



FACTCOALITION

Financial Accountability & Corporate Transparency

February 24, 2016

Chairman Kevin Brady  
Committee on Ways and Means  
United States House of Representatives

Ranking Member Sander Levin  
Committee on Ways and Means  
United States House of Representatives

Committee Members  
Committee on Ways and Means  
United States House of Representatives  
Submitted via email to: [waysandmeans.submissions@mail.house.gov](mailto:waysandmeans.submissions@mail.house.gov)

Re: February 24, 2016 Hearing on International Tax Reform

Dear Chairman Brady, Ranking Member Levin, and Honorable Members of the House Ways and Means Committee,

The undersigned members of the Financial Accountability and Corporate Transparency Coalition (FACT) Coalition—along with the Coalition itself—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 more than 100 civil society representatives from small business, labor, investor, government watchdog, faith-based, human rights, anti-corruption, public-interest, and international development organizations from across the ideological spectrum. We seek an honest and fair international 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 multinational 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 honesty 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 normal taxpayers. In addition to harming vulnerable communities across the country, these offshore loopholes help facilitate the outflow of trillions of dollars from developing countries—exacerbating global poverty and inequality and increasing national security

risks. We must correct these systemic inequities 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 \$111 billion in lost revenue every year.<sup>1</sup> In total, more than \$2 trillion in profits are booked offshore.<sup>2</sup> Often, these “offshore” profits are being attributed to an entity that 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 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 the Bahamas, Bermuda, the British Virgin Islands, the Cayman Islands, and Luxembourg were many times greater than the entire Gross Domestic Product (GDP) of those nations, sometimes more than 10 times greater.<sup>3</sup>

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.<sup>4</sup>
- **Microsoft.** With subsidiaries in five tax havens, Microsoft reported \$108.3 billion in overseas profits according to its 2014 filings, allowing it to avoid almost \$34.5 billion in taxes in the process.<sup>5</sup>
- **Apple.** With subsidies in Ireland, Apple has managed to avoid paying the over \$60 billion it owes in taxes on the \$200 billion it currently holds offshore.<sup>6</sup>
- **Bank of America (BofA).** BofA reported \$17.2 billion in offshore profits in 2014, using 21 subsidiaries, allowing it to avoid a \$4.5 billion tax bill.<sup>7</sup>

<sup>1</sup> Clausing, Kimberly A., “The Effect of Profit Shifting on the Corporate Tax Base”, *Tax Notes*, (Jan. 25, 2016), <http://www.taxanalysts.com/www/features.nsf/Features/622F036AA4CAD8DF85257F5D006799D2?OpenDocument> (accessed Feb. 22, 2016).

<sup>2</sup> Drawbaugh, Kevin, and Patrick Temple-West, “Untaxed U.S. Corporate Profits Held Overseas Top \$2.1 Trillion: Study”, *Reuters* (Apr. 8, 2014), <http://reut.rs/1gdTGhp>.

<sup>3</sup> *Citizens for Tax Justice and U.S. PIRG Education Fund*, “Offshore Shell Games 2015: The Use of Offshore Tax Havens by Fortune 500 Companies” (Offshore Shell Games), (October 2015), <http://ctj.org/pdf/offshoreshell2015.pdf>, at 14.

<sup>4</sup> Gardner, Matt, “Imagination at Work? GE Once Again Pays Less Than 1% in Federal Taxes”. *Tax Justice Blog: A Project Of Citizens for Tax Justice and the Institute on Taxation and Economic Policy*, (Mar. 3, 2015), <http://bit.ly/1CHF13I>.

<sup>5</sup> *Citizens for Tax Justice*, “Ten Corporations Would Save \$97 Billion in Taxes Under ‘Transition Tax’ on Offshore Profits”, (Feb. 16, 2016), <http://ctj.org/pdf/obama14guys2016.pdf>.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

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There are a number of provisions in the tax code that exacerbate the problems created by allowing companies to defer taxes on their foreign profits. For example, the 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.<sup>8</sup>

Another issue occurs because of a once “temporary” tax break—unfortunately made permanent in December 2015—that had been 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.<sup>9</sup> Another costly loophole included in the extender package is the “Controlled Foreign Corporation (CFC) Look-Through Rule,” which was extended in December for five years and 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 through an inversion, 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.

These tax maneuvers have been on a steady uptick in recent years.<sup>10</sup> For the past couple of years, the news has been filled with big name American companies considering or completing inversions such as Pfizer, Johnson Controls, Burger King, and Walgreens. The Treasury Department’s actions on inversions in 2014<sup>11</sup> and 2015<sup>12</sup> were important first steps, 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 House Ways and Means 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

<sup>8</sup> Scott, Jeremy, “Check the Box for Tax Avoidance”, *Forbes*, (Feb. 19, 2014). <http://onforb.es/1yj9hHY>.

<sup>9</sup> *CNN Money*, “America’s Debt: Wall Street’s \$11 Billion Windfall In the Fiscal Cliff Deal”, (Jan. 22, 2013), <http://cnnmon.ie/1kVYRRN>.

<sup>10</sup> *Bloomberg News*, “Tracking Tax Runaways”, (Updated on Apr. 13, 2015), <http://bloom.bg/1ohNlYz>.

<sup>11</sup> *U.S. Department of the Treasury*, “Fact Sheet: Actions to Rein In Corporate Tax Inversions”, (Sept. 22, 2014), <http://1.usa.gov/1oeeM02>.

<sup>12</sup> *U.S. Department of the Treasury*, “Fact Sheet: Additional Treasury Actions to Rein in Corporate Tax Inversions”, (Nov. 19, 2015), <https://www.treasury.gov/press-center/press-releases/Pages/jl0281.aspx>.

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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.<sup>13</sup> 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 \$900 billion in new revenue according to an analysis of estimates from the Joint Committee on Taxation and the Treasury Department.<sup>14</sup>

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;
- 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; and
- Strongly implementing the Foreign Account Tax Compliance Act (FATCA).

Any international 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

<sup>13</sup> *Center for American Progress*, “Offshore Corporate Profits: The Only Thing ‘Trapped’ Is Tax Revenue”, (Jan. 9, 2014), <http://ampr.gs/1IRrEUt>.

<sup>14</sup> Offshore Shell Games, at 18.

Bermuda or the Caymans from receiving federal contracts. The time has come to employ this policy across-the-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 shift profits overseas and engage in a “race to zero.”

Similarly, Congress should reject patent or innovation box proposals, which would go against the entire premise of international tax reform by creating yet another costly, unnecessary and ineffective loophole for companies to take advantage of.<sup>15</sup>

Another shortsighted change would be a “repatriation holiday” that has been proven to be a revenue loser in the long run.<sup>16</sup> 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.”<sup>17</sup> 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.<sup>18</sup>

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.

For questions on these comments, please contact Clark Gascoigne, Interim Director of the FACT Coalition, at [cgascoigne@thefactcoalition.org](mailto:cgascoigne@thefactcoalition.org).

Thank you for considering our views.

Sincerely,

American Sustainable Business Council

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<sup>15</sup> *Citizens for Tax Justice*, “A ‘Patent Box’ Would Be a Huge Step Back for Corporate Tax Reform”, (June 4, 2015) <http://ctj.org/pdf/patentboxstepback.pdf>

<sup>16</sup> 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>.

<sup>17</sup> Permanent Subcommittee on Investigations, “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/1cjhqJL>.

<sup>18</sup> *Id.*

Americans for Tax Fairness

Citizens for Tax Justice

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Fair Share

Global Financial Integrity

Jubilee USA Network

Main Street Alliance

New Rules for Global Finance

Oxfam America

Public Citizen

Tax Justice Network USA

U.S. Public Interest Research Group (PIRG)

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FACTCOALITION

2040 S St. NW, Lower Level | Washington, DC | 20036 | USA  
Tel. +1 (202) 683-4816 | Fax. +1 (202) 683-4849 | [www.thefactcoalition.org](http://www.thefactcoalition.org)