April 15, 2015

United States Senate Committee on Finance
Business Income and International Working Groups
Via email to: Business@finance.senate.gov and International@finance.senate.gov

Re: Comments on Bipartisan Tax Reform

Dear Honorable Senate Finance Committee Members,

The undersigned members of the Financial Accountability and Corporate Transparency Coalition (FACT) Coalition urge you to close various international corporate tax loopholes that incentivize profit shifting and other tax avoidance maneuvers that force small businesses and average taxpayers to pick up the tab for the cost of government services.

The FACT Coalition is a broad and diverse coalition that unites civil society representatives from small business, labor, government watchdog, faith-based, human rights, anti-corruption, public-interest, and international development organizations. We seek an honest and fair corporate tax code, greater transparency in corporate ownership and operations, and commonsense policies to combat the facilitation of money laundering and other criminal activity by the legitimate financial system. The FACT Coalition was founded specifically to advocate for measures to halt corporations' ability to avoid paying their fair share of U.S. taxes through the abuse of offshore tax havens and corporate tax loopholes.

It's clear that any proposal for bipartisan tax reform should restore fairness to the tax code. Currently, the tax code is riddled with loopholes that were systematically inserted by special interests resulting in the ability for large, multinational corporations to shift their tax responsibilities to small businesses, domestic businesses and average taxpayers. This creates winners and losers, where the winners are lawyers, accountants, tax advisors, and the losers are average taxpayers. We must correct this systemic unfairness where certain players manipulate our tax laws to their own advantage.

Because of the current system of deferral, where taxes may be indefinitely put off until profits are "brought back" to the U.S. in the form of dividends or other shareholder payments, multinational corporations are able to play games with their accounting books and transfer profits between entities, usually to companies located in low or no tax jurisdictions.

This type of corporate tax haven abuse costs the federal government $90 billion in lost revenue every year.[1] In total, almost $2 trillion in profits are booked offshore.[2]Often, these "offshore" profits are being attributed to an entity that often consists of nothing more than a P.O. Box in a tax haven country—a very low tax jurisdiction—where the company does not have an actual

[1] CITIZENS FOR TAX JUSTICE AND U.S. PIRG EDUCATION FUND, OFFSHORE SHELL GAMES 2014: THE USE OF OFFSHORE TAX HAVENS BY FORTUNE 500 COMPANIES (OFFSHORE SHELL GAMES) (June 2014), http://bit.ly/1D3IRbL.
[2] Kevin Drawbaugh and Patrick Temple-West, *Untaxed U.S. Corporate Profits Held Overseas Top $2.1 Trillion: Study*, REUTERS (April 8, 2014), http://reut.rs/1gdTGhp.

physical presence. The most illustrative example of this can be found in the fact that profits reported to the Internal Revenue Service (IRS) that reportedly were made by subsidiaries located in Bermuda, the Cayman Islands, the British Virgin Islands, the Bahamas, and Luxembourg were many times greater than the entire Gross Domestic Product (GDP) of those nations, sometimes more than 1000 times greater.[3]

There are many well-known examples of huge, profitable multinational corporations that have effectively used tax haven profit shifting and other accounting gimmicks to shave billions of dollars off of their tax bills. Take for example:

- General Electric (GE). By using tax havens, GE paid an effective federal tax rate of *negative* 7.3 percent between 2008 and 2014, while booking billions in profits.[4]
- Microsoft. With subsidiaries in five tax havens, Microsoft reported $92.9 billion in overseas profits according to its 2014 filings, allowing it to avoid almost $30 billion in taxes in the process.
- Bank of America (BoA). BoA reported $17.2 billion in offshore profits last year, using 21 subsidiaries, allowing it to avoid a $4.5 billion tax bill.[5]

Specific problems related to deferral of "foreign-made" taxes are so-called "check-the-box" provisions where, by checking a box, a company can make one of its foreign affiliates a "disregarded entity" for tax purposes, enabling income shifting from a subsidiary in a high tax country to one in a low tax country.[6]

Another issue occurs because of a supposedly "temporary" tax break contained in the package of credits referred to as the "extenders" called the "active financing exemption." Though U.S. companies generally cannot defer paying taxes on the foreign-made income of a subsidiary that is considered "passive," such as interest, dividends, rents, and royalties, under active financing a company may do so if it is related to financing of investments, broadly defined.[7] Another costly loophole included in the extender package is the "Controlled Foreign Corporation (CFC) Look-Through Rule," which allows U.S. multinational corporations to defer tax liabilities on income generated by one of its foreign subsidiaries from sources of income such as royalties, interest or dividends.

Another important tax avoidance strategy is the concept of inversions, where a domestic company purchases a foreign firm that's usually much smaller and reincorporates, changing its corporate address to the country where the other firm is located. The new, combined "foreign" firm is typically located in a very low tax jurisdiction. These inversions are merely paper transactions and usually there is no change in the formerly domestic company's operations; management and control of the company continues in the U.S.

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[3] OFFSHORE SHELL GAMES, at 14.
[4] *Imagination at Work? GE Once Again Pays Less Than 1% in Federal Taxes*, Matt Gardner, TAX JUSTICE BLOG: A PROJECT OF CITIZENS FOR TAX JUSTICE AND THE INSTITUTE ON TAXATION AND ECONOMIC POLICY (March 3, 2015), http://bit.ly/1CHFl3l.
[5] CITIZENS FOR TAX JUSTICE, DOZENS OF COMPANIES ADMIT USING TAX HAVENS: HUNDREDS MORE LIKELY DO THE SAME, AVOIDING $600 BILLION IN U.S. TAXES (April 1, 2015) http://bit.ly/1CBleoK. .
[6] Jeremy Scott, *Check The Box For Tax Avoidance*, FORBES (Feb. 19, 2014), http://onforb.es/1yj9hHY.
[7] *America's Debt: Wall Street's $11 Billion Windfall In the Fiscal Cliff Deal*, CNN MONEY (Jan. 22, 2013), http://cnnmon.ie/1kVYRRN.

These tax maneuvers have been on a steady uptick in recent years.[8] In 2014 the news was filled with big name American companies considering or completing inversions such as Burger King, Walgreens, and Pfizer. The Treasury Department's actions[9] on inversions last year were an important first step, but more has to be done. Without specific, meaningful legislation to address inversions head on, there will continue to be an incentive to shift companies, at least on paper, overseas.

A related accounting gimmick that flows from inversions is known as "earnings stripping." This occurs when companies load the American side of the company with debt owed to the foreign entity. The interest payments on the debt are tax deductible, reducing its U.S. profits and thus eliminating any tax that would otherwise be paid.

The FACT Coalition believes that members of the Senate Finance Committee have a unique opportunity to comprehensively address these international tax loopholes that are draining our nation of much needed revenue and placing large and small businesses on unequal footing. Below, we offer a series of recommendations that would eliminate the most egregious loopholes, and introduce greater fairness and transparency in the system.

The most comprehensive solution to tax avoidance by multinational corporations is to simply end deferral. Though companies contend that their profits are "trapped" overseas, in reality much of those dollars booked as "foreign-made profits" are already invested through American banks.[10] The FACT Coalition believes that instead of indefinitely deferring taxes on these profits, these taxes should be paid when the income is earned while keeping in place the foreign tax credits received for taxes paid to foreign governments. This could create more than $600 billion in new revenue according to analysis of estimates from the Joint Committee on Taxation.[11]

Other wide-ranging tax avoidance schemes could be stopped by incorporating elements of broad reform legislation such as the Stop Tax Haven Abuse Act (S. 174, H.R. 297).This bill does many laudable things such as ending profit shifting abuses and reducing the incentive for corporations to license intellectual property (for example, patents and trademarks) to shell companies in tax haven countries. It does that by:

- Removing the deduction of interest expenses related to deferred income;
- Determining foreign tax credits on a pooled basis to stop companies from manipulating foreign tax credits to avoid taxes;
- Requiring multinational companies to report employees, revenues, and tax payments on a country-by-country basis;
- Ending the so-called "check-the-box" rules for foreign entities.
- Eliminating the "Controlled Foreign Corporation (CFC) Look-Through Rule";
- Ending the "active financing exception" to subpart F of the tax code;
- Preventing companies that are managed and controlled in the U.S. from claiming foreign status;

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[8] *Tracking Tax Runaways*, BLOOMBERGBUSINESS (Updated on Dec. 12, 2014), http://bloom.bg/1ohNlYz.
[9] Fact Sheet, *U.S. Department of the Treasury, Actions to Rein In Corporate Tax Inversions* (Sept. 22, 2014), http://1.usa.gov/1oeeM02.
[10] CENTER FOR AMERICAN PROGRESS, OFFSHORE CORPORATE PROFITS: THE ONLY THING "TRAPPED" IS TAX REVENUE (Jan. 9, 2014), http://ampr.gs/1IRrEUt.
[11] CITIZENS FOR TAX JUSTICE, ADDRESSING THE NEED FOR MORE FEDERAL REVENUE (July 8, 2014), http://bit.ly/1DbzLtF.

- Equipping the Department of Treasury with the enforcement power it needs to stop tax haven countries and their financial institutions from impeding tax collection in the United States;
- Strongly implementing the Foreign Account Tax Compliance Act (FATCA);

Any bipartisan tax reform solution should also address the problem of inversions. It should do that by treating as domestic for tax purposes any formerly American company that either retains a majority of the same U.S. shareholders after reincorporation or that is managed and controlled in the U.S. without significant foreign operations. (See the Stop Corporate Inversions Act, S. 198, H.R. 415.)

Congress also should prohibit the awarding of federal contracts to an American company that has inverted, since it is gross abuse of tax dollars to reward companies that desert our nation for the purpose of avoiding paying their fair share of the taxes—the same taxes that fund government contracts. There have already been bipartisan amendments to some appropriations bills that barred companies reincorporated in Bermuda or the Caymans from receiving federal contracts. The time has come to employ this policy across board for the entire federal government, and apply these restrictions to all companies that have reincorporated in tax havens.

Congress must also avoid embracing changes to the tax code that provide false "solutions" like a shift to a territorial tax system. Such a system would truly bleed government coffers dry since it would only further incentivize multinational corporations to engage in a "race to zero."

Another shortsighted change would be a "repatriation holiday" that has been proven to be a revenue loser in the long run.[12] Allowing corporations that have hoarded profits on the books of foreign subsidiaries to repatriate taxes at a lower rate would be a reward for wrongful behavior. In 2011 a Senate report analyzing a tax repatriation holiday in 2004 found that much of the profits that multinational corporations were supposedly holding offshore were actually sitting in U.S. bank accounts and other assets, undercutting the very premise of "bringing the money back."[13] Moreover, the vast majority of the repatriated taxes came from only a handful of firms, the money was doled out in dividends versus being reinvested in the economy, and companies that chose to take the "holiday" ended up cutting jobs rather than expanding their workforces.[14]

A related idea that also would create a loss of revenue when compared to immediate taxation at the full statutory rate, would be a "deemed repatriation." This differs from a "holiday" because companies are required to repatriate profits but they are still given a break on the tax rate, thus extending the incentive for companies to continue to play accounting games and shift profits to overseas subsidiaries. The American people should not have to settle for discounted tax revenue at the expense of further incentivizing activities by multinationals that disadvantage responsible small business owners and ordinary taxpayers.

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[12] Letter from U.S. Joint Committee on Taxation to U.S. Senator Orrin Hatch, Chairman of Senate Finance Committee (June 6, 2014), http://1.usa.gov/1Dtoqqq.

[13] REPATRIATING OFFSHORE FUNDS: 2004 TAX WINDFALL FOR SELECT MULTINATIONALS: MAJORITY STAFF REPORT FOR THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS OF THE U.S. SENATE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS (Oct. 11, 2011), http://1.usa.gov/1cjhqlJ.

[14] *Id.*

For questions on these comments, please contact Rebecca Wilkins, Executive Director, FACT Coalition, at rwilkins@thefactcoalition.org or at (303) 250-0081.

Thank you for considering our views.

Sincerely,

Center for Effective Government

Citizens for Tax Justice

Global Financial Integrity

Government Accountability Project

Public Citizen

U.S. Public Interest Research Group