Testimony
of
Anthony Smith
Vice President of Tax & Treasurer
Thermo Fisher Scientific Inc.

before the

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Chairman Hatch, Ranking Member Wyden, and distinguished members of the committee, it is an honor to appear before you today to discuss how this committee and the Senate can build a more competitive U.S. international tax system.

I am Tony Smith, Vice President of Tax & Treasury and Treasurer for Thermo Fisher Scientific Inc. Prior to joining the company over 10 years ago, I worked as a tax professional, beginning my career 25 years ago in the United Kingdom and focusing largely on U.K. tax matters. I then shifted my focus to U.S. tax matters in 1993 and moved here in 1998. My experience qualifies me to comment on U.S. and overseas tax regimes as well as company and shareholder reaction to tax rules and reforms. I have appreciated the opportunity to meet with many of your staffs over the past couple of years to discuss the pressing need for international tax reform.

I recognize that the committee is faced with difficult decisions and complex trade-offs as you consider corporate, small business and personal tax reform that will result in an optimal tax system for the United States in today's global economy. My focus today is on corporate tax reform – with particular emphasis on international tax reform. I appreciate this opportunity to provide perspectives from the front lines on why international tax reform is so important to U.S.-based, globally engaged companies like Thermo Fisher. I'll also speak to the kinds of changes that I believe will make a real difference to the competitiveness of U.S.-based companies and their contributions to economic growth and jobs in the United States.

Thermo Fisher Scientific's business

First, a little background on our company. Thermo Fisher Scientific is the world leader in serving science. Our mission is to enable our customers to make the world healthier, cleaner and safer, and we fulfill this mission by providing advanced technologies, products and services that help our customers address some of the most important challenges facing society today. For example, we have helped our customers screen for and contain the Ebola virus, discover better cancer treatments, monitor the environment to understand climate change and protect the safety of our citizens.

Thermo Fisher is headquartered in Massachusetts, but is a globally engaged company with 50,000 employees worldwide. Approximately half of that workforce is in the United States. We are proud to have major facilities in many of the states represented on this committee – including facilities in Logan, Utah, and Eugene, Oregon.

Our portfolio consists of some 1.3 million products, including analytical instruments used in research labs and production lines, specialty diagnostics that test for myriad health conditions, life sciences solutions to accelerate research, discovery and diagnosis, and a comprehensive offering of laboratory products and services.

Thermo Fisher's global revenue is approximately $17 billion. That revenue is split roughly 50/50 between the United States and overseas. We have a significant overseas customer base, and much of this revenue is derived from "Made in America" products that we sell to science customers around the world. These products come from not just Logan and Eugene, but also Lenexa, Austin, Asheville, Marietta, Allentown, Rochester, Kalamazoo, Fair Lawn, Rockville, Lafayette and Middletown, to name but a few.

Thermo Fisher's revenues have grown at an average rate of 10 percent per year since 2000. We continue to invest in technology innovation, commercial capabilities and emerging markets to grow our existing businesses. We have also acquired businesses to further strengthen our strategic position. In the last five years alone, we have spent more than $20 billion on acquisitions – both within and outside of the United States.

Thermo Fisher's tax profile

Thermo Fisher manufactures a substantial volume of products in the United States. The company spends over $500 million per year in the United States on research and development to support new and existing products. The company benefits from the R&D tax credit when it is available. In 2014, the R&D tax credit was worth $25 million to Thermo Fisher. The company also benefits from the reduced effective corporate tax rate on domestic manufacturing under section 199, which was worth about $30 million to us last year. In addition, the company benefits from some timing items provided for in the current tax law, including use of the LIFO inventory valuation method.

Given our active acquisition history, Thermo Fisher has approximately $14 billion of debt. The company's interest expense is approximately $400 million per year.

In addition to our large U.S. manufacturing presence, Thermo Fisher manufactures products overseas in multiple jurisdictions, including China, Finland, Germany, Lithuania, Singapore, Sweden, Switzerland and the United Kingdom. We sell products in nearly every jurisdiction through both distribution affiliates and unrelated distributors. In all cases, the corporate tax rate imposed on profits earned in those jurisdictions is lower than the U.S. corporate tax rate.

Like many companies that have grown in part through acquisitions funded partly from U.S. sources and partly from overseas cash, Thermo Fisher has a complex overseas treasury and legal structure. Nearly all of the company's external debt is owed by U.S. members of the Thermo Fisher group to U.S. lenders. This is because it is optimal for a corporate group to issue debt through one face to the capital markets and because the capital markets in the United States are the most efficient in the world. The proceeds of this debt, along with funds generated from operations, are then used by our U.S. or overseas businesses to make acquisitions. While approximately half of the company's annual cash flow is generated overseas, Thermo Fisher currently has very little cash overseas. The vast majority of the cash from our overseas earnings is reinvested in the business or used for strategic acquisitions that increase our competitiveness and stimulate growth.

Some of Thermo Fisher's overseas income is subject to current tax in the United States under the Subpart F regime. This is because of the complex overseas treasury and legal structure just mentioned, which is a byproduct of the company's significant international growth via acquisition.

The need for international tax reform

The current U.S. international tax rules are unwieldy, subject to varying interpretation, and difficult to comply with. All of this gives rise to uncertainty for U.S.-based companies that are globally engaged.

Investors and companies want predictability and certainty. And the entire marketplace remains cautious as a result of questions about when – or if – Congress will reform the U.S. tax code. Recent inversion activity is a sign of frustration with an uncompetitive U.S. system and lack of confidence that reforms to make the system more competitive are imminent.

The combined effect of the high U.S. corporate tax rate and the U.S. worldwide tax system limits the flexibility of U.S.-based global companies to deploy the cash earned in their foreign businesses where it would be most productive. Given the high U.S. tax rate, U.S. multinationals will have overseas subsidiaries that make profits that are subject to taxes lower than in the United States. Most U.S. multinationals allow these earnings to remain overseas rather than face a large tax cost to repatriate the funds. If funds are needed in the United States, such companies borrow in the United States rather than access the earnings trapped overseas. Having a tax regime that creates a disincentive for U.S.-based companies to pay down debt – and indeed creates an incentive to incur new debt – is not sustainable in the longer term.

The current U.S. tax system also impedes the ability of U.S.-based global companies to undertake acquisitions that make good business sense and that would contribute to our domestic economy.

The existing tax rules can have the unintended effect of encouraging U.S.-based global companies to overpay for overseas acquisition targets because they have no other more productive use for the cash generated from their overseas operations. As a result, in pursuing non-U.S. acquisition targets, Thermo Fisher has been outbid several times by other U.S. multinationals that were willing to pay what we considered to be an above-market price for the foreign target. The other bidders had available cash from overseas operations and limited options for deploying this cash without incurring the prohibitive costs of repatriating funds to the United

States; because of this, they were willing to pay a premium for the foreign target. Ultimately, this distortion of the acquisition market extends to similar targets in the same industry, because the excessive price paid sets an artificial new benchmark.

Conversely, the current tax system also places U.S.-based companies at a significant disadvantage when bidding against a foreign entity, regardless of where the target may be incorporated. Recent large acquisitions of U.S. targets by foreign acquirers have been valued more highly by the foreign buyers as compared to would-be U.S. buyers because their home country's tax laws allow them to structure transactions more efficiently and access the targets' global earnings without the home country tax that a U.S. buyer would face.

To restate: When it comes to M&A activity, the combined effect of the high U.S. corporate tax rate and the U.S. worldwide tax system means that:

- U.S. companies are more likely to be bought by foreign companies; and
- U.S. companies are more likely to overpay for foreign acquisitions.

Such a result – which is detrimental to the growth of U.S. companies – could not have been what the designers of the U.S. tax law intended. But this is the reality that currently exists.

Corporate inversion transactions are a related phenomenon. Notwithstanding the chilling effect of the notice issued by the Treasury Department last summer, the current U.S. tax system encourages inversion-type structuring in large M&A transactions. Like my example earlier, this can lead U.S. purchasers to overpay for target foreign companies. The market has seen the price for foreign targets being bid up simply because they are large enough for a U.S. company of the right size profile to invert into without a tax penalty. The long-term tax savings from inverting out of the United States can support the higher cost of the deal.

Finally, it is important to note that the U.S. tax system generally is more complex than foreign tax rules. Available R&D credits and other incentives are much lower in the United States than in many countries. And the U.S. R&D credit is rife with uncertainty due to its perpetually temporary and short-term nature. This encourages the development of high-value research centers, and the associated creation of high-value jobs, overseas where generous and stable incentives are available.

Key elements of tax reform

I commend the committee for its focus on tax reform in general and international tax reform in particular. I urge you to continue the effort to get much needed international tax reforms across the finish line as soon as possible. Such reforms are critical to the competitiveness of U.S.-based companies and to the continued strengthening of the U.S. economy.

Reforms should be designed to end the uncertainty that currently pervades the tax system for U.S. companies with global operations. Clearer and more stable rules would enable better investment decisions. I am convinced that many investment decisions are currently on hold while companies and investors wonder whether much-needed tax reforms will advance. This is a drag on the economy in the United States.

Tax reform should stimulate the U.S. economy, create jobs and strengthen the ability of U.S.-based global companies to succeed in an ever more competitive marketplace. And it should incentivize companies to make decisions – about mergers and acquisitions as well as general investment – based on total value rather than localized tax policies.

We should all recognize that other countries are taking measures to stimulate their own economies, including lowering their corporate tax rates and providing tax incentives, while the continuation of the high U.S. tax rate puts our future competiveness at risk.

Finally, I want to be clear: Thermo Fisher recognizes that Congress needs to achieve a delicate balance in terms of revenue and understands that corporations may need to be prepared to cede certain long-standing tax benefits in the interests of improving the overall corporate tax system.

My suggestions for international tax reform are as follows:

1. Reduce the corporate tax rate:
    - A corporate tax rate between 25 percent and 30 percent would put the United States closer to other developed economies. There will continue to be lower rates in other countries, so this would not be any kind of a race to the bottom.
    - There will always be significant advantages to being headquartered in the United States. Therefore, it would not be necessary for the United States to match the world's lowest tax regimes. But we ought to lower the U.S. corporate tax rate to prevent the job leakage and other unintended consequences that arise with our current corporate tax rate that is out of line with the rest of the developed world.

2. Move closer to a territorial system by allowing repatriation of foreign earnings at a lower – but not zero – tax cost:
    - Repatriated overseas earnings should be taxed at a lower rate than the regular corporate rate. A U.S. tax on repatriated foreign earnings at a rate of 5 percent or slightly higher would not be a significant barrier to repatriation because most U.S.-based companies will value the flexibility to redeploy earnings in the United States rather than having to retain such earnings overseas.
    - This tax should be imposed when the earnings are repatriated to the United States.

3. Incentivize research in the United States:
    - Incentivize the development of intellectual property in the United States by making permanent the R&D credit.
    - Incentivize the utilization of intellectual property in the United States and generation of income here by a reduction in the rate of tax on earnings from that activity.

4. Simplify the Subpart F and foreign tax credit rules:
    - The existing rules are an administrative burden, over-complicated and too prone to different interpretations. Simplifying the rules could reduce the administrative burdens and uncertainties and better target the rules to their intended purpose.

5. Impose an appropriate limit on interest deductibility:
    - Consideration could be given to a limit on deductions for interest expense, based on an appropriate ratio of net interest expense to U.S. taxable income, with any surplus interest deductions being deferred. Today's historically low interest rate environment makes clear that any such limit would have to be based on a ratio that adjusts by being tied to prevailing interest rates. An appropriately structured limitation would encourage repatriation to pay down debt where the other reforms make such repatriation feasible from a cost perspective.

6. Avoid one-off tax incentives and holidays and reduce the number of cash-flow-only items:
    - In my opinion, LIFO inventory accounting and accelerated depreciation are timing items only and eliminating these benefits could be an acceptable trade-off for longer term permanent rate reduction and the other items mentioned here.

7. Continue to incentivize manufacturing activity and the generation of earnings in the United States through the reduced rate of tax on manufactured earnings under section 199.

8. Simplify reporting as much as possible.

These priorities echo themes that are reflected in tax reform proposals that have been proposed in recent years in the Senate and the House of Representatives and by the President. I believe the work that this committee and your colleagues in the House have already done provides a strong foundation for the development of a detailed tax reform package.

As I have emphasized throughout these comments, this committee's goal ought to be providing a more stable and more competitive environment for U.S.-based companies operating in today's global economy. This ultimate goal is more important than achieving the lowest possible corporate tax rate. But lowering the corporate tax rate is an important element of competitive, pro-growth international tax reform. I stand ready to provide whatever assistance I can in this important initiative.

Thank you for the opportunity to present Thermo Fisher Scientific's perspective. I am happy to answer any questions that the committee may have.