate that pays tax at a high rate on reported income) by financing the affiliate with debt that is held by a low-tax affiliate. The interest deduction shifts income from the high-tax affiliate to the low-tax affiliate. Another common BEPS strategy involves transfer pricing. A low-tax affiliate will over charge for property or services it provides to a high-tax affiliate. The over-charge shifts income from the high-tax affiliate to the low-tax affiliate

[17] Inbound portfolio investment was $16,677 billion. By comparison outbound and inbound portfolio investment were $9,606 billion and $16,677 billion, respectively. The dominance of portfolio investment over direct investment in the financial accounts of the U.S. continues a trend observed by Michael Graetz and Itai Grinberg in 2003. Michael Graetz and Itai Grinberg, Taxing International Portfolio Income, 56 Tax L. Rev. 537 (2003)(reporting that outbound FBI by U.S. nationals total $10 billion in 1960, $158 billion in 1986, $1,700 billion in 1997, and $2,262 billion in 2001).

[18] Reuvan S. Avi-Yonah, Structure of International Tax, 74 Tex L. Rev. 1301, 1306 (1996).

[19] Michael J. Graetz and Itai Grinberg, Taxing International Portfolio Income, 56 Tax L. Rev. 537 (2003).

[20] There is a substantial literature on the effective tax burden of the U.S. corporate income tax on foreign source income of U.S. MNCs. Mellisa Costa and Jennifer Gravelle, Taxing MNCs: Average Tax Rates, 65 Tax L. Rev. 391 (2012), report that in 2007 U.S. MNCs paid taxes to the U.S. equal to 3.3 percent of their reported foreign source income. Rosanne Altshuler and Harry Grubert, Repatriation Taxes, Repatriation Policies and Multination Financial Policy, 87 Journal of Public Economics 73 (2002), estimate that the effective tax burden of the U.S. corporate income tax on U.S. MNC foreign source income is around 5.4 percent. This estimate assumes there is a deadweight burden of 1.7 percent on unrepatriated earnings held offshore in low tax nations.

A recent paper by Clausing estimates that BEPS activities reduced U.S. tax revenues by $77 to $111 billion in 2012 and worldwide tax revenues by $280 billion in the same year.[21] Another recent paper by Dharmapala presents a somewhat more sanguine picture of the magnitude of BEPS activities.[22] Dharmapala investigates how income reported by MNCs responds to changes in corporate tax rates by surveying the existing empirical literature that examines firm-level data on how the location of income reported by firms changed in response to changes in tax rates. Dharmapala concludes that we should expect that "a 10 percentage point increase in the tax rate between an affiliate and its parent . . . would increase the pre-tax income reported by the affiliate by 8 per cent."[23]

Many experts believe that the existing system of source-based taxation of the income of MNCs is unsustainable in the long run.[24] Certainly MNCs enjoy a significant degree of freedom in allocating income amongst their affiliates in response to differences in national corporate tax rates. Some freedom to choose the source of income is inevitable when a significant part of the value of a MNC is based on intangible assets—e.g., intellectual property, good will, market power, and synergistic value—that have no physical location. No law prohibits a MNC from transferring ownership of transferable intellectual property rights—like patents and copyrights—to an affiliate in a low tax nation as a capital contribution. Once ownership of intellectual property is transferred to an affiliate income attributable to the transferred property is legitimately allocated to the affiliate that owns the intellectual property. Intra-corporate sales, leases, licenses, service agreements and the like are subject to rules that require that prices in transactions between affiliates correspond to "arms-length prices." But arms-length pricing rules are difficult to enforce even in the best of circumstances, and they are almost impossible to enforce when there is no market to set a benchmark arms-length price for a transaction between affiliates. A MNC also has a largely free hand in choosing between debt and equity in determining an affiliate's capital structure when the parent corporation holds all of an affiliate's debt and equity either directly or indirectly. Finally, the existing system encourages competition between nations to capture a larger share of reported income by lowering corporate tax rates generally or by creating special tax regimes like a "patent box" that offer lower rates for easily shifted income.[25]

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[21] Kimberley A. Clausing, the Effect of Profit Shifting on the Corporate Tax Base in the United Nations and Beyond.

[22] Dhammika Dharmapala, What Do We Know About Base Erosion and Profit Shifting? A Review of the Empirical Literature, 35 Fiscal Studies 421 (2014). An earlier paper by xxx finds that approximately 80% of BEPS activity involves transfer pricing and 20% involves inter-affiliate debt.

[23] Id. at 423.

[24] See, e.g., Michael P. Devereux and John Vella, Are We Heading towards a Corporate Tax System Fit for the 21st Century?, 35 Fiscal Studies 499 (2014); Daniel N. Shaviro, Fixing U.S. International Taxation (Oxford 2014); Michael J. Graetz, Can a 20th Century Business Income Tax Regime Serve a 21st Century Economy, 30 Austl. T. Forum 551 (2015).

[25] The reduction in global revenue from tax competition to capture a larger share of reported income is an expected by-product of nations pursuing their individual interests with respect to tax policy. Vincent Arel-Bundock, The Unintended Consequences of Bilateralism: Treaty Shopping and International Tax Policy, 71 International Organizations 349 (2017), explains that the bilateral character of tax treaties has had the

b) What if the U.S. replaced the corporate income tax with the securities tax?

Replacing the U.S. corporate income tax with the securities tax would not help shore up the existing system for taxing MNCs. To the contrary—it could present a fatal blow to the existing system. If the U.S. eliminated its corporate income tax, then there would be a significant decrease in global tax revenue as a result of MNCs engaging in BEPS activities to shifted reported income to the U.S. and away from nations with a corporate income tax.[26] A U.S. MNC would remit the tax based on the market value of its publicly traded debt and equity, and not its reported U.S. income, so it would pay no additional tax on income that was shifted to the U.S. A foreign MNC with a U.S. affiliate would pay no federal corporate income tax on the affiliate's reported U.S. income, and so the MNC could largely eliminate the burden of the corporate income tax on reported income that was shifted to a U.S. affiliate.

The loss in global tax revenue could be quite significant because of the size of the U.S. economy. If Dharmapala's sanguine estimate of the response of reported income to changes in corporate tax rates is accurate, then we would expect pre-tax income reported by U.S. affiliates of foreign parents to increase by 28 percent as a result of the U.S. abolishing the corporate income tax (this is .8 of a 35 percent reduction in the U.S. corporate tax rate). The revenue loss to other nations would equal whatever tax they had collected on the income that is shifted to the U.S. There would be a similar effect in how U.S. MNCs report income. The income reported by the U.S. parent would increase and the income reported by foreign affiliates would decrease, which would further reduce foreign tax revenues.[27]

The reduction in global tax revenues is a short-run effect that may not involve a significant distortion in actual flows of cross-border direct investment. If the U.S. eliminated the corporate income tax, then the long-run effect should be to decrease outbound direct investment by U.S. MNCs to other nations that tax corporation income and to increase inbound direct investment by foreign MNCs into the U.S. and from nations that tax corporate income.[28] Outbound direct investment by a U.S. MNC would

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unintended consequence of enabling MNCs to reduce their tax burden by "treaty-shopping" or making payments through conduits established to exploit advantageous treaty terms.

[26] This would be an enormous change from the status quo. When U.S. MNCs engage in BEPS activities it is to shift income from a high-tax foreign affiliate to a low-tax foreign affiliate and to manage its tax credit position under U.S. tax law. Edward D. Kleinbard, 11 Fla. Tax Rev. 699 (2011). Itai Grinberg, The New International Tax Regime, 104 Geo. L.J. 1137, 1143-1145 (2016), argues that the fact foreign tax laws set "the rules of the game" for U.S. MNCs with respect to income shifting diminished the political leverage of the U.S. in the BEPS project.

[27] The current strategies being pursued to combat BEPS are ill suited to combating profit shifting to the U.S. The strategies are designed to combat profit shifting to small, tax-haven nations in which multinational companies do not engage in substantial "value-creating" economic activities. Michael P. Devereux and John Vella, Are We Heading towards a Corporate Tax System Fit for the 21st Century, 35 Fiscal Studies 449, 463 (2014).

[28] The extent to which differences in national corporate tax rates influences the flow of cross-border investment is unclear. If a multinational company has monopoly power and is able to earn a supra-normal yield (economic rents) on a cross-border investment, then the corporate tax rate would have to be very high to deter the company from raising capital to make an investment. And the ability of a multinational

bear a higher tax burden than investment in U.S. assets and operations because it would bear the burden of the securities tax plus any foreign corporate income tax. Inbound direct investment by a foreign MNC in U.S. assets and operations would not bear the burden of a federal corporate income tax. It would only bear the burden of state corporate income taxes in the U.S. Nor would inbound investment by foreign MNCs be subject to the securities tax.

This state of affairs is likely to be unstable. Other nations would be likely to retaliate to discourage MNCs from shifting reported income to the U.S. and to reduce the tax-preference for direct investment in the U.S. Other nations could solve half of the problem unilaterally by adopting rules similar to controlled-foreign-corporation rules to require a local parent company to pay the local corporate income tax on the U.S.-source income of a U.S. affiliate.[29] This would eliminate the tax benefit of shifting reported income from the foreign parent to a U.S. affiliate and the tax preference for capital invested by a foreign parent in a U.S. affiliate. The problem of a U.S. MNC engaging in BEPS activities to shift reported income to the U.S. to avoid foreign corporate taxes does not lend itself to a straightforward unilateral solution. But this does not mean other nations would not retaliate on this front. For example, a nation could use the stick of aggressively challenging transfer pricing by a U.S. MNC in transaction between the U.S. parent and a local affiliate. Or a nation could use the carrot of offering incentives to attract investment by a U.S. MNC that offset the cost of the local corporate income tax. Or a nation could use both sticks and carrots.

c) Preserving something like the status quo

i) An income tax on a foreign MNC's U.S. source income

If you care about preserving the status quo, then happily there is a relatively simple way to do this with respect to foreign MNCs. The U.S. could retain the corporate income tax on the U.S. source income of a foreign MNC.[30] This would reduce the tax

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company to engage in BEPS activities to shift income to low-tax affiliates reduces the tax burden on an investment in a high-tax nation.

[29] For a recent survey of the development, spread, and rationale for CFC rules, see Peter Koerver Schmidt, Taxation of Controlled Foreign Companies in the Context of the OECD/G20 Project on Base Erosion and Profit Shifting as well as the EU Proposal for the Anti-Tax Avoidance Directive—An Interim Nordic Assessment, 2016 Nordic Tax Journal 87.

[30] This footnote addresses the relative merits of, and the relationship between, the corporate income tax and the complementary tax as mechanisms for taxing foreign investment in the U.S. Under existing U.S. tax law a foreign corporation or individual generally is required to pay the U.S. income tax if they are engaged in an active trade or business in the U.S. They are required to pay tax on income that is effectively connected to the trade or business (or that is deemed to be effectively connected). The securities tax and complementary tax require rethinking these lines.

Whether income is or is not effectively connected to a U.S. trade or business should be irrelevant to whether foreign investment in the U.S. was subject to the complementary tax. Much foreign investment that is now subject to the U.S. income tax under these rules would instead be subject to the complementary tax. For example, if a foreign individual invested in a U.S. partnership that was engaged in an active trade or business the investment would be subject to the complementary tax, and not the income tax. Similarly, if a foreign individual invested in U.S. real estate, then the investment would be subject to the complementary tax, and the not the income tax. And if a foreign individual invested in a U.S. partnership incentive for a foreign MNC to engage in BEPS related activities to shift reported income to the U.S.[31] The tax rate should be significantly lower than the current U.S. federal corporate income tax rate of 35 percent. Adding state corporate income taxes, and using a blended rate, brings the top U.S. tax rate to around 39 percent. Two benchmarks can be used to set the tax rate on a foreign MNC's U.S. source income. Both benchmarks indicate that the top federal income tax rate on a U.S. MNC's foreign source income should be around 20 to 25 percent and that effective tax rate on a U.S. MNC's foreign source income should be around 20 percent.

One benchmark is the top corporate income tax rates in other nations. This benchmark follows from the purpose of taxing a foreign MNC's U.S. source income, which is to discourage a foreign MNC from shifting reported income to the U.S. Corporate tax rates have been trending downward around the global. Tax Foundation reports that the worldwide average top corporate income tax rate is 22.5 percent (26.22 percent weighted by GDP), and that the average top corporate tax rate in Europe is 18.88 percent (26.22 percent weighted by GDP).[32]

The other benchmark is the effective income tax rate that is implied by the securities tax rate. A tax on the value of capital, like the securities tax, is equivalent to an income tax on the normal return on capital. This equivalency makes it possible to identify an effective income tax rate that is implied by the securities tax rate. This is the effective income tax rate that equalizes the burden of the securities tax and an income tax,

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or in U.S. real estate, then the investment would be subject to the U.S. complementary tax whether or not the individual was considered to be engaged in an active trade or business in the U.S.

Two general considerations bear on the choice between the income tax and the complementary tax as a mechanism to tax foreign investment in U.S. assets. The text focuses on one general consideration, which is the ability of a foreign investor to reduce its global taxes by engaging in BEPS activities to shift reported income from other nations to the U.S. The second general consideration is whether reported income (under the rules for reporting income) or estimated value (under the rules for estimating value) is a better measure of the value of an investment in the U.S.. The time horizon of an investment is an important factor. If an investment has a relatively short time horizon, then estimated value generally is a fair proxy for the actual value of an investment when the initial value of the investment is observable (e.g., an investment is made in cash) or when the agreed value of an investment is a product of arms-length bargaining in a transaction in which the agreed value determines the investor's return. The estimated value of an investment also generally is a fair proxy for the actual value of an investment when the value can be inferred from an arms-length transaction involving a similar asset (e.g., a redemption or a sale in a secondary market).

The paradigmatic example of a case in which reported income is likely to be a better proxy for the real value of an investment in the U.S. is when a foreign corporation does business in the U.S. through a wholly owned affiliate. An investment in a wholly owned subsidiary is likely to have a long time horizon. The initial value of an investment is not observable by the government. Much of the capital contributed by a foreign MNC to a U.S. affiliate is likely to be intangible and difficult to value. And the value of an investment cannot be inferred from an arms-length transaction involving a similar asset. In addition, if a U.S. affiliate generates a positive cash flow, then a foreign parent could use its power to control cash distributions to game the complementary tax.

[31] Section 4 considers how the asymmetrical treatment of U.S. source income of a foreign corporation (which is subject to an income tax) and the foreign source income of a U.S. corporation (which provides a credit against the securities tax) might affect an MNC's choice between a foreign and a U.S. tax home. Section 5 considers line-drawing problems and issues such as the taxation of a U.S. joint venture that is jointly owned by a U.S. corporation and a foreign corporation.

[32] https://taxfoundation.org/corporate-income-tax-rates-around-world-2016/.

assuming capital yields a normal return. If r is the normal return on capital and t_c is the capital tax rate, then the effective income tax rate that is implicit in the securities tax equals t_c/r. Piketty finds that the normal real return on capital is around 4 percent. If 4 percent is the normal rate of return, then a securities tax rate of .08 percent implies an effective income tax rate of 20 percent.

ii) A partial credit against the securities tax for foreign taxes paid by a U.S. MNC on foreign source income

The elimination of the corporate income tax gives a U.S. MNC an incentive to engage in BEPS activities to shift reported income to the U.S. To create a disincentive for this sort of activity the U.S. could give a U.S. MNC a credit against the securities tax for foreign income taxes an MNC pays on its foreign source income. A U.S. MNC that shifted reported income to the U.S. to reduce foreign corporate income taxes would incur a U.S. tax cost through the foregone credit. The credit would also be a way for the U.S. to satisfy the existing international norm that active business income should be taxed by the nation in which the income is generated. The U.S. would cede primary jurisdiction to tax a U.S. MNC's foreign source income to foreign nations through the credit against the securities tax.

The credit should be capped so that the U.S. does not bear the full burden of foreign taxes on a U.S. MNC's foreign source income. The cap should be set at a percentage of a U.S. MNC's total tax liability under the securities tax, which is the securities tax rate applied to the market value of a U.S. MNC's publicly traded debt and equity.[33] The percentage would be a fraction of the share of a U.S. MNC's global consolidated reported income that is foreign source income. For example, if 12 percent of the global consolidated reported income of a U.S. MNC is foreign source income, then the credit would be capped a fraction of 12 percent of the company's total securities tax liability. I will call the fraction of an MNC's global consolidated income that is foreign source income an MNC's "FSI Share." The cap would be a fraction of an MNC's FSI Share.

There is a straightforward rationale for capping the credit at a U.S. MNC's FSI Share. A capital tax like the securities tax is equivalent to an income tax on the normal or expected yield on capital. Thus a tax on the total market value of a U.S. MNC's securities (debt as well as equity) is equivalent to an income tax on a U.S. MNC's normal or expected global income. To cede primary jurisdiction to tax a U.S. MNC's foreign source income to other nations the U.S. could give a credit against the securities tax for the share of a U.S. MNC's global income that is foreign source income. Another way to think about his is that a U.S. MNC's FSI Share is a rough way of identifying the percentage of the market capitalization of a U.S. MNC (defining an MNC's market

[33] This assumes that all of a U.S. MNC's capital is represented by publicly traded debt and equity. If a U.S. business raises capital by issuing debt that is held by U.S. persons who are subject to the complementary tax or by foreign persons, then the business would be required to remit the complementary tax on the estimated value of the debt. If the business has foreign source income then the credit would be based on the business's total tax liability (securities tax plus complementary tax).

capitalization to include debt as well as equity) that is attributable to a U.S. MNC's foreign assets and foreign operations.

The credit should be for a fraction of a U.S. MNC's FSI Share because the securities tax replaces the individual income tax on interest, dividends, and capital gains as well as the corporate income tax. Currently when U.S. wealth owners invest abroad by investing in a U.S. MNC that has foreign assets and operations returns that are attributable to the foreign assets and operations bear the burden of the U.S. individual income tax on interest, dividends, and capital gains. Capping the credit at a fraction of a U.S. MNC's FSI Share is a substitute for the individual income tax on interest, dividends, and capital gains.[34]

Two plausible benchmarks for the fraction of a U.S. MNC's FSI Share at which the credit should be capped suggest it should be a large fraction, perhaps in the range of .75 to close to 1. One benchmark is to equalize the implicit tax cost to a U.S. MNC of shifting reported income to the U.S. in foregone credits with the top foreign corporate income tax rates. This benchmark follows from the purpose of the credit, which is to deter U.S. MNC's from engaging in BEPS activities to shift reported income to the U.S. to avoid foreign corporate income taxes. This benchmark suggests a fraction close to 1 since the income tax rate that is implied in the securities tax rate is in the range of the top foreign corporate income tax rates.

The other benchmark is to set the fraction to approximate the fraction of the existing tax burden on capital invested in corporations that is attributable to the individual income tax on interest, dividends, and capital gains and not to the corporate income tax. This benchmark follows from one rationale for capping the credit at a fraction of a U.S. MNC's FSI Share—which is to be a surrogate for the tax burden now placed the foreign source income of a U.S. MNC by individual-level capital income taxes. My best guess is that this benchmark would yield a fraction in the neighborhood .75 to .80. But this is only a guess.[35]

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[34] Capping the credit at a fraction of a U.S. MNC's FSI share somewhat reduces the difference in the U.S. tax burden on U.S. capital that is invested abroad through a U.S. MNC and the U.S. tax burden on capital that is invested abroad through a foreign MNC. A U.S. wealth owner who invests capital abroad through a foreign MNC would pay the securities tax on the market value of the MNC's securities and receive no credit for foreign taxes paid by the MNC on its foreign source income. On the other hand, a U.S. wealth owner who invests capital abroad through a U.S. MNC would get a credit for foreign taxes paid by the MNC on its foreign source income. Capping the credit at a fraction of the foreign taxes paid on foreign source income reduces the tax advantage of investing U.S. capital abroad through a U.S. MNC.

[35] Michelle Harding, Taxation of Dividend, Interest, and Capital Gain Income, OECD Taxation Working Papers, No. 19 (2013), is a good comparative analysis of the basic components of the analysis of the sources of the nominal tax burden, which requires integrating the nominal burden of the corporate income tax with the nominal burden of individual income taxes on interest, dividends, and capital gains. Because of the interest deduction the nominal tax burden on capital represented by debt is borne entirely by the individual. In the U.S., which combines a high corporate income tax rate with a low individual income tax rate on dividends and capital gain, most of the nominal tax burden on capital represented by corporate equity is attributable to the corporate income tax. Thus the relative nominal significance of the corporate income tax and the individual income tax depends on the relative significance of debt and equity as sources of capital, and on the fraction of the return on equity that is represented by dividends.

iii) A few loose ends

Retaining an income tax for a foreign MNC's U.S. source income and giving a U.S. MNC a partial tax credit for foreign taxes paid on its foreign source income would do little to reduce the global level of BEPS activities. That is not the purpose of these rules. Their purpose is to prevent the elimination of the corporate income tax by the U.S. from significantly increasing the level of BEPS activity by MNCs, and to remove the tax preference that would otherwise exist for corporate investment in the U.S. over corporation investment in nations with a corporate income tax.

These rules may provide a small benefit in simplification by eliminating the tax incentive for some types of BEPS-related activities by U.S. MNCs. U.S. MNCs would no longer have an incentive to keep foreign earnings abroad. The securities tax would capture the value of unrepatriated earnings that are reflected in the price of a corporation's securities. Foreign earnings that were not reinvested abroad would not generate foreign source income that would provide a credit against the securities tax. And U.S. MNCs might have a smaller incentive to engage in activities that were designed to maximize the value of foreign tax credits.

The existence of two systems for taxing capital used by MNCs would create some new sources of tax distortion and new tax gaming opportunities. The rules could influence the choice of an MNC between a U.S. tax home and a foreign tax home. The choice would determine whether an MNC paid the securities tax and received a partial credit for foreign taxes paid on foreign source income or whether an MNC paid the corporate income tax on U.S. source income. Section 4 addresses this issue.

3. Cross-border portfolio investment

This Section addresses the taxation of cross-border portfolio investment, focusing on investment that is represented by publicly traded securities. The volume of cross-border portfolio investment significantly exceeds the volume of cross-border direct investment. The table below shows the amount of all types of U.S. cross-border investment in the last quarter of 2015.[36] All figures are in billions. As a point of comparison, in the same quarter U.S. households were estimated to hold assets worth $101,696.8 billion and to have a net worth of $87,118 billion.[37]

	Outbound	**Inbound**
Total	**$20,945**	**$28,283**
Direct investment	**$6,978**	**$6,544**
Equity	$5,811	$4,979
Debt instruments	$1,167	$1,565

[36] The data is from the Bureau of Economic Analysis report of the Net International Investment Position and are from the fourth quarter of 2015. The figures exclude financial derivatives. A significant part of foreign holdings of U.S. debt securities are in U.S. Treasury bills and certificates. Of $9,503 billion of foreign holdings in long-term U.S. debt securities $5,423 billion was in U.S. Treasury bills and certificates.
[37] Board of Governors of the Federal Reserve System, Financial Accounts of the United Nations, Third Quarter 2016 (Dec. 8, 2016). Table B.101.

Portfolio investment	**$9,606**	**$16,677**
Equity + investment fund shares	$6,828	$6,219
Debt securities	$2,778	$10,458
Short term	$486	$955
Long term	$2,292	$9,503
Other investment	**$3,977**	**$5,062**
Currency and deposits	$1,629	$2,914
Loans	$2,304	$1,924
Reserve assets	$384	

The figures for portfolio investment include investment through private channels such as private investment funds. Data from the Treasury International Capital (TIC) survey of U.S. portfolio holdings of foreign securities and foreign portfolio holdings of U.S. securities provides a rough sense of the relative volume of cross-border investment through publicly traded securities and cross-border investment through private channels. At the end of 2015, $6,756 billions of outbound portfolio investment was in foreign equity, 85 percent of which was common stock,[38] 9 percent was fund shares, and 6 percent was "other," which includes limited partnership interests and preferred stock.[39]

There is a long-standing consensus that "that passive income should be taxed in the country in which the recipient of the income resides (the residence country)." For example, if a resident of Nation A invests in the securities of a corporation in Nation B, then Nation A (the source of the capital and the destination of the capital income) will tax any interest, dividends, or capital gain with respect to the securities. Thus under existing law, a U.S. citizen or resident is required to pay U.S. tax on her worldwide income,

[38] Chris William Sanchirico, As American as Apple Inc.: International Tax and Ownership Nationality. 68 Tax. L. Rev. 207 (2015), tries to answer the question: what percentage of the equity of U.S. MNC's is owned by non-U.S. investors? He concludes existing data does not make it possible to answer the question with confidence. According to the TIC data 13.6% percent of U.S. equity was foreign-owned in 2012. This number rose steadily in the preceding decade from a level of 6.9% is 2000 and 7.5% in 2002.

[39] Department of Treasury, Federal Reserve Bank of New York, and Board of Governors of the Federal Reserve System, U.S. Portfolio Holdings of Foreign Securities as of December 31, 2015 (Oct. 2016), p. 12.

The volume of cross-border investment through private investment funds is large and growing. International Private Equity Flows (ssrn.com/abstract=1361494), provides data on the growth of cross-border investment through private equity funds through 2007. The paper reports that the majority of the deals done by private equity funds involved capital from the U.S. and the U.K., and that much of this capital came from large institutional investors. France and Germany were the dominant capital recipient countries, followed by the U.S. and the U.K. The paper also reports strong regional and cultural clustering. For example, European capital generally stays in Europe and capital from a culturally Anglo-Saxon nation is invested in another Anglo-Saxon nation.

Many private investment funds are established in tax haven nations. The Cayman Islands are a case in point. The TIC survey reports that U.S. portfolio investment in the Cayman Islands included $393.9 billion in "fund shares" and $235.9 billion in "other," which includes limited partnerships. TIC,US Portfolio Holdings of Foreign Securities, Table A12, at A-43. $300 billion was in long-term debt, almost all of which was private. Table A11, at A-39. $285 billion was in common stock. Table A12, at A-43. This was over 50 percent of total U.S. portfolio investment in the Cayman Islands ($1,217.1 billion). U.S. Portfolio Holdings of Foreign Securities as of Dec. 31, 2015 (Oct. 2016), at 5. A smaller fraction of inbound investment to the U.S. from the Cayman Islands was represented by fund shares ($142.9 billion) and other ($177.6 billion). Most inbound investment was in common stock ($563 billion). Foreign Portfolio Holdings of U.S. Securities as of June 30, 2015 (May 2016), Table A4, at A-19 including dividends and interest paid with respect to a foreign security and capital gains realized on sale or exchange of a foreign security. Similarly, a U.K. resident is required to pay U.K. tax on her worldwide portfolio income.

Cross border portfolio investment in equity implicitly bears the burden of a foreign corporate income tax. Nations like the U.S. that require a domestic parent corporation to pay tax on income repatriated by a foreign subsidiary give the parent corporation a tax credit for corporate income tax paid by the subsidiary.[40] But individual investors who invest in foreign equity generally are not given a credit for corporate income tax paid by a corporation. Many nations impose a withholding tax on dividends paid to foreign equity holders. When there is a tax treaty the usual withholding tax rate on dividends is 15 percent. But it is easy for a foreign investor to avoid the U.S. withholding tax on dividends by investing in U.S. equity through a U.K. account. Under the U.S.-U.K. tax treaty no tax is withheld on dividends paid to an account in the other nation. When a withholding tax is paid on a dividend often the destination nation will give a credit against the local tax on the dividend income. It is unusual for a nation to impose a withholding tax on interest. And it is unusual for a nation to tax a foreign holder of a domestic security on capital gain on sale or exchange of the security.[41]

a) U.S. investment abroad

The securities tax and the complementary tax would replace the U.S. individual income tax on interest, dividends, and capital gains. They are designed to be the sole taxes on capital owned by U.S. households and nonprofits. Thus the U.S. would not tax U.S. households on interest, dividends, and capital gains associated with outbound portfolio investment. Instead the U.S. would tax the market value of foreign publicly traded securities held by U.S. households and nonprofits.

A large percentage of the value of the wealth of U.S. households and nonprofits that currently is classified as outbound foreign portfolio investment would be captured by the securities tax without any special rules. Almost half of outbound foreign portfolio investment by U.S. persons in the last quarter of 2015 was through mutual funds.[42] These funds include some funds that specialize in foreign investment such as closed-end

[40] Graetz and Grinburg, 56 Tax L. Rev. at 548. A U.S. corporation which owns 10 percent or more of the voting stock of from which it receives dividends gets a "deemed paid" tax credit under IRC § 902.
[41] Foreign persons, including foreign companies, generally are not subject to information reporting requirements under U.S. law, including the requirement to file Form 1099 when interest or dividend is paid. When a foreign security is held through a U.S. intermediary, such as fund or a broker, then the intermediary is required to file an information return with respect to a foreign security. Foreign Financial Institutions are subject to special reporting requirements under the Foreign Account Tax Compliance Act ("FATCA").
[42] Department of Treasury, Federal Reserve Bank of New York, and Board of Governors of the Federal Reserve System, U.S. Portfolio Holdings of Foreign Securities as of December 31, 2015 (Oct. 2016), pp. 25-26: "As of December 2015, mutual funds were by far the largest holdings of foreign securities, at $4.4 trillion or nearly half of the total. The second largest U.S. holders of foreign assets were pension funds, with $1.3 trillion (13 percent of the total), followed by nonfinancial firms ($1.2 trillion or 12 percent). Investment funds, a group that consists mainly of hedge funds . . . held $0.6 trillion, or 6 percent of total U.S. overseas securities holdings."

country funds and foreign index funds.[43] These funds are established in the U.S. and the shares of a closed-end fund will be listed and traded on a U.S. exchange. A U.S. mutual fund would be required to remit the securities tax on the market value of its shares. If a U.S. mutual fund holds a foreign security on which the securities tax had not been paid, then the fund would end up bearing the cost of the securities tax.

When a U.S. household or nonprofit invests in foreign securities through a private investment fund, like a U.S. hedge fund, the complementary tax, which is remitted on the estimated value of an interest in the fund, usually would capture the value of the foreign-listed securities. A special rule is needed for a U.S. defined benefit pension fund because interests in a defined benefit pension fund are not subject to the complementary tax. This investment can be handled by requiring a U.S. defined benefit pension fund to remit the securities tax on the market value of foreign-listed securities the fund holds.

When a U.S. individual invests in foreign securities through a family limited partnership or when a U.S. individual holds foreign-list securities directly through a securities intermediary (i.e., a bank or broker-dealer), then the family limited partnership or the individual would be required to remit the tax on the market value of the foreign securities. This opens the door for a U.S. individual to evade the tax by holding foreign securities through an unreported offshore account. Section 5 addresses this problem, which is an aspect of the global problem of tax havens and hidden wealth.

b) Foreign investment in the U.S.

Currently foreign wealth owners who invest in U.S. securities pay no U.S. tax on interest, dividends, or capital gain income. A foreign investor who invests in U.S. corporate stock implicitly pays the U.S. corporate income tax. If the U.S. were to adopt the securities tax, then a U.S. corporation would be required to remit the securities tax on the market value of its publicly traded securities (debt as well as equity), including securities that are held by foreign wealth owners. Thus a foreign wealth owner who invests in U.S. securities of any type (debt as well as equity) would bear the full burden of the U.S. securities tax, in addition to the burden of his home nation's income taxes on interest, dividends, and capital gains associated with a security.[44]

[43] Investment Company Institute. See also, Anita K. Pennathur, Natalya Delcoure, and Dwight Anderson, Diversification Benefits of iShares and Closed-End Country Funds, 25 Journal of Financial Research 541 (2002).

[44] The general rules for taxing inbound portfolio investment through private investment funds (or other private channels) follow from the tax treatment of inbound portfolio investment through public securities markets. To maintain neutrality on the margin between foreign portfolio investment in U.S. securities and foreign portfolio investment through private investment funds (or other private channels), a U.S. private equity fund should be required to remit the complementary tax on the estimated value of an interest in the fund that is held by a foreign person. More generally, a U.S. entity that raises capital through private channels should be required to remit the complementary tax on the estimated value of a capital interest in the entity (both debt and equity) that is held by a foreign person. For example, a U.S. partnership with a foreign partner would be required to remit the tax on the estimated value of the foreign partner's capital interest. And a U.S. business entity that obtains debt financing from a foreign lender should be required to remit the tax on the estimated value of the debt. The tax would be rebated to a foreign owner (or lender) if

To reduce the tax burden on foreign capital invested in the U.S., the U.S. could rebate part of the securities tax to foreign investors.[45] Section i) examines the arguments for rebating part of the tax. Section ii) explains the structure of a rebate. Section iii) explains the need for anti-arbitrage rules. Section iv) examines the interaction of the rebate with a rule giving a U.S. company a credit against the securities tax for foreign taxes paid on foreign source income. I defer to Section 5 the question whether the rebate should be integrated into tax information reporting systems to tax evasion by investing capital through unreported offshore accounts.

I assume the rebate would be for only part of the securities tax, but for a generous part.[46] In the domestic context, the securities tax replaces both the corporate income tax and the individual income tax on interest, dividends and capital gains. The fraction of the tax not rebated to a foreign investor is meant to replace the corporate income tax, which is borne by foreign investment in U.S. equities.

This suggests one possible benchmark for the percentage of the securities tax that should be rebated—this would be the fraction of the total tax burden on capital (debt and equity) used by corporations that is a product of the corporate income tax. But I expect political and economic considerations would ultimately determine the amount of the rebate. A less than complete rebate would increase the U.S. tax burden on foreign

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income associated with the interest is reported in such a way that any foreign tax due with respect to the income is paid.

These rules mean that a U.S. business would face different tax consequences depending on whether it obtained capital through private channels from a U.S. source or from a foreign source. A U.S. business would not be required to remit the complementary tax on capital it raised from U.S. sources through private channels. For example, if a U.S. business borrowed from a U.S. commercial bank, then the business would not remit the tax on the estimated value of the bank loan. There is no need to impose a remittance obligation on a loan from a U.S. bank because the wealth represented by the loan will be taxed at the bank level. Similarly, when a U.S. startup obtained capital from a U.S. private equity the startup would not remit the complementary tax on the estimated value of its stock held by the private equity fund. The capital tax would be paid by the U.S. private equity fund on estimated value of interests in the fund that are held by persons who are subject to the complementary tax.

When a U.S. business obtained capital from a foreign source through private channels the U.S. business must be required to remit the tax on the estimated value of the capital because the tax may not be paid later. For example, if a U.S. business borrowed from a foreign commercial bank, then either the U.S. business or the foreign commercial bank should be required to remit the complementary tax on the estimated value of the bank debt. Otherwise the capital might escape U.S. taxes. And when a U.S. startup company obtained capital from a foreign private equity fund, then either the startup or the fund should be required to remit the complementary tax on the estimated value of stock held by the foreign private equity fund.

[45] An alternative to a partial rebate is to separate the securities tax into two taxes, one paid by a security issuer and the other paid by U.S. individuals who hold securities.

[46] The complementary tax would also be partially rebated (or partially not paid). An exception could be made for foreign investment where an investor's nation of residence cedes to the U.S. primary jurisdiction to tax the investment. Tax treaties often cede primary jurisdiction to tax investment income that is effectively connected with a trade or business to the nation in which the trade or business is conducted. For example, the U.S.-U.K. tax treaty cedes to the U.S. primary jurisdiction to tax U.S. source income that is effectively connected to a U.S. trade or business by allowing a U.K. taxpayer to take a credit against his or her U.K. tax liability for U.S. taxes. See, e.g., Anson v. HMRC (2015) U.K.S.C. 44 (explaining history of relevant treaty provisions and holding U.K. individual who invested in a Delaware LLC may claim a credit against U.K. taxes for U.S. taxes on distributive share of LLC income).

investment in U.S. debt, increasing the cost of debt financing to U.S. borrowers. It could also decrease the implicit tax on U.S. Treasury securities owned by U.S. households, increasing the cost to the U.S. of financing its large public debt. For this reason, I expect that a rebate would be for a large fraction of the securities tax, possibly on the order of 60 to 80 percent of the tax.

i) Argument for a rebate

The argument for rebating a substantial part of the securities tax to foreign investors and for the need for rules to constrain tax-credit arbitrage has several moving parts.[47] The relevant considerations include the extent to which a rebate would lower the cost of capital in the U.S. and increase U.S. social welfare (revenue considerations to the side); the fiscal cost to the U.S. of a rebate; the public administrative and private compliance costs of a rebate; and the ability to design a rebate to deter tax evasion by U.S. wealth owners and foreign wealth owners by secretly investing capital in the U.S. This Section addresses all of these considerations except the last, which is addressed in Section 5.

The consensus "that passive income should be taxed in the country in which the recipient of the income resides" has lasted as long as it has because national elites generally believe it is in a nation's interest (and in their interest) to attract foreign capital investment, so long as investment does not come with foreign ownership and management of local businesses.[48] This suggests one way a rebate may advance U.S. national interests. A rebate may increase inbound portfolio investment, which may in

[47] I put to the side the argument that the rebate is required to avoid double taxation. As Daniel Shaviro has explained, there is nothing inherently objectionable about double taxation as a matter of policy. Daniel Shaviro, Fixing U.S. International Taxation (2014), at 4-7. I also put to the side the argument that a principle of tax neutrality requires that a rebate be paid so that a foreign investor faces the same burden whether he invests in domestic securities or U.S. securities. It is impossible to integrate a U.S. securities tax, which is in the nature of a wealth tax or a tax on the expected return on capital, with other nations taxes on capital income to achieve general tax neutrality with respect to in-bound investment. Inevitably some types of cross-border investment will bear either a higher or a lower aggregate tax burden than would a comparable domestic investment, or a comparable investment in a different nation, because of the interaction of the different systems for taxing capital.

The interaction of the U.S. securities tax with U.K. capital income taxes illustrates the impossibility of integrating the two tax systems to achieve general tax neutrality. An investment by a U.K. resident in the stock of a U.S. company will bear the burden of the U.S. securities tax but it will not bear the burden of the U.K. corporate income tax. Thus an investment in U.S. company stock will bear a higher tax burden than a comparable investment in U.K. company stock only if and to the extent the burden of the U.S. securities tax exceeds the burden of the U.K. corporate income tax. The relative burden of the two taxes depends on the rate of return, and on the actual effective tax rate paid by a U.K. companies, which varies across companies. It follows that rebating the securities tax will not equalize tax burdens with respect to investments in stock by U.K. residents because an investment in U.K. stock will bear the burden of the U.K. corporation income tax in addition to the individual income tax on dividends and capital gains while an investment in U.S. stock will only bear the burden of the individual income tax on dividends and capital gains.

[48] Joseph Isenbergh, International Taxation 70 (2000)("The overall pattern of U.S. taxation of foreign persons . . . is relatively benign taxation of passive investment income . . . This tax regime reflects, I believe, a combination of the large U.S. appetite for foreign capital . . . and an accompanying wariness of surrendering day-to-day control over economic activity in the United Nations to foreigners.")

turn decrease the cost of capital in the U.S. and increase U.S. social welfare. Call this the "increased foreign portfolio investment benefit."

The size of this benefit is uncertain.[49] To begin, the magnitude of the effect of a rebate on the volume of inbound portfolio investment is uncertain. Capital markets are segmented so that capital does not inevitably flow across borders seeking the highest expected yield, leveling the after-tax cost of capital around the globe.[50] Nevertheless there is abundant evidence that the volume of capital flows across borders responds to changes in returns.[51] It would be surprising if it were otherwise. Thus it is likely that a rebate would increase the volume of inbound portfolio investment by increasing the return on an investment in a U.S. security (or other U.S. asset) by the amount of a rebate. What is uncertain is the magnitude of this effect.

There also is uncertainty about the extent to which an increase in the volume of inbound portfolio investment would decrease the cost of capital in the U.S. and increase U.S. social welfare. Governments engage in many practices that influence cross-border capital flows, some intentionally (e.g., capital export or import controls) and some

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[49] This footnote explains why the literature on the effect of replacing a corporate income tax with a comprehensive business income tax ("CBIT") does not help in estimating the size of the benefit. The CBIT retains the corporate income tax but eliminates the interest deduction, while also eliminating the investor level tax on interest and dividends (though preserving the investor level tax on capital gains). Like the securities tax, the CBIT is a single tax (putting aside the investor level tax on capital gains) on capital used by business enterprises that is remitted by a business entity. The difference between the two taxes is that CBIT is based on a company's reported income while the securities tax is based on the market value of a company's public traded securities. This difference is important with respect to the taxation of cross-border direct investment by a business enterprise (the issue examined in Section 2) but it is important with respect to the taxation of cross-portfolio investment by wealth owners. Both the CBIT and the securities tax would significantly increase the tax burden on foreign portfolio investment in the U.S.

Treasury's 1992 report proposing the CBIT acknowledges the additional tax burden that would be imposed on foreign portfolio investment in the U.S., but the report does not attempt to assess the impact this would have on capital flows, and it leaves the political issues to be resolved by treaty negotiations. Report of the Department of the Treasury on Integration of The Individual and Corporate Tax Systems (Jan. 1992), at 79-80, 137-138, 143-144, 185-186, 191, 195-198. The decision not to try to model the effects of CBIT on cross-border portfolio investment is explained at 315-316.

Ruud A. de Mooij and Michael P. Devereux, An Applied Analysis of ACE and CBIT Reforms in the EU, 18 Int. Tax Public Finance 93 (2011), models the welfare impact if EU nations individually or collectively replaced their existing corporate income taxes with CBIT (which makes debt and equity equivalent by eliminating the interest deduction) or an Allowance for Corporate Equity (or ACE, which makes debt and equity equivalent by providing an imputed deduction for the cost of equity). The paper concludes that replacing a corporate income with either a CBIT or an ACE would be welfare enhancing for almost every EU nation, and that a CBIT is modestly superior to an ACE, if one assumes the corporate tax rate is set to produce the same revenue as the existing corporate income tax. But the authors decided to disregard investor-level, residence-based taxes. Id. at 100.

[50] Martin Feldstein, Tax Policy and International Capital Flows, 130 Review of World Economics 675 (1994), summarizes the evidence. Michael J. Brennan and H. Henry Cao, International Portfolio Investment Flows, 52 Journal of Finance 1851 (1997), address possible reasons for the segmentation and focus on asymmetric information. Richard Portes and Helene Ray, The Determinants of Cross-Border Equity Flows, 65 Journal of International Economics 269 (2005), examine data on cross-border equity flows and find "a very important geographical component in international flows," which they find could be explained by "informational asymmetries or familiarity effects."

[51] Kenneth A. Froot, Paul G.J. O'Connel; and Mark S. Seasholes, The Portfolio Flows of International Investors, 59 Journal of Financial Economics 151 (2001).

unintentionally. There is a large literature on the effects on national financial markets and on national welfare of policies that eliminate significant barriers to cross-border capital flows. These policies are called "capital account liberalization," which is thought to generate both benefits and harms to national financial markets and to national welfare.[52] For example, while an increase in inbound portfolio investment is thought to generate benefits in decreasing the cost and increasing the availability of capital in a nation during periods in which a nation's financial markets are stable or booming,[53] it also is thought to generate offsetting harms because foreign capital tends to move out of a nation's capital markets quickly in response to local market shocks, which increases market volatility and exacerbates credit crunches in the event of a market shock.[54] The effects of increased cross-border investment flows appear to be positive on balance for industrialized nations. Thus a recent paper finds "an economically important and statistically significant effect of capital account liberalization on economic growth through the channel of financial depth," though these results were "driven largely by industrialized countries.[55]

The literature on capital account liberalization understandably focuses on major policy changes that make it significantly easier or significantly harder to move capital across borders. Often these policy changes affect both inflows and outflows. This makes it difficult to draw lessons from this literature on how a rebate that would increase the yield on in-bound portfolio investment by somewhere between 48 basis points (a 60 percent rebate) to 80 basis points (a full rebate) would be likely to affect the cost of capital in the U.S. and U.S. social welfare. In addition, one must subtract the revenue loss to the U.S. government from any positive effects on the cost of capital and national welfare. I expect that the sign of the effects of rebating the tax on the cost of capital and national welfare are positive, even accounting for the loss in revenue. But the magnitudes of these positive effects are uncertain.

Even if the signs of the effects of a rebate on the cost of capital in the U.S. and on U.S. national welfare were negative this might not justify a no-rebate policy because maintaining an effective no-rebate policy involves significant public administrative and

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[52] Barry Eichengreen, Capital Account Liberalization: What Do Cross-Country Studies Tell Us?, 15 World Bank Econ. Rev. 341 (2001), is a clear-eyed review of the literature involving cross-country comparisons. Eichengreen observes that "[p]erhaps the single most robust regularity [in the literature on what leads nations to open capital accounts] is the negative association between per capital income and controls." Id. at 347. But he goes on to observe that there is no consensus for why nations tend to open capital accounts as they become richer. Turning to studies that investigate the correlation between capital account liberalization and growth, Eichengreen observes that while the leading study in economics "finds no association between capital account openness and growth," the "leading study of the question in political science reaches the opposite conclusion." Id. at 351.

[53] Peter Blair Henry, Capital Account Liberalization: Theory, Evidence, and Speculation, 45 Journal of Econ. Literature 887, 904-906 (2007), summarizes studies that find liberalization is associated with a significant short-term reduction in the cost of capital in stock markets, which is reflected in a sharp rise in stock prices and a fall in average dividend yields.

[54] Eichengreen, supra n. xxx, at 357, observes that while "[t]he currency and banking crises of the 1990s did much to encourage the belief that capital account liberalization raises the risk of financial instability . . . few cross-country studies have sought to systematically weigh the evidence."

[55] M.W. Klein and G.P. Olivei, Capital Account Liberalization, Financial Depth, and Economic Growth, 27 Journal of Int'l Money and Finance 861, 862 (2008).

private compliance costs. This is because foreign holders of U.S. securities could obtain an implicit rebate in the absence of an explicit rebate by tax-credit arbitrage transactions. U.S. entities that remit the securities tax or the complementary tax would get a credit against their remittance obligation for the market value of U.S. securities they hold. Not paying a rebate of the tax to foreign holders of U.S. securities would create an opportunity for tax-credit arbitrage by a trade of U.S. securities for foreign securities around the date ownership of a security is determined for purposes of determining the right to a credit. The trade would be between a foreign holder of a U.S. security and a U.S. entity that gets a credit against its remittance obligation for U.S. securities it holds, such as a U.S. mutual fund. A U.S. entity wanting to purchase tax credits could temporarily acquire U.S. securities from a foreign holder of a U.S. security. This does not require a short-term purchase and sale of a security that would briefly shift the risk of a change in the price of a security from the foreign security holder to the U.S. counter-party. For example, legal ownership of a security can be temporarily transferred without shifting price risk through a repo transaction. Thus a U.K. mutual fund that invests in U.S. securities and a U.S. mutual fund that invests in U.K. securities could use offsetting repo transactions so that the U.S. mutual fund was legal owner of the U.S. securities for purposes of claiming the credit against the securities tax.

If the signs of the effects of a rebate on the cost of capital in the U.S. and on U.S. social welfare were positive,[56] then an explicit rebate clearly is superior to an implicit rebate by unconstrained tax-credit arbitrage.[57] This is because foreign investors should capture the entire value of an explicit rebate (subtracting transaction costs and any taxes their nation imposes on a rebate) while foreign investors would capture only part of the value of the tax credit in an arbitrage transaction (and also subtracting transaction costs and any taxes their nation imposes on income derived from an arbitrage transaction). The U.S. counter-party to an arbitrage transaction (the U.S. mutual fund in the earlier example) would capture part of the value of the tax credit. The revenue cost to the U.S. is the same either way. To the extent U.S. counter-parties capture part of the value of the tax credit, an implicit rebate by unconstrained tax-arbitrage transactions would deliver a smaller increased foreign portfolio investment benefit. An explicit rebate has the additional benefit that wide scale avoidance of the securities tax and the complementary tax by U.S. companies and funds through engaging in tax-credit arbitrage transactions might undermine the legitimacy of the taxes in the U.S.

ii) Structure of a rebate

The rebate could not be modeled on existing systems that give a resident of a nation who invests in foreign dividend-paying stock a credit against his home nation's tax on dividend income for the foreign withholding tax. A tax credit is of no value to a tax-

[56] This is without regard to the revenue cost of a rebate.

[57] An unconditional rebate policy might well be similar to an implicit rebate by unconstrained arbitrage with respect to the revenue cost to the U.S. The difference would be a function of difference between the percentage of foreign holders of U.S. securities who would claim a rebate and the percentage of foreign holders of U.S. securities who would engage in an arbitrage transaction.

exempt investor, such as a nonprofit, a pension fund, or a sovereign wealth fund.[58] Foreign tax-exempt investors should receive a rebate as well as foreign taxable investors, if the goal is to increase the flow of in-bound portfolio investment to the U.S.

As for foreign taxable investors, the U.S. could remit a rebate to a foreign investor's home nation, which would then apply a rebate as a credit against the tax due to the home nation. But it is simpler and yields a similar outcome economically to a foreign investor and to his home nation for the home nation to allow an investor simply to exclude a rebate from income.[59] Importantly, this makes it possible to rebate the tax on a wholesale basis to a financial intermediary like a mutual fund. The importance of this follows from the general principles on which the design of the securities tax and the complementary tax are based. I will briefly explain these principles.

The securities tax and complementary tax are designed to take advantage of the way most capital is held in the modern world. Ultimately individuals, nonprofits, or governments own all of the world's wealth, if one defines wealth as objects of value that can be owned and transferred or traded through a market.[60] Real assets (real estate and consumer durables) that are owned by individuals, nonprofits, or governments represent a small fraction of the world's wealth. Most real assets are owned by business enterprises. And a large and increasing share of the world's wealth is represented by intangible assets, which include intellectual property and good wealth. Business enterprises also own most of the world's intangible assets. Individuals, nonprofits, and governments ultimately own real assets and intangible assets owned by business enterprises through financial claims upon business enterprises. Often these claims are held through financial intermediaries such as large commercial banks and mutual funds. It is useful to think of a "wealth chain"[61] that connects the economic owner of wealth (i.e., an individual, nonprofit, or

[58] S.R. Callaghan and C.B. Barry, Tax-induced trading of equity securities: evidence from the ADR market, 58 Journal of Finance 1583 (2003). When stock on which a dividend is paid is held by a pension fund or in a tax-deferred account there is no tax benefit. This creates a conflict for a fund manager when the fund serves a mixed clientele and a potential arbitrage opportunity by moving shares back to the home country for the record dates of their dividends by a repo. S. Christoffersen, C. Geczy, D. Musto, and A. Reed, Crossborder Dividend Taxation and the Preferences of Taxable and Nontaxable Investors: Evidence from Canada, 78 Journal of Financial Economics 121 (2005), find that fund managers cannot exploit the arbitrage opportunity, and that they resolve the conflict by structuring the fund portfolio to serve the dominant clientele

[59] The functional similarity is clearest with respect to debt securities when the tax on interest income imposed by the destination nation exceeds the rebate amount. Assume a debt security with a fair market value of $1,000 that pays 4 percent interest ($40). The issuer would pay $8 securities tax (.8% or .008 x $1,000). Assume 75% of the securities tax ($6) is rebated to a foreign investor. Further assume the local tax rate on interest income is 30%. If the rebate is credited against local taxes, then an investor's after tax income is $34 ($40 – ($12 tax @ 30% rate - $6 credit). If the rebate is excluded from income by the destination nation, then an investor's after tax income also is $34 ($40 - $12 tax @ 30% rate + $6 rebate).

[60] This is Piketty's definition of capital. Piketty at 46.

[61] I borrow the term wealth chain from Leonard Seabrooke and Duncan Wigan, The Governance of Global Wealth Chains, 24 Review of International Political Economic 1 (2017). They define global wealth chains as "transacted forms of capital operating multi-jurisdictionally for the purposes of wealth creation and protection." Id. at 2. To be clear, a link in a wealth chain often adds social value. Banks add social value by financial intermediation. So do mutual funds and securitization vehicles. On the other hand, a link in a wealth chain can be like a shell holding company and can serve a purely private purpose that adds no social

government who is the ultimate owner of wealth)[62] through a chain of financial claims to some ultimate object of wealth, which can be a debt or equity claim against a business (which owns real and intangible assets); a debt claim against an individual, nonprofit, or government; or a claim upon a real asset, such as title to land or ownership of a consumer durable.

The securities tax and complementary tax are based on three general design principles: (1) Tax wealth at a link on a wealth chain where wealth is represented by a publicly traded security (or by a debt or equity claim that is regularly exchanged in arms-length transactions) at a flat rate on the market value of the security (or estimated value of the claim). (2) The issuer of a security (or obligor on a claim) remits the tax. (3) An issuer of a security (or obligor on a claim) that remits the tax is given a credit against its remittance obligation for the market value of publicly traded securities it holds (as well as a credit for the estimated value of other types of financial claims it holds on which the complementary tax has been remitted).

A security issuer's remittance obligation under the securities tax is based entirely on public information: the existence of a publicly traded security, the issuer's identity, and the market value of the security. The only private information needed to administer the securities tax is the identity and quantity of securities held by a person who itself is subject to a remittance obligation under the securities tax or the complementary tax, and who claims a credit against this obligation for securities it holds. The securities tax places the burden on a person claiming a credit to report this information. This information is easy for a person claiming a credit to acquire and report. And the information is easy for the government to verify. Basing the tax on a combination of public information and easily collected, reported, and verified private information minimizes public administrative and private compliance costs. Imposing the remittance and reporting obligations on securities issuers (or a business entity in which individuals or other persons subject to the complementary tax hold an interest), rather than on individual wealth owners, further reduces public administrative and private compliance costs.

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value, or a link can even serve an illicit purpose. And a link in a wealth chain can obscure the identity of the economic owner of wealth connected through a chain.

[62] I use the term "economic owner" rather than "beneficial owner" of wealth because the latter term is too narrow for my purposes. In the U.S., the term "beneficial owner" of a security often is used to describe a person who has the legal rights of an owner of a security that is held by a nominee or a fiduciary. See, e.g., Petition of Bowman, 98 Misc.2d 1028, 1031, 414 N.Y.S.2d 951, 953 (1978). A legal person can be the beneficial owner of a security, including a corporation, partnership, or trust under this definition. The Financial Asset Task Force defines the term "beneficial owner" more broadly than the legal definition of the term in the U.S. to look through legal persons and define the "beneficial owner" of an entity as "the natural person(s) who ultimately owns or controls an" entity. FATF, Transparency and Beneficial Ownership (Oct. 2014), 16.

The FATF definition is close to what I mean by the economic owner of an equity claim in the case of a closely held entity. But this definition of beneficial owner does not cover the situation in which the economic owner of wealth (again this can only be an individual, a nonprofit, or a public entity) holds a claim against a large financial intermediary such as mutual fund, a securitization vehicle, or a commercial bank, which in turns holds securities that represent a financial claim in the form of a security that is against a business, a household, a nonprofit, a public entity, or a real asset. I use the term economic owner of a wealth to describe the ultimate owner of the wealth represented by a security in this case.

These design principles require that U.S. wealth taxes be rebated to a foreign financial intermediary like a foreign mutual fund that holds U.S. securities or other U.S. assets. This reduces public administrative and private compliance costs in implementing a rebate and increase uptake of a rebate. This might seem to open a wide door to tax evasion by U.S. wealth owners. A U.S. wealth owner could capture the value of the rebate by secretly investing in U.S. securities or other U.S. assets through a foreign intermediary. But, as Section 5 explains, it is possible to integrate the rebate with the CRS and FATCA information reporting systems to deter tax evasion by U.S. wealth owners while also making the U.S. unattractive as a tax haven for foreign wealth owners.

iii) Anti-arbitrage rules

One reason for rebating the securities tax to a foreign holder of a U.S. security is that a no-rebate policy would encourage foreign holders of U.S. securities to engage in tax credit arbitrage transactions with U.S. taxpayers who are entitled to a credit against their remittance obligation under the securities tax and the complementary tax for U.S. securities they hold on the credit determination data. A policy of rebating only a part of the securities tax to foreign holders of U.S. securities leaves an incentive for foreign holders of U.S. securities to engage in tax arbitrage transactions, if a foreign security holder can capture part of the value of the securities tax that is not rebated through an arbitrage transaction. If a rebate were to be structured to prevent tax evasion, then a foreign holder of a U.S. security who was not eligible for a rebate would have that much greater incentive to engage in a credit arbitrage transaction. For example, a tax haven mutual fund that was not eligible for a rebate could do a repo transaction involving U.S. securities with a U.S. person who was entitled to a credit.[63]

It is quite difficult to design a strong anti-arbitrage rule. A strong rule would deny a credit on a U.S. security if a person who would otherwise be entitled to a credit acquires the security within a specified number of days before the or credit determination date from a person who does not qualify for a credit. But this type of rule is unfeasible because a purchaser of a publicly traded security generally does not know the seller's identity. Securities markets are anonymous. An alternative strong rule would deny a credit on any U.S. security acquired within a specified number of days without regard to the source. But this rule would create significant harms by imposing a tax penalty on security trading within the window.

What is feasible is a weak anti-arbitrage rule that would deny a credit or rebate when a security is acquired through a repo transaction with a person who does not qualify for a credit or rebate. A weak anti-arbitrage rule could also cover arrangements like swaps. These weak anti-arbitrage rules are feasible because the holder of the security, who is claiming the credit or rebate, will know the identity of counter-party to the arbitrage transaction.

A weak anti-arbitrage rule could be made more effective by reducing the payoff from engaging in an arbitrage transaction so that the net benefit of a transaction after

[63] Or the tax haven fund could do a rebate arbitrage transaction with a foreign mutual fund that was entitled to a rebate of the securities tax.

subtracting transaction costs is smaller. The value to a person who acquires U.S. security through an arbitrage transaction to obtain the credit tax could be halved by assessing the securities tax and the credit bi-annually. If the tax period were bi-annual rather than annual, then the value of the tax credit would be 40 basis points per tax period rather than 80 basis points. The payoff from engaging in an arbitrage transaction could be quartered by assessing the securities tax and credit quarterly. If a foreign holder of a U.S. security is entitled to a rebate equal to 60 basis points, then the net value of an arbitrage transaction would be 20 basis points (before transaction costs are taken into account), if the securities tax and the credit is assessed annually. Assessing the tax and credit biannually reduces this to 10 basis points.

A weak arbitrage rule would deter inexpensive arbitrage transactions like a repo transaction or a swap. Halving or quartering the potential benefit from an arbitrage transaction by making the tax period bi-annual or quarterly would further reduce the net benefit from an arbitrage transaction. This would go a way long away towards limiting arbitrage transactions. A U.S. wealth owner who considered avoiding U.S. capital taxes by investing in U.S. securities through a tax haven and then using arbitrage transactions to capture the value of the credit (or rebate) would expect to capture only a fraction of the value of the credit (or rebate). He would subtract both transaction costs and the fraction of the net benefit (after transaction costs) that the counter-party to the arbitrage transaction captures.

The U.S. could monitor securities markets for price movements around the credit and rebate determination date for evidence of significant arbitrage activity.[64] If the U.S. finds evidence of significant arbitrage activity, then anti-arbitrage measures that target identified arbitrage-driven trading patterns could be considered. For example, the U.S. could monitor sales and repurchases of U.S. securities for suspicious patterns of trading and then target participants in the trades as aiders and abettors of tax evasion by wealth owners who invest in U.S. securities through unreported accounts.

iv) Interaction of rebate and credit

This Section addresses the interaction of a policy of giving a U.S. MNC a partial credit against the securities tax for foreign taxes its pays on its foreign source income with a policy of giving a partial rebate of the securities tax to persons who currently do not pay U.S. income taxes on interest, dividends, and capital gains. This includes foreign owners of U.S. securities, U.S. individuals who hold securities in tax-deferred accounts, U.S. pension funds, and U.S. nonprofits. Recall that the purpose of a rebate is to replicate the value of the current exemption from U.S. taxes on interest, dividends, and capital

[64] Robert L. McDonald, Cross-Border Investing with Tax Arbitrage: The Case of German Dividend Tax Credits, 14 Review of Financial Studies 617 (2001), illustrates the type of analysis that is involved. The paper examines an arbitrage possibility created by the fact that German investors but not foreign investors receive a tax credit on dividends paid on German shares. McDonald finds a significant increase in the volume of trading before the dividend ex-date, which is consistent with arbitrage activity. Id. at 641-643. He also finds a price effect around the dividend ex-date, leading him to conclude "that approximately one-half to two-thirds of the value of the dividend tax credit is reflected in prices of German stocks and equity derivatives."

gains. The rebate this capital. For example, if a U.S. pension fund held $1 billion in U.S. securities, the securities tax rate was .08 percent, and the rebate was for 60 percent of the securities tax, then the pension fund would receive a rebate of $4.8 million (.048 percent of $1 billion). The tax burden on capital invested by the pension fund is the spread between the securities tax rate and the rebate rate (.032 percent in the example). This is meant to roughly replicate the burden of the corporate income tax.

Investment in the U.S. always bears a U.S. tax burden equal to the spread between the securities tax rate and the rebate rate. But the availability to a U.S. MNC of a credit against the securities tax for foreign taxes it pays on its foreign source income creates the possibility that investment outside the U.S. through a U.S. MNC could bear no U.S. tax burden, or that such investment could even bear a negative U.S. tax burden, meaning the U.S. could suffer a net revenue loss as a result of the combination of the credit and the rebate. This possibility could be exploited. For example, a company that wanted to raise capital from U.S. pension funds to invest in a project that is expected to generate most of its income outside the U.S. in nations that tax corporate income at a high rate could organize as a U.S. company. It would pay the securities tax on the market value of its securities but it would get a large credit against the tax because a large share of its income is foreign source and is taxed by other nations. The value of the rebate paid by the U.S. to pension funds on the company's securities could exceed the value of securities tax paid by the company to the U.S. on its securities.

More generally, the effect of the rebate is to lower the tax burden on capital to the spread between the securities tax rate and the rebate rate (the spread is .032 percent in the earlier example). Allowing a U.S. MNC a credit against the securities tax for foreign taxes paid on foreign source income means that other nations (and not the U.S.) would capture any tax revenue up to this tax rate on foreign source income. If the foreign tax rate on foreign source income is higher than this tax rate, and if a sufficiently high percentage of the holders of a company's securities are entitled to a rebate and a sufficiently large percentage of a company's income is foreign source, then the U.S. could suffer a net revenue loss, through the combination of the tax credit and the rebate.[65]

To be clear, there is nothing inherently objectionable about other nations capturing most or even all of the available tax revenue when U.S. wealth owners invest capital abroad. Currently when U.S. pension funds and nonprofits invest in foreign

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[65] For example, assume MNC has securities worth $200x, half of the value of which is owned by foreign investors, who are entitled to a rebate of 3/4th of the securities tax. Further assume MNC's global income is $8x, which is split 50-50 between U.S. source income and foreign source income. Finally assume MNC pays $0.8x foreign corporate income taxes on $4x foreign source income. At a securities tax rate of .08%, MNC would pay $1.6x in securities tax before subtracting the credit. If the credit was capped at MNC's FSI share (one half), then the credit would be for $0.8x and MNC would pay $0.8x in securities tax to the U.S. The rebate would cost the U.S. $0.6x (3/4th of $0.8x securities tax on $100x securities owned by persons entitled to the rebate). The U.S. would end up with $0.2x in tax revenues.

The same example can be used to illustrate the possibility that the U.S. could suffer a net revenue loss with respect to a security as a result of the combination of the credit and a rebate. If 70 percent of MNC's income is foreign source income and it pays $1.2x foreign taxes on this income, then MNC would pay $0.4x securities taxes after the credit. The cost of the rebate would remain $0.6x, so the U.S. would suffer net revenue loss of $0.2x with respect to MNC.

equities other nations capture all of the tax revenue on the foreign source income associated with the securities through their corporate income taxes. This is because U.S. pension funds and nonprofits pay no tax on interest, dividends and capital gains. Indeed, the securities tax would increase the U.S. tax burden on investment by U.S. pension funds and nonprofits in foreign securities to the spread between the securities tax rate and the rebate rate. This investment currently bears no U.S. tax burden. It bears only the burden of any foreign corporate income tax.

I expect some people would find it objectionable if the U.S. suffered a net revenue loss as a result of the combination of the credit and the rebate. This would also create gaming opportunities. The possibilities are illustrated by the example above in which a company that expected to generate most of its income outside the U.S. in high-tax nations, and that wanted to raise capital from U.S. pension funds, organized as a U.S. company to reduce the foreign tax burden on capital invested by the pension funds to the spread between the securities tax rate and the rebate rate, with the U.S. Treasury compensating the pension funds for the difference. One way to prevent this sort of thing is to cap the rebate at the amount of securities tax actually paid by an issuer. But this is difficult to do administratively. Uncertainty about the value of a rebate due with respect to a security could also distort the price of a security. A cruder but effective solution is a rule that would gradually reduce the fraction of a U.S. company's FSI Share that yields a credit from the baseline fraction (which should be somewhere between .8 and close to 1) once a company's FSI Share exceeds a generous floor, such as sixty percent. This rule would deter companies with mostly foreign source income from choosing a U.S. tax home to exploit the combination of the credit and the rebate.

4. Corporate tax home and definition of a U.S. security

This Section addresses the question of what should be treated as a U.S. security for purposes of the securities tax. This question relates to the question of how to define the tax home of a MNC for an obvious possibility is to define a U.S. security as a security issued by an issuer with a U.S. tax home. The effect of tax law on an MNC's choice of a tax home has received a fair bit of attention recently in the U.S. in the wake of a number of high visibility corporate inversions by U.S. MNCs of a U.S. tax home to a foreign tax home.[66] Section a) provides background. Section b) explains why the rules described in Sections 2 and 3 make it advantageous for a company with significant U.S. source income and U.S. ownership to choose a U.S. tax home. Section c) suggests a corrective mechanism.

[66] Eric Talley, Corporate Inversions and the Unbundling of Regulatory Competition, 101 Va. L. Rev. 1649, 1748 (2015), reports 72 attempted outbound inversions by U.S. MNCs between 1994 and 2014. Most of these (but far from all) were to tax haven nations. The movement offshore has been limited to mature U.S. firms. Eric J. Allen and Susan C. Morse, Tax Haven Incorporations for U.S. Headquartered Firms: No Exodus Yet, 66 National Tax J. (2013), reports that of 918 U.S. headquartered MNCs that conducted a public offering between 1997 and 2010 only 27 (3 percent) incorporated outside the U.S. in tax havens. The authors attribute the increase in firms incorporating in tax havens to Chinese-headquartered firms.

a) The current landscape

Under current tax law a corporation's tax home is the same as it legal home, which is the state or nation that enacted the laws under which a corporation is established. This rule dates back to a time when the legal home of an MNC used to be the same nation in which a company's headquarters were located and in which a company's core operations began and were located. MNCs replicated their operations in other nations through foreign subsidiaries.[67] The legal home of an MNC also was likely to be the company's financial home, meaning the nation in which a company raised most of its capital and the nation in which most of the ultimate owners of this capital resided.

Today an MNC may have a legal home in one nation, a managerial home in a second nation, and a financial home in a third nation. For example, a U.S. company that wants to reduce the burden of the U.S. corporate income tax on its global income can restructure so that its U.S. operations are conducted through a U.S. subsidiary of a corporate parent that has a legal home in low tax nation, such as Ireland. The company's managerial home may remain in the U.S. Or the managers may be moved to London. The company's financial home can remain in the U.S. for the company may list the shares of the Irish parent on a U.S. stock exchange.

A company may also list its shares in a stock market in a nation that is neither a company's legal home nor its principal base of operations for non-tax reasons. A 2009 paper by Desai that succinctly explains all of this gives the example of Genpact, which was created by GE to outsource operations to India. When GE spun off Genpact its legal home was initially placed in Luxembourg and later moved to Bermuda while the company's financial home was the U.S. for its stock was listed on the NYSE.[68]

Desai argues that the location of a company's financial home—meaning the nation's exchanges on which its shares are listed—is important because "a financial home dictates who your owners are. Even though shareholder bases are becoming increasingly global, where a firm lists its shares does have a significant impact on who owns its shares."[69] Evidence of a strong correlation between the nationality of a company and the nationality of a company's shareholders has led some observers to conclude that there is a strong home equity bias.[70] Other significant consequences can follow from a company's

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[67] Mihir Desai, The Decentering of the Global Firm, The World Economy (2009).

[68] Desai at 1276.

[69] Desai at 1280.

[70] A leading article reporting a strong correlation is K. French and J. Poterba, Investor Diversification and International Equity Markets, 81 Amer. Econ. Rev. 222 (1991), which finds that 93.8% of the portfolio equity holdings of U.S. investors was in U.S. equities. The bias is observed in the investment behavior of sophisticated investors, such as fund managers, as well as individual investors. Possible causes for the bias informational advantages and over-optimism regarding the home equity market. See, e.g., A.G. Ahearne, W.L. Griever, and F.E. Warnock, Information Costs and Home Bias: An Analysis of U.S. Holdings of Foreign Equities, 62 Journal of Int'l Econ. 313 (2004)(exploring information cost theory); N. Strong and X. Xu, Understanding the Equity Home Bias: Evidence from Survey Data, 85 Review of Econ. Statistics 307 (2006)(advancing the over-optimism theory). Chris William Sanchirico, As American as Apple Inc.: International Tax and Ownership Nationality. 68 Tax. L. Rev. 207, 217-227 (2015), summarizes the

choice of a financial home. The exchange on which a security is listed determines the regulatory regime to which a security is subject, and therefore some of the legal rights of bondholders and stockholders.[71] Desai adds that managers who receive equity compensation may influence where a firm lists its shares. He gives as an example Alcon, a pharmaceutical company owned by Nestle (a Swiss firm). U.S. managers of Alcon who received equity compensation in Alcon demanded that the shares be listed on the NYSE.[72]

To further complicate matters, a company's shares may be listed on the multiple national exchanges. A 2003 paper by Karolyi reports "today about 12% (3.4%) of the average daily turnover on the NYSE (Nasdeq-Amex) is comprised of foreign listings."[73] A foreign security may be listed on a U.S. exchange by placing the security in a foreign account of a U.S. bank and trust company, which will issue and list an American Depository Receipt (ADR) to be traded on a U.S. exchange.[74] A foreign entity may also directly list a security on a U.S. exchange. The 2003 Karolyi paper provides a detailed account of the structure of the dual listing of Daimler-Chrysler AG securities on US and European exchanges when Daimler Benz and Chrysler merged.

b) The tax advantage of a U.S. tax home

This Section explains why the rules described in Sections 2 and 3 create a tax advantage for a company with substantial U.S. source income and substantial U.S. ownership of its securities to choose a U.S. tax home. The basic reason why is that the choice of a U.S. tax home eliminates or reduces double taxation of capital as a result of the interaction of the unitary U.S. tax on capital and binary foreign taxes on capital income (entity level and individual level). To begin, by choosing a U.S. tax home a company would ensure that U.S. source income that is attributable to U.S. owned capital would bear only the burden of the securities tax, and not the combined burden of the U.S. corporate income tax and the securities tax. Meanwhile a U.S. company is given a partial credit against the securities tax for foreign taxes paid on foreign source income, which reduces the tax burden on a U.S. company's foreign source income. And foreign investors in U.S. securities are given a partial rebate of the securities tax, which reduces the tax burden on foreign investment in a U.S. company.

I conclude this feature of the rules described in Sections 2 and 3 is not a significant defect in the rules. It is not clear to what extent the tax advantage of a U.S. tax home will distort a company's choice of a tax home, for the tax benefits flow to holders of a company's securities, and not to the company. Typically, a company will reduce its tax expense by choosing a foreign tax home. This Section explains. And it is

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literature and argues that there are reasons to be skeptical about the extent of the bias with respect to securities in large MNCs.

[71] Desai at 1279.

[72] Desai at 1279.

[73] G. Andrew Karolyi, Daimler-Chrysler AG, the first truly global share, 9 Journal of Corp. Finance 409, 414 (2003).

[74] For an explanation of the regulation of ADRs and historical background see Guy B. Lander, American Depository Receipts, 29 International Lawyer 897 (1995).

possible to unbundle a company's choice of a tax home from its choice of a legal home, which would minimize the distortionary effect of the rules. In any event, if this is thought to be a significant defect in the rules, then the tax advantage of a U.S. tax home can be reduced by allowing a foreign company to issue a special class of securities that are treated as U.S. securities for purposes of the securities tax, which bring with them some of the tax benefits of a U.S. tax home. This solution is explained in Section (b).

i) Entity-level tax expense

Generally, a security issuer with global assets and operations would reduce its U.S. tax expense under the securities tax by choosing a foreign tax home rather than a U.S. tax home. If a company chooses a foreign tax home, then it would pay the corporate income tax on its U.S. source income. On the other hand, if a company chooses a U.S. tax home, then it would pay the securities tax on the total market value of its publicly traded securities, minus a credit against the securities tax for a large fraction of its foreign source income.

The choice of a foreign tax home would eliminate any U.S. tax expense to a company with respect to its foreign source income. On the other hand, if a company chooses a U.S. tax home, then the absence of a full credit against the securities tax for foreign taxes paid on foreign source income would result in a company paying some U.S. taxes on its foreign source income. To be clear, if a company with U.S. investors chooses a foreign tax home, then its foreign source income would still bear some U.S. tax burden under the securities tax. But the U.S. tax burden would be borne by U.S. investors who hold the company's securities, and not by the company.

For many companies the choice of a foreign tax home would also reduce a company's U.S. tax expense with respect to its U.S. source income. The tax paid by a company on its U.S. source income would be the same under the corporate income tax and the securities tax if two conditions are satisfied: 1) A company's global reported income represents a normal return on the market value of a company's securities (debt and equity); and 2) The effective U.S. corporate income tax rate on a foreign MNC's U.S. source income equals the income tax rate that is implied by the securities tax rate. Defects in how business income is measured under an income tax mean the first condition often would not be satisfied. The rest of this Section explains why.

It may seem that the first condition (a company's global reported income represents a normal return on the market value of its securities) often would not be satisfied for reasons other than defects in business income taxes. These other reasons flow from a fundamental difference between a tax on the value of capital (like the securities tax) and a tax on capital income. The ex post burden of a tax on the value of capital and a tax on capital income will differ because a tax on the value of capital is based on the normal or expected return on capital while a tax on capital income is based on the actual return on capital. The normal return on capital includes a risk premium (along with a premium for illiquidity). For risky assets with a significant variance in return the ex post burden of the two taxes can vary significantly. In addition, some investment opportunities may offer supra normal returns because a company that is in a position to make as investment has market power. For example, a monopolist should be able to capture supra normal returns on investment in producing and selling a product over which it has a monopoly.[75]

While a company's *actual* global income during a period generally will be more or less than a normal return on the market value of a company's securities at the beginning of the period (this is a matter of fortune), a company's *expected* global income during a period generally should represent a normal return on the market value of a company's securities at the beginning of the period. This is because securities prices should adjust to reflect a company's expected global income. Securities prices should also adjust to reflect the ability of a company to reap a supra normal return on future investment as a result of market power. For example, if a company obtains a patent on an extraordinarily valuable technology (such as an energy efficient battery), then the price of its securities will rise to reflect the supra normal returns on the company's investment in research.

Thus the securities tax captures the value of a company's future expected earnings when a company is successful. The existing income tax does not. This creates a tax incentive for a successful U.S. company that earns supra normal returns on investment to move its tax home offshore to escape the securities tax as the company's stock price increases to reflect supra normal returns. But note that in this case it is the securities tax, and not the income tax, that better captures the company's *actual* income. The securities tax is superior to the income tax in capturing actual income in this case because the income tax does not capture unrealized gains.

The income tax has other defects that prevent it from capturing normal returns on investment for certain types of business. An example is the rules that allow businesses to deduct investments in intangible assets, such as R&D expenses, while deferring recognition of long-term returns on investment in R&D. As a result of these rules a company that reinvests a significant share of its earnings in R&D with positive future returns that are reflected in its share price, but that are not reflected in its current earnings, could reduce the tax burden on its U.S. source income by choosing a foreign tax home. Similarly, a startup that is expected to have negative cash flow for several years despite a high stock price (which reflects expected future earnings) would have an incentive to choose a foreign tax home to avoid the securities tax.

The fact that U.S. companies could reduce their U.S. tax expense with respect to both foreign source income and U.S. source income by choosing a foreign tax home might seem to be a serious flaw in the securities tax. But a company's tax expense is only part of the story. A company with substantial U.S. source income and substantial U.S. ownership would have a strong tax incentive to choose a U.S. tax home because the tax expense to a U.S. holder of a company's securities of choosing a foreign tax home swamps the tax savings to a company. The next Section explains.

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[75] Conversely, sometimes an individual wealth owner will accept a return below the normal rate of return on an investment because he is risk averse and/or because he values liquidity. Managers of a business may also accept a below normal return on investment, though ideally the managers of a business generally should distribute capital to a businesses' owners rather than pursue poor investment opportunities.

ii) Holder-level tax expense

A securities issuer's choice of a tax home determines whether the issuer or a U.S. person who holds its securities pays the securities tax. If an issuer has a U.S. tax home, then it would remit the securities tax on the market value of its securities. I will call these U.S. securities, meaning securities issued by a company with a U.S. tax home.[76] If U.S. securities were held by a U.S. mutual fund, then the mutual fund would get a credit against its obligation to remit the securities tax on the market value of its shares for the market value of U.S. securities it holds. The credit ensures wealth that is represented by U.S. securities is not taxed twice. If U.S. securities were held by a U.S. individual or by a defined benefit pension fund, then the individual or the pension fund would not be required to remit the securities tax on the securities. On the other hand, a U.S. person who held foreign securities would be required to pay the securities tax on the market value of foreign securities. A U.S. mutual fund would pay the tax implicitly when the fund paid the tax on the market value of its shares and it did not receive a credit for the market value of foreign securities it held. And a U.S. individual or a U.S. defined benefit pension fund would be required to pay the securities tax on the market value of foreign securities they hold.

While a security issuer's choice of a tax home merely determines who remits the securities tax with respect to its securities that are held by U.S. persons, the choice of a tax home determines whether the securities tax is remitted with respect to securities held by foreign persons. If an issuer chooses a U.S. tax home, then it would remit the securities tax on all of its securities, including securities held by foreign persons. A foreign holder of a U.S. security would be entitled to a rebate of part of the securities tax, if the holder were eligible to receive a rebate. On the other, if an issuer chooses a foreign tax home, then its securities would bear no U.S. taxes (unless the securities were held by a U.S. person).

These rules might seem to create a tax incentive for a securities issuer to choose a foreign tax home, if non-U.S. persons hold its securities in material quantity. The choice of a foreign tax home would eliminate U.S. taxes on foreign-owned securities and avoid any restrictions that might be imposed on eligibility for a rebate. But a securities issuer that has substantial U.S. source income and substantial U.S. owners would be strongly deterred from choosing a foreign tax home by the U.S. corporate income tax on its U.S. source income.

Importantly, U.S. holders of a foreign security would not get any tax relief for U.S. income taxes paid by a security issuer on an issuer's U.S. source income. A U.S. holder of a foreign security would pay the securities tax on the market value of a security and would receive no credit against the securities tax for U.S. income taxes paid by the issuer on its U.S. source income. This would give a company that has substantial U.S. source income and substantial U.S. ownership of its securities a strong tax incentive to choose a U.S. tax home. By choosing a U.S. tax home a company would ensure that U.S. source income attributable to U.S. owned capital would bear only the burden of the

[76] The assumption is that a company's choice of a tax home determines whether its securities are subject to the securities tax. The next section relaxes this assumption.

securities tax, and not the combined burden of the securities tax and the U.S. corporate income tax.

A U.S. company also gets a partial credit against the securities tax for foreign taxes it pays on its foreign source income. The credit reduces the tax burden on foreign source income that is attributable to both U.S. owned capital and to foreign owned capital in a company. The choice of a U.S. tax home also gives foreign owned capital in a company the benefit of a partial rebate of a securities tax. One effect of the rebate is to reduce the burden of U.S. taxes on foreign capital invested in the U.S. If a company chooses a foreign tax home, then foreign capital invested in the U.S. through the company would bear the full burden of the corporate income tax on U.S. source income. If a company chooses a U.S. tax home, then foreign capital invested in the U.S. through the company would only bear the burden of the spread between the securities tax rate and the rebate rate, assuming the company's securities are held by foreign persons who qualify for the rebate.

The upshot is that U.S. tax law would not be neutral with respect to a company's choice between a U.S. tax home and a foreign tax home. There would be a significant tax advantage to the choice of a U.S. tax home, if a company had substantial U.S. income and substantial U.S. ownership. But the extent of the distortionary impact of this is not clear. Tax consequences seem to have little bearing on a new company's initial choice of a tax home. Thus any distortionary effect is likely to involve mature companies that change their tax home for tax reasons. The specific concern is that a foreign MNC that has substantial U.S. assets and operations and substantial U.S. ownership will move its tax home to the U.S. to eliminate double-taxation of its U.S. income. But moving its tax home to the U.S. would increase the company's U.S. tax expense by the difference between the amount of income tax on the company's U.S. source income and the amount of the securities tax on all of the company's securities. The increase in a company's U.S. tax expense is likely to be quite significant, if a company has significant foreign source income and foreign ownership. The tax benefit would be realized by the holders of the company's securities, and should be reflected in an increase in the price of a company's securities. This could have knock-on benefits to the company. For example, the yield the company has to pay on newly issued debt could decrease. The size of this benefit to the company depends on who is the marginal price-setting clientele for a company's securities. If it is U.S. investors, then the yield the company has to pay on its debt could drop by 80 basis points, which is the amount of the securities tax. If it is foreign investors, then the yield could drop by as much as the amount of the rebate.

Happily there is a simple way to minimize the possible deadweight loss of any tax distortion of a company's choice of a U.S. tax home.[77] This is to decouple the choice of a tax home from a company's choice of a legal home and a company's choice of where to list a security. The possible deadweight loss could also be reduced by allowing a company with a foreign tax home to issue a U.S. security with some of the tax benefits that accrue to being a U.S. company. The next Section explains how this might be done.

[77] It is not obvious that there would be a significant distortionary effect.

c) A mechanism to reduce the tax advantage of a U.S. tax home

The analysis to this point assumes that a company's choice between a U.S. and a foreign tax home would determine whether the company has an obligation to remit the securities tax on every publicly traded security a company issues. This Section relaxes this assumption. It explains how a concern that the securities tax creates too strong a tax bias in favor of the choice of a U.S. tax home could be addressed by allowing a foreign company to issue a U.S. security that would carry with it some of the benefits of a U.S. tax home.

I will use the example of the 1998 merger between Daimler Benz, a German company, and Chrysler, to explain the relevant considerations and a way to allow a foreign company to issue a U.S. security with some of the tax benefits that accrue to being a U.S. company. Before the merger each company had shares that were primarily listed in a company's home nation and that were also listed on other exchanges globally through ADRs. In the merger shareholders of both companies swapped their shares for a global registered shared with the name DaimlerChrysler (trading as DCX).[78] The analysis to this point assumes that DaimlerChrysler would have to choose either a U.S. tax home or a non-U.S. tax home, and that if the company chose a U.S. tax home it would have to remit the securities tax on the total market value of all DCX shares (as well as any publicly traded debt securities issued by the company), while if it chose a non-U.S. tax home it would remit the securities tax on none of the DCX shares (and none of its publicly traded debt securities). If put to this choice, then the company would have a strong tax incentive to choose a U.S. tax home for reasons explained above.

It is possible to modify the securities tax to reduce the tax advantage to DaimlerChrysler of the choice of a U.S. tax home. A solution is to allow the German company to issue a special class of DCX shares on which it would remit the securities tax and that would provide some of the tax benefits of choosing a U.S. tax home. The company would be allowed to take a credit against its U.S. corporate income tax liability for the amount of the securities tax it paid on the U.S.-DCX shares. This rule produces the same U.S. tax consequence as placing the assets and operations that produce U.S. source income in a separate company that was owned by the owners of U.S.-DCX shares.[79]

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[78] G. Andrew Karolyi, supra n. , at 411-412.

[79] It is possible to design a rule that would allow a U.S. MNC to issue a special class of foreign securities that would not be subject to the securities tax and that would provide some of the tax benefits of a foreign tax home. The U.S. company would get a credit against the securities tax for foreign taxes it paid on its foreign source income but only to the extent the ratio of its foreign source income to its global consolidated income (the FSI Share) exceeded the ratio of the market value of its foreign securities to the market value of all of its securities. This produces the same U.S. tax consequences as placing the assets and operations that produce foreign source income in a separate company that was owned by the owners of the foreign shares. There is less need for this rule because the combination of the credit against the securities tax based on a company's FSI Share and a rebate of the securities tax goes a long way towards eliminating any excess tax burden on foreign source income that flows to foreign owners. Indeed, the combination of the credit and the rebate could result in foreign source income that flows to foreign owners bearing a lower tax

While this rule reduces the tax advantage to the choice of a U.S. tax home it creates another distortion. This rule would give Daimler Benz and Chrysler a tax incentive to merge. Prior to the merger Daimler Benz had some U.S. source income and some U.S. shareholders while Chrysler had some foreign source income and some foreign shareholders. This rule basically allow a company to allocate U.S. source income to U.S. security holders (for U.S. tax purposes) and to allocate foreign source income to foreign security holders, which reduces the possibility that income would bear an excess tax burden as a result of the securities tax. U.S. source income that is allocated to U.S. security holders would bear only the burden of the securities tax while foreign source income that is allocated to foreign security holders would bear no burden under the securities tax. The merger creates a company that has large pools both of U.S. and foreign source income and of U.S. and foreign security holders, which makes it more cost-efficient to issue two classes of securities to separate the pools and reap the tax benefits.

More generally, this rule would create a tax advantage for large MNCs that earn substantial inside and outside the U.S. and that have substantial blocs of security holders inside and outside the U.S. To compensate for this tax advantage a small and graduated penalty could be built into the rules. For example, if DaimlerChrysler chooses a foreign tax home, then rather than giving the company a dollar-for-dollar credit against the corporate income tax on its U.S. source income for securities taxes it paid on US-DCX shares, the credit could start at 100 cents on the dollar and be gradually reduced to 80 cents on the dollar.

5. Tax havens and hidden wealth

a) The current landscape

A large share of U.S. and global cross-border investment flows through tax havens, which include Bermuda, the Cayman Islands, Hong Kong, Ireland, Luxembourg, and Switzerland.[80] The tables below provide a rough sense of the importance of tax haven nations in the global financial network, if one places the U.S. at the hub of the network. The tables show by nation the volume of cross-border investment from the U.S. and into the U.S. in 2015. The figures are from the TIC survey. The first table shows outbound portfolio investment from the U.S. The 18 nations shown accounted for 82% of total outbound portfolio investment ($9,454.8 billion). All figures are in billions.

United Kingdom	$1,239.5	13.1%	Bermuda	$216.6	2.3%
Cayman Islands	$1,217.1	12.9%	Korea, South	$171.1	1.8%
Japan	$821.6	8.7%	Mexico	$147.6	1.6%

burden than would exist if the assets and operations that produce foreign source income were placed in a separate company owned by foreign shareholders.

[80] Jane G. Gravelle, Tax Havens: International Tax Avoidance and Evasion, Congressional Research Service (Jan. 15, 2015), 3-9, compiles several lists of tax havens and addresses the definitional problem. See also Ronen Palan, Richard Murphy, and Christian Chavagneux, Tax Havens: How Globalization Really Works (Cornell Univ. Press 2012)(reporting 11 lists).

Canada	$705.3	7.5%	Sweden	$137.5	1.5%
Ireland	$498.3	5.3%	Hong Kong	$136.0	1.4%
France	$473.6	5.0%	India	$130.0	1.4%
Switzerland	$419.7	4.4%	Luxembourg	$127.6	1.3%
Netherlands	$404.1	4.3%	Brazil	$116.2	1.2%
Germany	$377.8	4.0%	Spain	$115.2	1.2%

The second table shows inbound portfolio investment to the U.S. The 18 nations shown accounted for 81.8% of total inbound portfolio investment ($14,013.5 billion).

Japan	$1,903.1	11.1%	Taiwan	$453.8	2.6%
China, mainland	$1,844.0	10.8%	Germany	$343.7	2.0%
Cayman Islands	$1,505.8	8.8%	Singapore	$331.1	1.9%
United Kingdom	$1,448.3	8.5%	Netherlands	$317.6	1.9%
Luxembourg	$1,296.6	7.6%	Norway	$309.3	1.8%
Canada	$992.0	5.8%	Hong Kong	$298.0	1.7%
Ireland	$830.7	4.8%	Bermuda	$286.6	1.7%
Switzerland	$708.5	4.1%	France	$274.2	1.6%
Belgium	$602.1	3.5%	Brazil	$267.9	1.6%

It is important to be clear about what these figures do and do not show. The figures do not show the amount of capital owned in one nation that is used in another nation. The figures merely show that an entity established in one nation (or an individual resident) holds a financial claim against an entity established in another nation (or an individual resident). This includes a claim held by an entity in a custodial account.[81] Often a financial claim is part of a chain of claims that crosses multiple borders. A chain may be a circle, ending in the nation where it began. For example, much of the outbound investment from the U.S. to the Cayman Islands and much of the inbound investment from the Cayman Islands to the U.S. is investment by U.S. wealth owners in U.S. businesses that is intermediated through a Cayman Islands entity, such as a Cayman Island private equity fund.

A large share of the world's wealth is intermediated through the Cayman Islands because, like other tax haven nations, it offers political stability, a common law legal system, strong financial secrecy laws, minimal taxes and fees on intermediated capital, and a tractable government that is willing to facilitate financial innovation by creating legal infrastructure when asked by the financial services industry.[82] Often a Cayman Islands intermediary is used in the capital structure of a business enterprise or a financial intermediary to facilitate regulatory arbitrage or tax arbitrage. For example, a large

[81] Carol C. Bertaut, William L. Griever, and Ralph W. Tryon, Understanding U.S. Cross-Border Securities Data, Federal Reserve Bulletin (2006), A60, A63, explain that the practice of collecting holder data from U.S. resident entities "tends to create a 'custodial bias' in the liabilities survey by attributing excessively large holdings to countries that are major custodial, investment management, or security depository centers, such as Belgium, the Cayman Islands, Luxembourg, and Switzerland."
[82] Jan Fichter, The Anatomy of the Cayman Islands Offshore Financial Center: Anglo-America, Japan, and the Role of Hedge Funds, Review of Intl Pol. Econ. 1034 (2016).

percentage of U.S. capital that is invested in Cayman Islands private investment funds comes from tax-exempt nonprofits, pension funds, and charitable trusts. Much of this capital is invested back into the U.S. The capital is intermediated by a private investment fund through a Cayman Islands' "blocker corporation" so that U.S. tax-exempt investors do not incur U.S. tax liability under the unrelated business income tax when a fund uses debt financing.[83] This use of the Cayman Islands is not illegal (it may not even be socially undesirable), so this is tax avoidance and not tax evasion.[84]

This example shows that when capital is intermediated through a tax haven like the Cayman Islands it can be to achieve perfectly legal and even socially desirable objectives.[85] But often people invest through a tax haven to avoid tax or to hide wealth. Gabriel Zucman has tried to estimate the amount of the world's wealth that is hidden in tax havens by comparing national accounts of financial assets and liabilities. He uses Luxembourg as an example to explain his method.[86] At the beginning of 2015 the

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[83] Samuel D. Brunson, Repatriating Tax-Exempt Investments: Tax Havens, Blocker Corporations, and Unrelated Debt-Financed Income, 106 Nw. L. Rev. 225, 236-237 (2012). The example also illustrates how a fund can be structured to serve multiple tax clienteles. A fund that raises capital from both U.S. tax-exempts and high wealth U.S. individuals will be structured as an onshore fund for the individual investors and a parallel offshore fund for the tax-exempt investors. Id. at 237.

[84] A U.S. startup that obtained capital from a Cayman Islands fund would be required to remit the complementary tax on the estimated value of the fund's interest in the company. U.S. persons who were subject to the complementary tax would be required to remit the tax on the estimated value of their interest in the fund. This creates a possibility for double taxation when investment by U.S. wealth owners in U.S. business is routed through a foreign fund. To avoid double taxation in this case the foreign fund could be given a credit against its remittance obligation on the estimated value of an LP interest held by a US person for the tax remitted by the startup or the fund on the estimated value of the fund's interest in the startup. A dilution rule similar to the rule that applies to a tax rebate should apply to the credit to prevent the functional equivalent of tax-credit arbitrage through an off-shore fund.

A special anti-abuse rule may be needed to deal with the case in which a foreign investment fund holds a large portfolio of U.S. assets when a fund is in a position to game the estimated value rule by holding assets with above normal returns while disposing of assets with below normal returns. A U.S. investment fund would get no tax benefit from engaging in this strategy because a fund's remittance obligation is determined by the estimated value of interests in the fund, and not the estimated value of assets held by a fund. When an interest in a fund is purchased, redeemed, or sold in an arms-length transaction that price will be used to determine the remittance obligation for all interests in the fund of that kind. But a foreign investment fund could engage in this strategy because the tax is based on the estimated value of assets held by the fund, and not the estimated value of interests in the fund. To limit the payoff from engaging in this strategy, a foreign investment fund that holds a sufficiently large portfolio of U.S. assets could be required to report the difference between "inside" asset value and "outside" interest value, and to remit an additional tax based on outside interest value that is a mixed function of the percentage of a fund's assets that are U.S. assets and the excess of outside value over inside value.

[85] That said, the managers of private investment funds are adept at gaming domestic and international tax rules to minimize the tax burden on capital invested through a fund. Omri Marian, The Other Eight Percent: Private Investment Funds, International Tax Avoidance, and Tax-Exempt Investors, 2016 B.Y.U.L. Rev. 1715 (2017), makes the general point with respect to international tax avoidance and provides simplified examples (pp. 1729-1740), drawing on documents leaked by two former employees at the PricewaterhouseCoopers Luxembourg office. The documents are connected to fund structures that include a Luxembourg entity and in which an Advanced Tax Agreement is obtained from the Luxembourg tax administrators concerning the tax treatment of the Luxembourg entity that facilitates reducing the burden of taxes in other nations.

[86] Gabriel Zucman, The Hidden Wealth of Nations. Two recent papers on which Zucman is a co-author provide additional information.

national accounts of Luxembourg reported that persons in other nations held $3.5 trillion in shares in mutual funds domiciled in Luxembourg while the national accounts of all other nations reported that persons in other nations held only $2 trillion in Luxembourg mutual fund shares. Zucman surmises the imbalance represents unreported shares in Luxembourg mutual funds that are held through tax havens.[87] While the shares appear as a liability on the national accounts of Luxembourg they do not appear as a corresponding asset on any other nation's accounts. Zucman estimates using this method that around 8 percent of the world's wealth is "hidden" in tax havens,[88] including around 4 percent of the wealth of U.S. households.[89] While the owners of this wealth are invisible the wealth takes highly visible forms. Most of this capital is invested in publicly traded securities.[90] And many of these securities are held through public or private investment funds that are established in tax havens.[91]

Nations have tried to prevent their residents from using tax havens to avoid capital taxes or to hide wealth for other reasons by entering into bilateral and multilateral agreements that require financial institutions in one nation to report to another nation accounts held by its residents. I will say more about recent developments in this area in a moment.[92] There are reasons to be pessimistic that these efforts will put a significant

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[87] Zucman 38.

[88] Zucman 34. This estimate includes only wealth represented by financial assets. It does not include wealth held in physical form, such as "bank notes held in vaults," gold, chattels, or real estate. Id. 43-45. Zucman estimates that around 20 percent of the income on financial assets is declared for tax purposes. Id. 47. Annette Alstadsæter, Niels Johannesen, and Gabriel Zucman, Who Owns the Wealth in Tax Havens? Macro Evidence and Implications for Global Inequality, NBER Working Paper 23805 (Sept. 2017), revises the 8 percent global estimate upward to 10 percent using newly available bilateral data on the amount of deposits residents of one nation hold in the banks of another nation. For example, the data shows the amount of deposits U.S. residents hold in Cayman Islands banks. Zucman's early study used aggregate date. The estimates for specific nations are also revised upward. The paper also estimates how accounting for this hidden wealth would change national estimates of wealth distribution.

[89] Zucman 53. Zucman estimates that 10 percent of the wealth of Europe is held through tax havens, 22 percent of the wealth of Latin America, 30 percent of Africa, 52 percent of Russia, and 57 percent of the Gulf Countries. Id. M. Hanlon, E. Maydew, and J. Thornbeck, Taking the Long Way Home: U.S. Tax Evasion and Investments in U.S. Equity and Debt Markets, 70 Journal of Finance 257 (2015), find evidence of U.S. wealth holders evading U.S. tax by investing in U.S. securities through tax havens in the fact that flows of FPI from tax havens to the US increase when use capital gains and ordinary tax rates increase and in the fact flows of FPI from tax havens to the US decrease when the US signs a bilateral information sharing agreement with a tax haven.

[90] Zucman 16-17. Zucman (at p. 31) estimates that in Spring 2015 of $2,300 billion held by banks domiciled in Switzerland belonging to nonresidents $750 billion was invested in Luxembourg mutual funds (which largely hold publicly traded equities), $200 billion was invested in Irish mutual funds (which largely hold debt instruments), $500 billion was directly invested in global equities, $600 billion was directly invested in global bonds, and $250 billion was in cash deposits or other types of assets. Zucman estimates U.S. households had $80 billion invested through Swiss bank accounts. Much of this capital was routed through offshore intermediaries in places like Panama.

[91] Zucman at 26-27 (reporting most wealth is invested through "funds domiciled in Luxembourg, Ireland, and the Cayman Islands," with Luxembourg specializing in mutual funds, the Cayman Islands in hedge funds, and Ireland in money market funds).

[92] Itai Grinberg, The Battle Over Taxing Offshore Accounts, 60 UCLA L. Rev. 304 (2012), is a good summary of developments through 2012. In 2010, the U.S. adopted the Financial Account Tax Compliance Act ("FATCA"), which requires foreign financial institutions to collect and report to the I.R.S. information on financial accounts of U.S. persons and foreign entities with significant U.S. ownership or face a

dent in the problem. Studies find that wealth owners and managers who invest through tax havens respond to measures that partially crackdown on financial secrecy by shifting to other channels of investment or to other types of investment to avoid taxes and preserve financial secrecy.[93] This has led some observers to conclude that a global solution, like a global registry of securities ownership, is required.[94]

But political dynamics may make a global solution difficult to achieve. Global taxation of capital has been described as a "weakest-link common good" because the mobility of capital intermediation means that taxing capital requires the cooperation of every nation (or almost every nation) through which capital could be intermediated.[95] One (or a few) tax haven nations could serve as a tax haven and as a repository of hidden wealth for the entire world. The problem is made harder to solve by the fact that the returns to a nation's financial services industry of serving as a tax haven increase as the number of tax havens decreases. The pressure needed to coerce a nation not to serve as a tax haven increase as the number of tax havens decreases.

In addition, nations have different preferences with respect to taxing capital, and so have varying stakes in combatting tax havens. A nation with a small capital base generally prefers not to tax capital (or to tax capital at a very low rate), particularly if the nation has a large financial services sector, while a nation with large capital base may prefer to tax capital at a meaningful rate, if it could reduce capital flight to acceptable levels. Nations also have inconsistent preferences. The U.S. is an important example. While the U.S. has made tremendous efforts to prevent U.S. wealth owners from avoiding U.S. capital taxes by investing though foreign tax havens, the U.S. itself is an important tax haven for foreign wealth because of state laws that make it possible to establish a legal entity without disclosing the beneficial owner, and because of the

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withholding tax on the gross amount of a broadly defined category of payments from U.S. sources and participating foreign financial institutions. Grinberg at 334-336.

[93] Neils Johannesen and Gabriel Zucman, The End of Bank Secrecy? An Evaluation of the G20 Tax Haven Crackdown, 6 Amer. Econ. Journal: Economic Policy 65 (2014)(finding that individuals who invested in offshore tax havens responded to bilateral tax treaties cracking down on secrecy by shifting deposits to havens not covered by a treaty with their home nation); Thomas Rixen and Peter Schwarz, How Effective is the European Union's Savings Tax Directive? Evidence from Four EU Member Nations, 50 Journal of Common Market Studies 151 (2012)(finding that investors in the EU responded to the EU Savings Tax Directive by reallocating investment from debt to equity and reallocating investment from co-operating nations to nonparticipating nations).

[94] Zucman proposes combatting the use of tax havens by wealth owners to avoid capital income and inheritance taxes by creating a global register that would identify the beneficial owner of every publicly traded security. Zucman 92 et seq.

Stuart Weinstein and Sina Yekini, Transparency in Securities Transactions and Custody Chains (2015), discusses some of the practical issues that would be involved in creating a database of securities ownership, if the problem of identifying the beneficial owner of a security could be solved. They focus on the operational efficiencies provided to a securities intermediary by holding securities in an omnibus account instead of a segregated account. Maria Vermaas, The Call for Proper Segregation in Intermediated Systems, 18 Uniform L. Rev. 589 (2014), advocates for segregated accounts on the ground that this makes it easier to resolve the competing claims of securities owners when an intermediary is insolvent.

[95] Katharina Holzinger, Tax Competition and Tax Co-operation in the EU: The Case of Savings Taxation, 17 Rationality and Society 475 (2005), makes this point and the other points in text.

absence of withholding taxes on interest, dividends, or capital gains paid to nonresidents.[96]

Despite these reasons for pessimism about the likelihood of effective international cooperation to combat tax havens and hidden wealth, recent developments raise the possibility that a corner is being turned on these issues.[97] The OECD is creating a global system in which financial institutions commit to collect information to identify non-resident account holders and to automatically transmit this information to a non-resident's home nation.[98] The system goes by the acronym CRS for Common Reporting Standard. As of September 2017, 97 nations had signed a multilateral convention,[99] agreeing to implement CRS. The signatories include many of the world's tax havens.[100] Information is actually exchanged pursuant to a bilateral agreement. There is a large and growing web of these bilateral information exchange agreements. They numbered over

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[96] The Tax Justice Network ranks the U.S. fourth in a 2015 Secrecy Ranking, behind Switzerland and Hong Kong and ahead of Singapore. http://www.financialsecrecyindex.com/ The score is a composite of a nation's secrecy score (which is a rough measure of the extent to which a nation's law facilitate financial secrecy and tax evasion) and a nation's share of the global market for offshore financial services. A report provides background, emphasizing the importance of state laws that make it possible to establish a legal entity without disclosing the beneficial owner and the absence of withholding taxes on capital income. See http://www.financialsecrecyindex.com/PDF/USA.pdf.

[97] Two recent unpublished papers suggest these programs may be having an impact. Simone, Lester, and Markle, Transparency and Tax Evasion: Evidence from the Foreign Account Tax Compliance Act (Sept. 2017), examines national-level data on investments in U.S. securities by foreign account holders. The authors find "a significant decrease in foreign portfolio investment to the U.S. from tax haven countries after signing on to FATCA, consistent with a decrease in 'round-tripping' activity attributable to U.S. investors." However, they also find "weak evidence of an increase in the amount of investment out of tax haven countries that do not agree to exchange information." The authors also estimated the amount of wealth held in tax haven nations using Zucman's methodology. They find "the estimated amount of hidden assets held in FATCA-signing havens declined 29 percent since 2012."

Omaratin, Tax Information Exchange and Offshore Entities (Sept. 2016), uses data from the Panama Papers of incorporations facilitated by Mossack Fonesca to examine the effects of regulatory reforms on the creation of offshore entities. Omaratin finds that Mossack Fonesca's customers responded to the EU Savings Directive by creating new offshore entities to circumvent the directive, almost doubling the number of annual incorporations reported in the Panama Papers. This is consistent with other studies that find the EU Savings Directive did little to reduce the level of tax evasion, but instead caused investors to shift channels used to evade taxes. On the other hand, Omaratin finds that Tax Information Exchange Agreements ("TIEA") and entries into information sharing agreements under CRS and FATCA were associated with a significant decrease in the creation of new offshore entities by Mossack Fonesca's customers, as well as closures of existing entities. Though he also finds that closures in response to a TIEA were associated with an increase in incorporations in other nations, suggesting investors responded to a TIEA by "haven hopping." And he finds no closure effect associated with FATCA, which he attributes to U.S. investors having previously disclosed hidden offshore wealth under the amnesty program.

[98] The information is transmitted to an institution's national tax authority, which transmits the information to a non-resident's home nation.

[99] As of Sept. 2017, 102 nations publicly committed to implement the CRS.

[100] Information on signatories can be found at http://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/. Signatories include Bermuda, the Cayman Islands, Ireland, Luxembourg, and Switzerland.

2000 in September 2017.[101] The first information exchanges under this program occurred in September 2017.

Before CRS there was FATCA.[102] This is a U.S. program begun in 2010 to coerce[103] foreign financial institutions ("FFIs") to collect information to identify U.S. account holders, and to automatically transmit this information to the U.S. The program induced other nations to enter into bilateral agreements with the U.S., agreeing to tax information exchanges.[104] As of 2017, there were 113 such agreements.[105] Many of these agreements are reciprocal and provide that U.S. financial institutions will collect information to identify non-resident account holders and to automatically transmit this information to a non-resident's home nation. However, the reciprocal reporting obligations imposed on U.S. financial institutions by these agreements has significant gaps, creating the possibility that the U.S. could serve as a tax haven for the world, if CRS was successful in combatting tax havens other than the U.S.[106] I will say more about these gaps below. The U.S. has not agreed to participate in CRS.

How successful CRS and FATCA will be in combatting tax havens is uncertain. CRS and FATCA require a financial institution to make a reasonable effort to determine the identity of a beneficial owner of an account.[107] A key question regarding how effective these programs will be in combatting tax havens is how successful financial institutions will be in obtaining this information. Typically, an account in a tax haven is held in the name of a legal entity or a designated individual nominee to mask the identity of the beneficial owner of an account. CRS and FATCA allow a financial institution to rely on self-certification of the identity of the beneficial owner of an account by the representative of an entity or by a designated nominee, unless an institution has information in hand (or information is readily available to it) calling the information that is provided into doubt. CRS and FATCA do not prohibit a financial institution from

[101] http://www.oecd.org/tax/exchange-of-tax-information/first-automatic-crs-exchanges-between-49-jurisdictions-to-take-place-over-2000-bilateral-exchange-relationships-in-place.htm (Sept. 14, 2017). A full fairly current list may be found at http://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/exchange-relationships/. For example, as August 7, 2017, the Cayman Islands had agreements to send information to 49 nations, including all of the EU nations and China.

[102] The acronym is from the title of the 2010 statute establishing the program: The Foreign Account Tax Compliance Act, IRC § 1471 et seq.

[103] The coercion took the form of a 30 percent withholding tax on all U.S. source portfolio income plus the gross proceeds from the sale of U.S. securities remitted to a non-compliant FFI by any U.S. payer who is subject to the withholding obligation. Susan Morse, Tax Compliance Under High-Penalty Regimes, 44 Conn. L. Rev. 675, 725 (2012), argues the penalty is too high and if imposed "could produce significant unwarranted capital market disruptions and require commitment of international relations resources."

[104] Joshua D. Blank and Ruth Mason, Exporting FATCA, Tax Notes 1245 (2014)("FATCA has enhanced multilateral cooperation in combatting tax evasion, and it has spawned similar legislation and treaties in other jurisdictions.")

[105] The agreements come in two general models. In Model 1 an FFI transmits information to its own tax authority, which transmits the information to the U.S. In Model 2 an FFI transmits information directly to the U.S.

[106] Allison Christian, What You Give and What You Get: Reciprocity Under a Model 1 Intergovernmental Agreement on FATCA, Cayman Financial Review (July 12, 2013)(explaining that the U.S. merely expresses a commitment to support relevant legislation to provide ownership transparency).

[107] OECD, Standard for Automatic Exchange of Financial Information in Tax Matters Implementation Handbook 47-48 (referring to "controlling persons" rather than "beneficial owners)".

having an account for which the institution has not obtained the required self-certification, or from having an account that an institution knows has an unknown beneficial owner.[108] Less stringent investigation and reporting requirements are imposed on financial institutions with respect to existing accounts. And is not clear what penalties a financial institution will suffer if it exercises less than due diligence in investigating beneficial ownership. Penalties are a matter of local law under CRS.

Meanwhile many states and nations have laws that make it possible to establish a legal entity without disclosing beneficial ownership. These laws have proven to be a very hard nut to crack. Establishing ownership registries has been a priority of the Financial Asset Task Force ("FATF") for over a decade. FATF a multi-nation organization that was established to examine and develop measures to combat "money-laundering, terrorist financing and other related threats to the integrity of the international financial system."[109] Among its recommendations is that a nation "should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed" by other nations.[110] FATF evaluates nations for compliance with its recommendations. In 2017 ratings of the compliance efforts of 35 nations, 13 nations had "not achieved" this outcome or had achieved it to a "negligible extent." The 13 non-achievers include the U.S. and Canada.[111]

If CRS and FATCA are successfully implemented, then as matters stand now the U.S. might well become the world's leading tax haven for non-U.S. wealth owners.[112] Under existing law, U.S. financial institutions are required to report to the I.R.S. only U.S. source interest and dividends paid to a nonresident, so this is the only information the U.S. government has to share with foreign governments. U.S. financial institutions are not required to report the beneficial owner of an entity that holds passive assets.[113]

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[108] OECD, Standard for Automatic Exchange of Financial Information in Tax Matters Implementation Handbook 65-69. An account with a known unknown beneficial owner is reported as an "undocumented account." The expectation is that an institution that reports an abnormally large number of undocumented accounts will be investigated.

[109] http://www.fatf-gafi.org/about/whatwedo/

[110] FATF Guidance, Transparency and Beneficial Ownership, at 10.

[111] Another 20 nations had achieved this outcome "to some extent" but still needed "major improvements." The ratings can be found at http://www.fatf-gafi.org/media/fatf/documents/4th-Round-Ratings.pdf. This is Immediate Outcome 5, which is that "Legal persons and arrangements are prevented from misuse for money laundering or terrorist financing, and information on their beneficial ownership is available to competent authorities without impediments."

[112] See Casey Michael, The U.S. is a Good Place for Bad People to Stash Their Money, Atlantic (July 13, 2017). The U.S. may already be the world's number one destination for laundered money. It is reported that in 2005 the U.S. was the number one destination in the world for laundered money, receiving an estimated 18.9 percent of all money laundered globally. Freidrich Schneider, The Financial Flows of Transnational Crime and Tax Fraud in OECD Countries: What Do We (Not) Know?, 41 Public Finance Review 677, 691 (2013), citing Brigitte Unger, The Scale and Impacts of Money Laundering (Edward Elgar 2007). The Cayman Islands were second at 4.9% See generally Fredrich Schneider and Ursula Windischbaeur, Money Laundering: Some Facts. 26 Eur. J. Law & Econ. 387 (2008).

[113] Starting in 2018, U.S. financial institutions will be required to collect and to retain information identifying beneficial ownership of a "legal entity customer." This is under regulations that were finalized in May 2016. Financial Crimes Enforcement Network, Treasury, Customer Due Diligence Requirements for Financial Institutions, 81 Fed. Reg. 29398 (May 11, 2016). A trust is not included in the definition of a

They are not required to report the balance in an account or income other than interest and dividends. And they are not required to report foreign source income earned in U.S. accounts.[114] There is no chance in the current political environment of federal legislation in the U.S. to strengthen these reporting requirements, or to impose information reporting requirements on U.S. financial institutions that are comparable to the requirements imposed by CRS. The current political winds in the U.S. are blowing in the other direction. The 2016 Republican Platform called for the repeal of FATCA on privacy grounds.[115]

If the U.S. adopted the securities tax and the complementary tax, then it would provide a way for the U.S. to deter both U.S. and foreign wealth owners from evading U.S. and foreign capital taxes on investment in the U.S., without the U.S. having to impose information reporting requirements on U.S. financial institutions that make it difficult for individuals to hide wealth from the state. The next section explains. I expect Republicans would consider this to be a bug, and not a feature, of the securities tax and the complementary tax because the privacy-related objections to FATCA are largely a pretext. But the securities tax and complementary tax have other features that may make them attractive to Republicans and to business interests.

b) Structuring a rebate to deter tax evasion by U.S. and foreign wealth owners on investment in the U.S.

This Section explains how a rebate could be integrated with CRS and FATCA to deter tax evasion with respect to investment in the U.S. Without the rebate the securities tax and the complementary tax would be withholding taxes that are remitted by capital users and intermediaries in the U.S. The basic idea is to condition payment of a rebate to a foreign financial institution on the institution being subject to the CRS and FATCA reporting requirements. A rebate would also be paid to a U.S. financial institution, but only if an institution documented and reported the beneficial owner of a security (or asset) to be a foreign individual or a qualified foreign entity. U.S. financial institutions would not be under a general obligation to determine when the beneficial owner of a security (or an asset) is a foreign person, or to report this information. Thus, foreign

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legal entity. See 31 C.F.R. § 1010.230(e)(1)(defining a legal entity customer to include "a corporation, limited liability company, or other entity that is created by the filing of a public document with a Secretary of State or similar office, a general partnership, and any similar entity . . .")

[114] Robert Owens, Treasury Deputy Assistant Secretary (international tax affairs) in the Obama Administration, notes these gaps in a conversation with Jeffrey Owens, published in 87 Tax Notes Int'l 715 (Aug. 14, 2017)("we give a lot of information. We'll tell you how much income is earned on that account in New York. We'll tell you a lot of the identifying data that's in the FATCA requirements. What we don't do, admittedly, is we don't tell you the beneficial owners of entities with passive assets, which we require of other countries. And we don't give the gross amounts in the account . . . Whether we become fully compliant with the CRS depends on an enactment of Congress to make those two types of information - and the third one is foreign-source income earned in U.S. accounts - put into U.S. statutory law.")

[115] Republican Platform 2016, p. 13 (FATCA and FBAR "requirements result in government's warrantless seizure of personal financial information without reasonable suspicion or probable cause. Americans overseas should enjoy the same rights as Americans in the United States, whose private financial information is not subject to disclosure to the government except as to interest earned.")

wealth owners would still have the option to hold wealth secretly in the U.S., but the investment in the U.S. would be subject to the securities tax or to the alternative tax.

A withholding tax can be effective in preventing tax evasion on investment in the U.S. both by U.S. and foreign wealth owners. A withholding tax does not prevent tax evasion by U.S. wealth owners investing in foreign assets. Thus the U.S. has no choice but to continue to rely on FATCA to prevent U.S. wealth owners from evading U.S. tax on foreign investment.[116] The addition of a partial rebate to a withholding tax would mean that the U.S. would also continue to rely on FATCA to prevent U.S. wealth owners from evading tax by round-tripping an investment in the U.S. through a tax haven. The partial character of the rebate would decrease the payoff from successfully round-tripping an investment in the U.S. through a tax haven, which would increase the effectiveness of FATCA as a deterrent.

i) Basic mechanics [to be done]

This part is to be done.

ii) What this policy would and would not accomplish

The securities tax is functionally similar to a withholding tax on capital income, which is why the tax would reduce the attractiveness of the U.S. as a tax haven, if the U.S. did not rebate a significant part of the tax. Many nations, including the U.S., impose withholding taxes on interest and dividends paid to non-residents.[117] But these withholding rules are a patchwork, which make them easy to avoid. They apply only to interest and dividend income (some apply to one but not to the other), and not to capital income generally. This makes it possible to avoid withholding taxes by shifting the character or form of an investment. In many nations, including the U.S., bilateral tax treaties eliminate withholding taxes on interest and dividends paid to a resident of a treaty partner, including interest and dividends paid to a financial intermediary that is established in a treaty partner, and without regard to the residence of the person who is the ultimate beneficiary of the income. For example, the U.S.-U.K. tax treaty eliminates the U.S. withholding tax on dividends paid to U.K. residents, including dividends paid to a U.K. bank, and without regard to the residence of the beneficial owner of the U.K. bank accounts. This makes it easy for anyone in the world to avoid the U.S. withholding tax on dividends by investing in U.S. stock through a U.K. bank.

The securities tax is unlike the existing patchwork of withholding taxes because it would apply to all capital that is invested in U.S. securities. The complementary tax would cover almost all other investment in the U.S. Together the taxes would create what could be described as a universal withholding tax on almost all capital that is invested in the U.S. The two taxes could also be described as capital taxes in which the

[116] The FATCA penalty is poorly designed to deal with this problem since the penalty is assessed on an FFI's holdings of U.S. securities and other U.S. assets. An FFI that plans to cater to U.S. investors seeking to evade U.S. taxes by investing abroad could avoid the FATCA penalty by specializing in foreign assets and not holding U.S. assets.

[117] Howell H. Zee, Taxation of Financial Capital in a Globalized Environment: The Role of Withholding Taxes, 51 National Tax Journal 587.

tax is paid by businesses and financial intermediaries that use capital, rather than being paid by individuals who own capital.

If other wealthy nations adopted the securities tax (or a comparably universal withholding tax on capital), then it could get around the "weakest-link common good" problem that has made it difficult for wealthy nations to solve the global problem of tax havens and hidden wealth. The securities tax ensures that capital invested in the U.S. bears either U.S. capital taxes (if an investor foregoes the rebate) or the capital taxes of an investor's home state. This means that wealth owners who seek to avoid capital taxes entirely would have to look outside the U.S. for investment opportunities. This could be costly to the U.S. for the reduced inflow of capital to the U.S. could raise the cost of capital in the U.S. and reduce U.S. national welfare. But there would be a corollary cost to wealth owners who forego investment opportunities in the U.S. to avoid capital taxes. The corollary cost would be embedded in their having to accept a lower expected return on their next-best investment alternatives outside the U.S. Basically capital that is invested outside the U.S. to avoid capital taxes would bear an implicit tax. If other wealthy nations adopted the securities tax (or adopted a comparably universal withholding tax), then the pool of investment opportunities that might not bear any capital tax would shrink even further, increasing the size of the implicit tax on investment that does not bear some nation's capital tax.

It might help to provide some raw numbers. A nation's gross domestic product (GDP) is a rough proxy for the size of a nation's economy and a nation's demand for capital. In 2016 the GDP of the U.S. was $18,569 billion, which was 24.55% of world GDP.[118] If the U.S. adopted the securities tax and the complementary tax, then owners or managers of wealth who wanted to avoid capital taxes entirely would have to forego roughly one-quarter of the world's investment opportunities. If Japan, Germany, the U.K., France, Canada, Australia, the Netherlands, and the Scandinavian nations adopted the securities tax and the complementary tax, then owners and managers of wealth who sought to avoid capital taxes would have to forego over half of the world's investment opportunities. The combined GDP of these nations was 55.43% of world GDP in 2016. This reduction in investment opportunities would result in investment that avoids capital taxes bearing a significant implicit tax.

The securities tax shares another characteristic with a withholding tax on capital income: collecting a tax on capital does not require knowing a wealth owner's identity. The anonymity of the securities tax is a source of both benefits and costs. The principal benefit of the anonymity of the securities tax is political. There is close to zero prospect of federal legislation overriding state laws that allow people to create a legal entity without disclosing the identity of the beneficial owner(s). The anonymity of the securities tax makes it unnecessary to override these laws. The anonymity of the securities tax might also reduce political resistance from financial service providers in the U.S. to a change in tax law that would greatly reduce the attractiveness of the U.S. as a

[118] These figures are from the World Bank (https://data.worldbank.org/data-catalog/GDP-ranking-table). This may understate the current importance of the U.S. as a tax haven for wealth owners in other nations for reasons explained earlier.

tax haven. They could continue to offer U.S. and foreign wealth owners the benefit of financial secrecy.[119] The anonymity of the securities tax may also provide economic benefits to the U.S. through increased capital flows into the U.S. by making the U.S. an attractive place to invest for people who value financial secrecy.

But the anonymity of the securities tax (when investors choose to forego the rebate) also entails costs. A 2012 paper by Itai Grinberg identifies some of these costs.[120] Grinberg frames the choice as being between "an information reporting model" and an "anonymous withholding model." Grinberg argues that an information-reporting model "preserves sovereign political autonomy" better than an anonymous-withholding model. This has to be right in a general sense. An information-reporting model has the capacity to give a nation whatever information the nation chooses to require to be reported concerning a resident wealth owner, which gives a nation the power to adjust the tax due based on individual information. An information-reporting model also provides a nation with verification that a resident wealth owner paid a tax. An anonymous withholding model provides a nation none of this information.

But the normative significance of this loss of "sovereign political autonomy" may be relatively small. Grinberg raises the specific concern that anonymous-withholding "is not compatible with a progressive income tax and benefits system."[121] Combining withholding with a conditional rebate addresses the progressivity concern in the domestic context. A nation can make an anonymous withholding tax on capital progressive by rebating the tax a wealth owner who establishes he is entitled to a rebate. For example, a large percentage of the tax could be rebated to nonprofits, to pension funds, and to individuals who hold capital in retirement accounts. Wealth owners who chose to remain anonymous would pay tax at the highest marginal rate.

The securities tax and conditional rebate do interfere with the ability of other nations to tax capital at higher rate than the U.S. taxes capital. This is because a resident of a nation that taxes capital at a higher rate could invest capital in the U.S. secretly and forego a partial rebate of the securities tax. But a conditional rebate delivers some

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[119] Tax havens may be willing to forego being able to offer customers the benefit of tax avoidance if they are allowed to continue to offer the benefit of financial secrecy. In response to FATCA, Switzerland negotiated an arrangement under which Swiss financial institutions avoided the punitive withholding tax by remitting the tax on an aggregate basis for U.S. account holders who requested to remain anonymous without providing identifying information on the holders. Grinberg at 338. Austria and Luxembourg agreed to withhold and remit tax on interest paid to residents of other EU nations on an anonymous basis in return for being excused from an obligation under the EU Savings Tax Directive to share tax information. Zucman 69-72 argues this was a largely empty gesture. A financial institution could retain a client while avoiding the withholding tax by shifting a portfolio from debt to equity or by instructing a client who wants to hold debt to create a holding company in a nation outside the EU for which there is no withholding obligation, such as in the Cayman Islands.

[120] Itai Grinberg, The Battle Over Taxing Offshore Accounts, 60 UCLA L. Rev. 304, 347-371 (2012). The concern that the withholding model does not reach "untaxed principal" is eliminated by a capital tax.

[121] Id. at 362. A related concern raised by Grinberg assumes that a withholding rate is set by a bi-lateral or multi-lateral treaty, which will not adjust with domestic tax rates. Id. at 361. The capital tax is not set by treaty. Grinberg also raises the concern that there is value in people knowing that the wealthy are being made to pay their fair share of taxes. Id. at 358-359. While anonymous withholding sacrifices in this dimension it provides offsetting benefits in other dimensions by making the tax non-salient.

benefits to other nations that want to tax capital at a higher rate than the U.S. A conditional rebate helps to deter foreign tax evasion because it reduces the benefit from successfully evading the local tax to the difference between the tax that would have been due on the reported investment and the value of the rebate. Basically a conditional rebate enables a nation that chooses to tax capital at a higher rate than the U.S. to reduce non-reporting to whatever level a nation's policy makers think desirable at a lower level of enforcement costs and a lower level of sanctions.

This does not respond to what I take to be Grinberg's most significant objection, which is that if the U.S. agrees to anonymous-withholding because it satisfies the national interests of the U.S. with respect to taxing capital, then this will prevent other nations that have different national interests with respect to taxing capital from satisfying their national interests. Grinberg is concerned that an anonymous-withholding tax on capital will evolve so that the interests of economically powerful nations are protected while the interests of less powerful nations are not protected. And there is a specific concern that when a nation is a Kleptocracy or an Oligarchy an anonymous withholding tax will make it easier for the Kleptocrats and Oligarchs to hide their wealth from their fellow countrymen.

An anonymous withholding tax on capital does make it easier for wealth owners to hide their wealth. Foreign wealth owners could invest in U.S. securities and pay U.S. capital taxes to avoid foreign taxes or to hide wealth. This is politically and morally objectionable. The U.S. would obtain a fiscal benefit at the fiscal expense of a foreign wealth owner's home nation, when a foreign wealth owner invests in the U.S. and foregoes the rebate in order to avoid taxes or to hide wealth. The fiscal benefit to the U.S. is the foregone rebate. The fiscal expense to the home nation is the loss of tax revenue. The concern that the U.S. would be unjustly enriched at the expense of other nations could be addressed indirectly. It should be possible to estimate the fiscal benefit to the U.S. and the fiscal expense to other nations of wealth owners from other nations investing in the U.S. and foregoing the rebate to avoid taxes or to hide wealth. The U.S. could pay this sum of money to other nations. Or the U.S. could pay this sum of money to the UN or to global NGOs.

The U.S. is an attractive destination for investing illicitly accumulated wealth because it offers financial secrecy, abundant investment opportunities, and imposes little or no taxes on foreign passive investment. Changing U.S. policy with respect to taxes by imposing a small withholding tax (on the order of 80 basis points) is unlikely to dissuade criminals who have strong reasons to hide their wealth from investing it in the U.S. An effective information-reporting model is clearly superior to an anonymous-withholding model with respect to reducing the attractiveness of the U.S. as a haven for hidden wealth and a destination for laundered money.