EDITORIAL BOARD MEMO

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WHILE AMERICANS CELEBRATE INDEPENDENCE DAY U.S. MULTINATIONALS PREPARE TO RENOUNCE THEIR AMERICAN 'CITIZENSHIP'

Corporations Will Dodge Billions in Taxes

This week, millions of Americans will celebrate Independence Day in a burst of national pride and patriotism. At the same time, some U.S. corporations are preparing to make a move to dodge paying their fair share of taxes, which many Americans will consider deeply unpatriotic.

Two U.S. companies – Walgreens and Medtronic – are on the verge of declaring that they are no longer American, choosing to reincorporate in Switzerland and Ireland, respectively, both tax havens. A third company – AbbVie – is trying to do the same in Ireland. (Pfizer tried to do it earlier this year by purchasing AstraZeneca, a British-based company, but its offer was spurned.)

In this legal maneuver known as an "inversion," companies dissolve their U.S. corporate "citizenship" and incorporate abroad by buying a foreign firm; but the buyer becomes a subsidiary of the foreign firm. The new parent firm is usually located in a tax haven, which has much lower corporate income tax rates than the United States or any other major industrial country. The point of this maneuver is to increase profits by dodging U.S. taxes. And it's all perfectly legal – unless Congress acts to stop it.

This is a time sensitive matter because the Walgreens board and corporate executives are deciding now whether to undergo an inversion by the end of July or early August. But unlike many other companies that have moved their corporate address to a tax haven, Walgreens is extremely well-known to American consumers, and it has virtually no offshore business. The company operates in all 50 states and it has 8,200 stores nationwide. Walgreens, which generates most of its $72 billion in annual revenues in the United States, will not move its stores overseas nor will it relocate its headquarters and corporate executives. If Walgreens announces in a month that it is abandoning the United States it will send shock waves through the country.

The Walgreens move may spark even more defections. It is likely that dozens of other companies already are planning to renounce their American status. *The New York Times* quotes an international tax lawyer saying that "it takes one company with enough public recognition to start [a] domino effect."

Walgreens and other companies that reincorporate in tax havens will continue to take advantage of the things that make the United States the best place in the world to do business – they will continue to rely on our educated American workforce; they will count on our legal system to protect their investments and patents; they will benefit from research funded by our federal government; they will be protected by the best military in the world; they will use our transportation system to get their products to market; they will raise capital in our financial markets; they will continue to sell billions of dollars of products and services to the federal government; and they will continue to have access to more than 300 million American consumers.

But corporations that undergo a tax inversion will save billions in federal taxes. (Our own analysis of Walgreens' tax savings, based on estimates provided by three equities research firms, is $4 billion over five years. Barclay's recently estimated Walgreens' tax savings at $783 million in the first year.) The U.S. government will take on more debt, American taxpayers will end up paying more, or American families will get fewer services for their tax dollars.

As conservative senator Chuck Grassley (R-IA) has said, "These expatriations aren't illegal. But they're sure immoral."

Americans will rightly be outraged. These legal moves are "unpatriotic" and "un-American." The question is whether they will vote with their feet by shopping at other pharmacies.

A recent poll by Hart Research Associates for Americans for Tax Fairness shows that voters strongly want to make the federal tax system fairer by closing tax loopholes for corporations and the rich. A Kentucky poll by Public Policy Polling released June 26, 2014, reveals that even voters in a conservative state would overwhelmingly favor candidates who support closing offshore corporate tax loopholes. Given these and similar results from other polls, it is highly likely that Americans will react very negatively to the next big corporate tax inversion.

Inversions are made possible by a loophole in U.S. law that allows corporations to invert when they buy a foreign company – even if it is much smaller than the American firm. To qualify for an inversion, more than 20% of the stock of the newly merged company must be owned by foreigners, or 25% of company operations must take place abroad. These are very low hurdles that make inversions relatively easy.

Walgreens can invert once it completes a two-step process to buy Alliance Boots, a Swiss pharmacy retailer with a reputation as a tax dodger. If it goes through with the inversion it will lose *none* of the benefits of operating in the United States. But by paying less in taxes – it is estimated its current 31% federal tax rate will drop to about 20% – it will gain a competitive advantage against other pharmacy chains and smaller independent pharmacies. CVS/Caremark, its chief rival, paid a 34% federal tax rate in recent years and it is not trying to invert.

Corporations argue that inversions are justified because the U.S.'s top corporate tax rate on profits – 35% – is the highest in the world, and it puts American companies at a disadvantage. They claim that if Congress would pass tax reform and lower corporate tax rates the incentive to invert would be removed.

Numerous independent studies have shown that cutting corporate tax rates won't boost the economy or employment. The Congressional Research Service has estimated a cut in statutory rates from 35 to 25 percent would result in an increase in economic output of less than two-tenths of one percent. Moreover, economic growth over the past 60 years has actually been *stronger* when corporate tax rates were higher, proving at the very least that there is no correlation between low corporate tax rates and a healthy economy.

Others point out that there will always be countries with tax rates that are much lower than here (sometimes 0 percent), which are known as tax havens. The question is should we make it easy for U.S. firms to incorporate there even when the company's true headquarters is in America, and that is largely where the company earns its profits?

Many large corporations don't pay anything close to the 35% statutory rate, in part due to the offshoring of profits even without a corporate inversion. Twenty-six profitable Fortune 500 firms paid no federal income taxes from 2008-2012, according to Citizens for Tax Justice. General Electric, one of the most notorious corporate tax dodgers, claimed $3.1 billion in refunds on $27.5 billion in profits during that period. The entire company paid less in federal taxes in five years than a single American family pays in one year. The report also found that 111 large, profitable corporations paid zero federal taxes in at least one of those five years. The 288 corporations studied paid an average effective federal tax rate of 19.4%, far lower than the 35% top statutory rate.

Corporate lobbyists also argue that companies that invert will continue to pay U.S. federal taxes. This is true but highly misleading – they will continue to pay some taxes in the United States, but the total they pay to the U.S. Treasury will drop precipitously and the total amount they pay worldwide will drop significantly. If this were not the case companies would have little reason to undergo a tax inversion.

Tax inversions also multiply the already prevalent practice of laundering profits made in the U.S. through low-tax or no-tax jurisdictions. These accounting gimmicks, known as "earnings stripping," "transfer pricing" and "profit shifting," enable companies to make it appear that they make little and sometimes no profit in the United States but earn fantastic profits overseas, typically in tax havens. Corporations that invert will have even greater opportunities to move U.S.-made profits offshore.

It is estimated that U.S. corporations already dodge $90 billion a year in income taxes by shifting profits to subsidiaries—often no more than a post office box—in tax havens like Bermuda and the Cayman Islands, a recent investigative report found. American corporations currently hold approximately $2.1 trillion in profits offshore – much of it in tax havens – that have not yet been taxed in the U.S.

Deeper analysis of the issues surrounding corporate inversions and tax havens is available through ATF coalition partners Center on Budget and Policy Priorities, Economic Policy Institute, Center for

American Progress and Citizens for Tax Justice. Links to reports by these organizations are listed in the appendix below.

Several key members of Congress have introduced legislation that would make it more difficult for U.S. corporations to invert for tax purposes. Sen. Carl Levin (D-MI), Chairman of the U.S. Senate subcommittee that has investigated tax avoidance by Apple and other corporations, has introduced the Stop Corporate Inversions Act of 2013 (S. 2360), with 20 other cosponsors. The legislation would increase the threshold for the percentage of foreign shareholders needed for a tax inversion to 50%, from the current 20%. It would effectively put a two-year moratorium on inversions while Congress tries to pass comprehensive corporate tax reform.

Rep. Sander Levin (D-MI), ranking member of the tax writing House Ways and Means Committee, has introduced similar legislation (H.R. 4679), but it would be permanent and would raise $19.5 billion over 10 years, according to the Joint Committee on Taxation. The Obama administration has supported a similar plan.

Rep. Chris Van Hollen (D-MD), ranking member of the House Budget Committee, has introduced with Rep. Levin the Stop Corporate Expatriation and Invest in America's Infrastructure Act (H.R. 4985, with 43 cosponsors). The legislation marries the Levin bill with a plan to keep the Highway Trust Fund solvent for another year to maintain road and transit construction projects. The Congressional Budget Office estimates the shortfall to be $12 billion next fiscal year, which means the VanHollen-Levin bill would pay for more than a year of the funding shortfall. Congress has been scrambling to come up with a solution. A measure to invest in the country's infrastructure while keeping U.S. companies invested in America seems like a sensible approach.

The issue of tax inversions challenges deeply held American values. It throws into question the fundamentals of a free-market economy, because corporate executives are able to increase profits not by creating new products, expanding markets and increasing efficiency, but by dodging federal taxes.

As always, there will be fireworks this Fourth of July. But the real fireworks may begin very soon when Walgreens decides if it will invert. Some will argue that corporations are merely pursuing their self-interest and serving their shareholders – they will say that it is America's system of taxation, not the corporate executives that are wrong. But millions of Americans will see tax inversions as deeply cynical and unpatriotic. This is a debate that will burn hot in coming weeks and the time to write about it is now.

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Americans for Tax Fairness *is a diverse coalition of 425 national and state organizations that collectively represent tens of millions of members. The organization was formed on the belief that the country needs comprehensive, progressive tax reform that results in greater revenue to meet our growing needs. ATF is playing a central role in Washington and in the states on federal tax-reform issues.*