WHOPPER OF A TAX DODGE

How Burger King's Inversion Could Shortchange America

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Introduction

On December 12 Burger King is expected to complete a corporate inversion by buying Tim Hortons, a Canadian doughnut company, becoming a subsidiary of a newly-combined multinational fast-food company located in Canada.[1]

"[W]e don't expect our tax rate to change materially . . . this transaction is not really about taxes. It's about growth."

Burger King CEO Daniel Schwartz

Bloomberg Businessweek

Under a corporate inversion, a U.S. company effectively renounces its American citizenship by merging with a foreign company. The U.S. company becomes a subsidiary of the foreign one, but the foreign firm is typically controlled by the owners of the original U.S. firm.[2]

Corporate inversions are commonly used to reduce corporate taxes.[3] Burger King executives deny that they are motivated by tax reasons. However, this report demonstrates that the inversion will result in substantial U.S. tax avoidance, while Burger King continues to generate significant profits from U.S. consumers, taxpayers and the Armed Services.

This report estimates that Burger King and its largest shareholders could dodge between $400 million and $1.2 billion in U.S. taxes over the next four years. At the same time, U.S. taxpayers provide an estimated $356 million a year – $1.4 billion over four years – subsidizing Burger King's low pay and meager benefits through public assistance programs.

Burger King, one of America's iconic hamburger chains, was founded in 1954 in Miami, Florida, where it remains headquartered today.[4] There are 7,155 Burger King restaurants currently operating in the United States,[5] generating an estimated $8.5 billion in annual sales.[6] America is the chain's largest market, responsible for an estimated 52 percent of global sales.[7]

Since 2010 Burger King has been owned primarily by 3G Capital, a private equity firm founded by three Brazilian billionaires, including the richest man in Brazil.[8] 3G owns 69 percent of Burger King,[9] and is incorporated in the Cayman Islands, a tax haven.[10]

Under the Burger King—Tim Hortons deal, both companies would become subsidiaries of a new Canadian entity, New Red Canada Partnership, relocating Burger King's ultimate ownership from the United States to Canada.[11]

Burger King Executive Chairman Alexandre Behring downplayed the importance of tax savings to the merger, saying "This is not a tax-driven deal."[12] 3G Capital and Burger King executives have offered other justifications for the move, including the misleading claim that Canada will be the combined company's largest market. [See Appendix A]

Tax experts on both sides of the border have expressed deep skepticism.[13] In fact, "anticipated tax benefits" are among the reasons for the merger listed in the proposed holding company's first Securities and Exchange Commission (SEC) filing.[14]

Given Burger King's and Tim Hortons' extremely limited disclosures about the tax consequences of the transaction,[15] this report examines the proposed inversion in four ways by: reviewing the history of tax avoidance by Burger King and its majority shareholder, 3G Capital; identifying the opportunities the deal presents for further tax avoidance; and highlighting the substantial benefits that Burger King already receives from U.S. taxpayers and from its presence on U.S. military bases around the world.

Key Findings

- **3G Capital is Already Avoiding Taxes at Burger King**

  3G Capital, the private equity firm controlled by three Brazilian billionaires which owns 69 percent of Burger King, already uses aggressive tax planning to reduce the burger chain's tax bill in some of its largest markets, including the United States. As a result, Burger King has one of the lowest effective worldwide tax rates of any major American fast food company – 27.5 percent in 2013. It has structured its international operations around subsidiaries located in tax havens and it dodges taxes by loading costs onto its U.S. operations to minimize its U.S. taxable income. Over the last three years, Burger King's "permanently reinvested" offshore profits on which it currently avoids paying U.S. taxes have more than doubled to $499 million in 2013, while the company's capital expenditures outside North America plummeted to just $2.4 million in 2013.

- **Burger King's Corporate Inversion Creates Substantial Tax Avoidance Opportunities**

  By renouncing its U.S. corporate citizenship and becoming a subsidiary of a new Canadian company, Burger King and its owners will be able to dodge an estimated $400 million to $1.2 billion in U.S. taxes over the next four years. It could do this by shifting profits overseas and routing them to Canada instead of the United States, thus avoiding nearly $400 million in U.S. taxes. It also appears to have structured the inversion transaction to shield its majority owners from as much as $820 million in U.S. capital gains taxes. It could employ the following tax avoidance strategies:

  - ***Burger King Could Dodge $117 Million in U.S. Taxes on its Existing Offshore Profits***

    The newly merged company should be able to avoid paying income taxes on the $499 million in profits that Burger King has "permanently reinvested" offshore in 2013, and on which it has not yet paid U.S. taxes. By keeping those earnings abroad, which will be much easier with the inversion, the company could avoid approximately $116.8 million in U.S. taxes it would have to pay if the funds were brought to the United States.

  - ***Burger King Could Avoid $275 Million in U.S. Taxes on Future Foreign Earnings***

    We estimate that Burger King may be able to avoid as much as $275 million in U.S. taxes from 2015 to 2018 – an average savings of $69 million a year. This calculation is based on analysts' earnings forecasts from Barclays, Morgan Stanley, Piper Jaffray, Stephens and UBS. As a subsidiary of a Canadian company, Burger King would be able to avoid these taxes because Canada has a tax system that does not tax many profits generated in foreign countries, unlike the United States, which taxes companies' overseas earnings when they are brought back to the United States. This amount of taxes avoided could grow considerably as Burger King continues its expansion in overseas markets.

- *Burger King's Owners Could Avoid up to $820 Million in U.S. Capital Gains Taxes*

  Burger King has proposed a unique structure for its merger with Tim Hortons that could allow Burger King's shareholders to avoid substantial capital gains taxes. The report examines the top three holders of Burger King stock and finds that the deal structure could enable them to avoid as little as $10 million -- an extremely conservative estimate -- or as much as $820 million. These estimates vary widely, in part, because it's not possible to identify everyone with a stake in the top three holders or their country of residence.

- **Taxpayers Already Spend an Estimated $356 Million a Year Subsidizing Burger King's Low Pay and Meager Benefits**

  That's because Burger King workers are paid so little that many of them rely on public benefits such as Medicaid, the Children's Health Insurance Program, food stamps, the federal Earned Income Tax Credit and basic household income assistance under Temporary Assistance for Needy Families (TANF).

- **Burger King is the #1 Burger Chain Serving Members of the U.S. Armed Forces**

  Burger King is the predominant hamburger chain on U.S. military bases. It serves troops everywhere from the biggest bases in America to dangerous combat zones in Afghanistan. Over the next five years, Burger King will generate an estimated $875 million in revenue on military bases. The armed forces will pay an estimated $35 million to Burger King in royalties and will spend an estimated $17.5 million marketing the Burger King brand to service members and their families. If sales continue at the current rate, Burger King could receive more than $150 million from its military restaurants over 15 years. Burger King's decision to become a Canadian company will mean that while U.S. military families support Burger King by buying its food, Burger King will no longer support service members by paying its fair share of taxes.

Together, these findings suggest that tax considerations have played a major role in Burger King's proposed corporate inversion, which would enable it to shed obligations to U.S. taxpayers, even as it benefits substantially from taxpayer support.

Burger King's Menu for Dodging up to $1.2 Billion in U.S. Taxes

$117 MILLION

Estimated amount of taxes Burger King may dodge on the $499 million in profits it has offshore.

$275 MILLION

Estimated amount of taxes Burger King may avoid on its future earnings over 4 years.

$820 MILLION

Estimated amount of U.S. capital gains taxes Burger King's largest shareholders may avoid with a corporate inversion.

$356 MILLION A YEAR

Estimated amount taxpayers spend a year subsidizing Burger King's low pay and meager benefits.

$150 MILLION+

Estimated amount of revenue and marketing support Burger King will receive over 15 years from its dominant role serving members of the U.S. Armed Forces.

3G Capital Is Already Avoiding Taxes at Burger King

The partners in 3G Capital, which owns 69 percent of Burger King, have a decades-long track record of acquiring companies and then aggressively cutting costs to maximize cash flow.[16] One of the ways 3G Capital's partners cut costs is by reducing their companies' tax bills. At Burger King, 3G Capital already uses a variety of strategies to minimize its tax liabilities here and offshore.

First, Burger King has structured its international operation around subsidiaries located in tax havens. [See Table 1]

Table 1. Burger King Subsidiaries in Known Tax Havens

Tax Haven	No. of Subsidiaries
Hong Kong	1
Luxemborg	4
Netherlands	1
Singapore	1
Switzerland	2
Total	**9**

Sources: Tax Havens, Number of Subsidiaries from Burger King Worldwide, 2013 10-K, p. 123.[17] Tax haven definitions from "Offshore Shell Games," p. 20.[18]

Royalty-based businesses such as Burger King often use subsidiaries in foreign tax havens to avoid taxes in higher tax markets.[19] Royalties, which are payments made to acquire the license for intellectual property, are a useful device for minimizing taxes. They allow a parent company to transfer the intellectual property on which the royalties are paid to subsidiaries in low-tax countries. For example, even though Burger King has only 37 stores in Switzerland, Burger King Europe GmbH, Burger King's Swiss subsidiary, recorded a profit of $127.6 million in 2012.[20] That was *greater* than parent company Burger King Worldwide's (BKW) global net income of $117.7 million that year.[21]

Switzerland is widely viewed as a tax haven, with low corporate tax rates and an extensive tax treaty network allowing multinational companies making intercompany payments, including of royalties, to subsidiaries in Switzerland to avoid taxes in the countries where the payments originate.[22] This structure has imparted great benefit to Burger King by allowing it to pay little or no tax in major foreign markets, such as in Germany, which boasts the largest number of Burger King locations outside of North America.[23]

Another way Burger King dodges taxes is to load costs onto its U.S. operations to minimize its U.S. taxable income. For example, in 2013 Burger King reported similar operating margins in its U.S./Canada segment (66 percent) and for the rest of the world (64 percent).[24] However, it claimed a much lower taxable income margin in the United States (21 percent) than in the rest of the world (36 percent).[25] This discrepancy between its operating and taxable income margins is due, in part, to the company holding virtually all of its debt in its U.S. subsidiaries, thereby reducing its U.S. earnings significantly through considerable interest expense, which is tax-deductible as long as it does not exceed 50 percent of earnings before interest, taxes, depreciation and amortization (EBITDA).[26] The interest expense has exceeded $200 million in each of the past three years.[27]

Given that Burger King allocates so many of its expenses to the United States, at the end of 2013 it had $499 million in profits "permanently reinvested" in overseas operations, which it did not plan to bring to the United States, thereby avoiding paying U.S. taxes on these profits.[28]

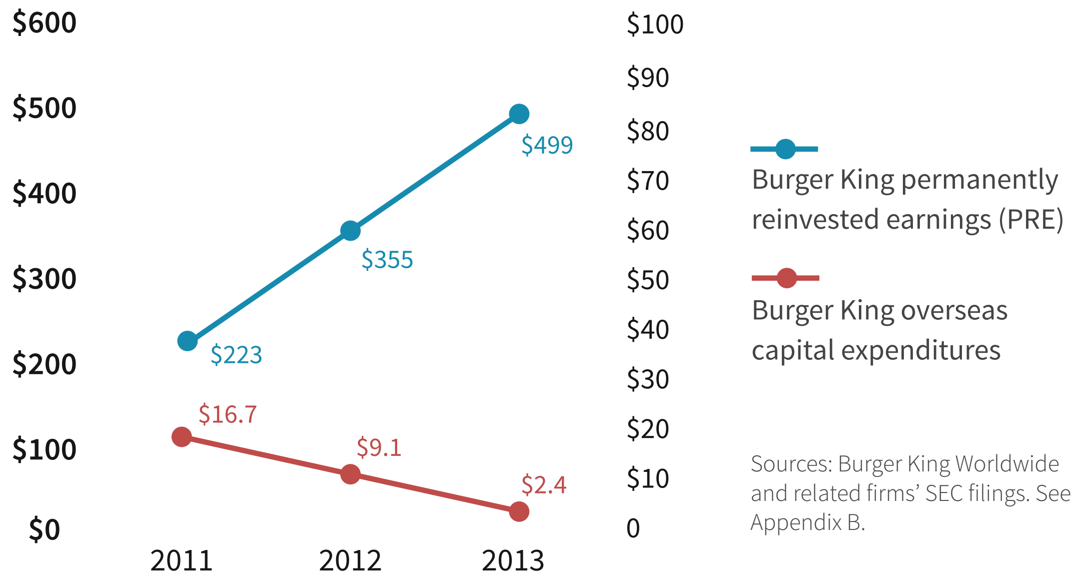
The United States has a worldwide tax system, in which all of the global earnings of U.S. companies are subject to U.S. tax when these earnings are repatriated to America. Burger King, like other U.S. corporations, legally is able to indefinitely put off paying U.S. taxes on those offshore profits by classifying them as permanently reinvested earnings (PRE).[29] There is no limit for how long a company can keep the money offshore, allowing it to avoid U.S. taxes forever.

But Burger King's operational trajectory and structure suggest that the decision to keep these funds offshore has little to do with "reinvestment" and more to do with tax avoidance.

Over the last three years, Burger's offshore profits have more than doubled – from $223 million in 2011 to $499 million in 2013. At the same time the company's overseas capital expenditures (outside of the United States and Canada) plummeted from a modest $16.7 million in 2011 to just $2.4 million in 2013. [See Figure 1]

Burger King also relies heavily on master franchisees with significant operational capacity and therefore invests little in international locations.[30] Burger King has also sold almost all of its corporate-operated stores to franchisees[31] and currently does not operate any foreign stores itself.[32]

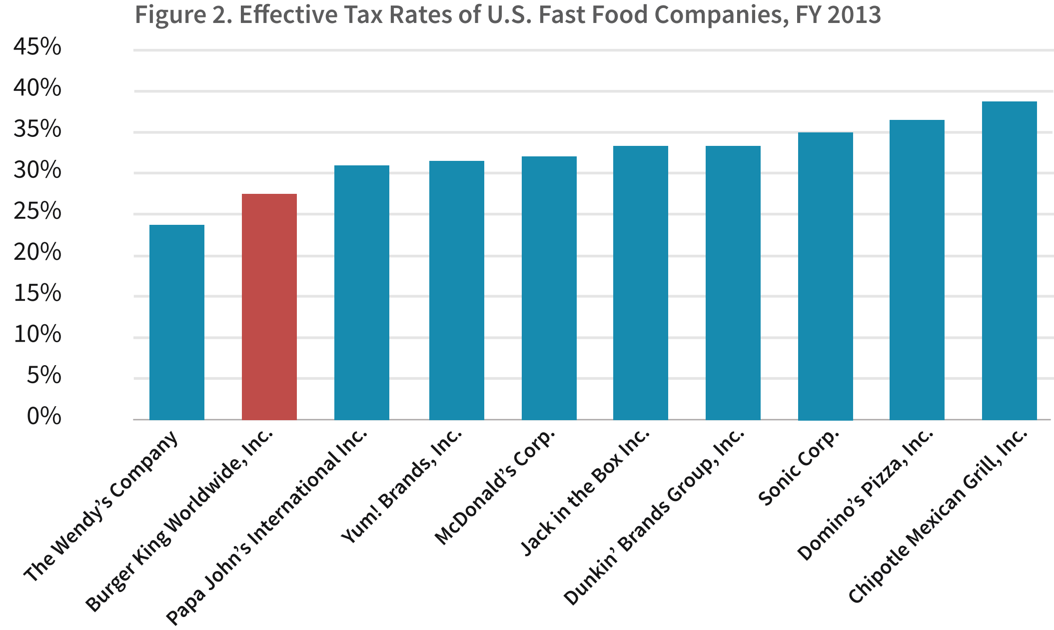
Figure 1. Comparison of Burger King's Untaxed Offshore Profits and International Capital Expenditures, 2011-2013 ($ Millions)



Sources: Burger King Worldwide and related firms' SEC filings. See Appendix B.

Taken together, these strategies enable Burger King to maintain one of the lowest worldwide effective tax rates in the fast food industry – at 27.5 percent, lower than all but one of its publicly traded U.S. fast food competitors. [See Figure 2] This effective tax rate likely significantly overstates the actual taxes that Burger King pays, as it includes considerable deferred taxes, which the company may or may not have to pay in the future.[33]

Figure 2. Effective Tax Rates of U.S. Fast Food Companies, FY 2013



Source: Standard and Poors Capital IQ data on effective tax rates, accessed September 2014 (via Trouble Brewing, Canadian Center for Policy Alternatives). Starbucks is not included because it had negative pre-tax earnings in FY 2013, but the company had an effective tax rate of 32.8% in FY 2012.

Burger King's Corporate Inversion Creates Substantial Tax Avoidance Opportunities

Burger King's management and board members have attempted to downplay the significance of tax savings to the Tim Hortons inversion, perhaps because of the significant blowback other corporations received when they first announced their plans to do a corporate inversion with a foreign firm. Inversions announced by Pfizer, Medtronic, AbbVie, Mylan and Walgreens all generated numerous headlines, including an outcry from President Obama and lawmakers in Congress.

This may explain why Burger King has provided no substantive disclosure about the "anticipated tax benefits" to the company from its merger with Tim Hortons that were disclosed in the Canadian holding company's first SEC filing.[35]

This report analyzes three major tax avoidance strategies that Burger King is likely to employ once the inversion is completed.

Burger King Could Dodge $117 Million in U.S. Taxes on Its Existing Offshore Profits

The newly merged company should be able to permanently avoid paying income taxes on the $499 million in profits that Burger King reported as "permanently reinvested" offshore in 2013, and on which it has not yet paid U.S. taxes. By routing those earnings to its new Canadian parent through a "hopscotch loan" or another similar strategy, the company would avoid approximately $116.8 million in U.S. taxes it would pay if the funds were brought back to the United States. [See Appendix C for methodology]

Alternatively, due to the significant borrowing to finance the transaction – $9 billion in total new debt[36] – the new company could charge the merger-related interest expense to Burger King in the United States, allowing it to offset any taxes it might owe from the repatriation of foreign income to the United States. Since one-half of Burger King's business is in the United States, the transaction also creates a new source of tax deductions in the form of interest expense that could be used to reduce taxes on future U.S. profits.

Burger King Could Avoid $275 Million in U.S. Taxes on Future Foreign Earnings

We estimate that the inversion could help Burger King avoid as much as $275 million in U.S. corporate income taxes on future offshore earnings from 2015 to 2018 – an average savings of $69 million a year. This estimate is based on analysts' earnings forecasts from Barclays, Morgan Stanley, Piper Jaffray, Stephens and UBS.

The estimate assumes Burger King has a pre-tax income of $1.3 billion on foreign sales of $2.7 billion during those years. It also assumes a 19.9 percent income tax rate on the estimated pre-tax foreign earnings. That is the difference between the U.S. statutory tax rate (35 percent) and Burger King's average foreign tax rate of 15.1 percent from 2011 to 2013. [See Appendix D for estimates]

Burger King would be able to avoid these U.S. taxes as a subsidiary of a Canadian company because Canada does not tax most overseas earnings. Unlike the United States the Canadian system is, in practice, a territorial tax system.[37] Profits earned by offshore subsidiaries of a Canadian company are exempt from further taxation in Canada under certain conditions, which most subsidiaries of a fast food company could easily meet.[38]

Moreover, Burger King's future growth plans are primarily focused on markets outside North America, such as China, Brazil, Russia, France and India.[39] When 3G took over Burger King in 2010, the company had 7,550 restaurants in the United States and Canada; at the end of 2013, that had shrunk slightly, to 7,436. During the same years, the number of restaurants outside North America grew from 4,701 to 6,231 – a 33 percent increase.[40] Achieving similar growth outside North America for the Tim Hortons brand is one of the stated goals of the merger.[41]

Once the merger is approved, the combined company could structure its international growth so that royalties flow to entities owned by Canada-based companies. This could be done by signing new franchise agreements with subsidiaries of the Canadian companies.

Burger King's Owners Could Avoid up to $820 Million in U.S. Capital Gains Taxes

Burger King has proposed a unique structure for its merger with Tim Hortons that could allow Burger King shareholders to avoid substantial capital gains taxes. This section examines the top three holders of Burger King stock and finds that the deal structure could enable them to avoid as little as $10 million -- an extremely conservative estimate -- or as much as $820 million in capital gains taxes. [See Table 2]

These estimates vary widely, in part, because it is not possible to identify everyone who owns Burger King shares, the percentage of shares that they own and their country of residence. More than 81 percent of Burger King shares are owned by three entities – 3G Capital (69.2 percent), Pershing Square Capital Management (10.9 percent) and William Ackman (1 percent), Pershing Square's Founder and CEO. Moreover, 3G Capital is domiciled in the Cayman Islands, and it does not disclose the tax residency of its partners and investors, some of whom could be non-U.S. residents.[42]

We also consider two scenarios in forming the estimates: one that assumes that any shareholder who is a U.S. resident would have paid capital gains taxes if not for the structure of the deal, and one that assumes that any shareholder who is a U.S. tax resident or has a controlling influence in a U.S. business would have paid taxes if not for the structure of the deal. Both scenarios suggest that top Burger King shareholders could avoid significant amounts of capital gains taxes as a result of the way 3G Capital has structured the transaction.

Table 2: Estimated Capital Gains Taxes That Could Be Avoided by Major Burger King Shareholders

Owner	Number of Shares Owned	Percent of Shares Owned	Estimated Capital Gains $ Millions	Estimated Capital Gains Tax at 15% $ Millions
3G Capital	243,858,915	69.2%	$4,665	$700
Pershing Square	38,361,360	10.9%	$734	$110
William Ackman	3,561,548	1.0%	$68	$10
Total	**285,781,823**	**81.1%**	**$5,467**	**$820**

Sources: S&P Capital IQ; YahooFinance.com[43]

A Partnership Structure Helps Shareholders Avoid Capital Gains Taxes

Typically, there are no capital gains realized when shareholders exchange their shares in one company for shares in another company.[44] However, when a U.S. resident shareholder transfers property to a foreign corporation (the new merged Canadian company) in connection with a stock-based acquisition, the foreign corporation is not treated as a corporation for capital gains purposes.[45] Instead, the shareholder must pay taxes on the gain as though she had sold the stock. The result is that many shareholders in inverted companies receive a bill for taxes even when they have received no cash compensation.[46]

The Burger King-Tim Hortons merger will involve two new entities, a holding company based in British Columbia and a limited partnership based in Ontario. Tim Hortons shareholders will have the option of receiving cash or shares in the holding company in exchange for their current shares in Tim Hortons. Burger King shareholders will have the option to exchange their shares either for an interest in the partnership or for shares in the holding company.[47]

Burger King has announced that under this structure, existing Burger King shareholders who are U.S. residents and who elect to receive partnership shares are likely to avoid U.S. capital gains tax on the transaction.[48]

3G Capital has already indicated that it will elect the partnership option for its Burger King shares.[49] On an August 26, 2014, investor conference call regarding the merger, when asked why 3G had chosen this option, Burger King CEO Daniel Schwartz stated:

"Having the partnership units will defer taxes until an ultimate sale, and given 3G's long-term commitment and approach to owning the business for the long-term, it's going to commit just to have the partnership units."[50]

Scenario One: Capital Gains Tax Savings

Scenario one assumes that any shareholder who is a U.S. resident would have paid capital gains taxes if not for the structure of the deal. If we conclude that we do not know enough about the residency of the partners in 3G Capital or Pershing Square to include them in the calculation and focus on only one shareholder, hedge fund kingpin William Ackman, then we estimate that $10.2 million in capital gains taxes will be avoided.

It is likely that far more than 1 percent of Burger King stock is owned by U.S. residents. For example, Ackman heads Pershing Square Capital Management, an activist hedge fund,[51] which owns 10.9 percent of Burger King shares. Most likely Ackman has a big stake in his own hedge fund; other U.S. residents may as well. If 100 percent of Pershing Square's Burger King stock is owned by taxable U.S. residents, that would add another $110 million to the first $10 million in capital gains taxes avoided.

3G Capital owns 69.2 percent of Burger King stock. While 3G was founded by Brazilians, some of its partners may be U.S. residents. For example, the firm's managing partner and Burger King's Chairman, Alexandre Behring, lives in Connecticut.[52] Under scenario one, if all of 3G's shares were owned by U.S. residents then all the capital gains would be tax free when the inversion is finalized – or $700 million in capital gains taxes avoided – for a grand total of $820 million.

Scenario Two: Capital Gains Tax Savings

Scenario two assumes that some foreign Burger King shareholders may also be subject to U.S. capital gains taxes and would therefore need to use the partnership structure to avoid realizing capital gains.

SEC filings by the new Canadian partnership make clear that non-U.S. holders of Burger King shares would realize capital gains on the merger transaction if "the gain is effectively connected with a U.S. trade or business of such non-U.S. holder."[53] A recent *Tax Analysts*' article by Steven Rosenthal outlines the ways in which foreign private equity firms such as 3G Capital engage in active management that could qualify under the effectively connected income (ECI) standard.[54] Given that the CEO of Burger King and half of its directors, including its chair and vice-chair, are 3G Capital partners, and 3G Capital owns 69 percent of Burger King, its gains on the transaction could be effectively connected to its business activities in the United States.[55]

Under scenario two, the entire 81.1 percent of Burger King shares owned by just three entities would be exempt from capital gains in the merger, avoiding $820 million in taxes.

Taxpayers Already Spend an Estimated $356 Million a Year Subsidizing Burger King's Low Pay and Meager Benefits

The taxes Burger King could dodge through its corporate inversion are all the more troubling because U.S. taxpayers pay an estimated $356 million a year to support the company's employees due to its low pay and meager benefits, according to an analysis from the National Employment Law Project.[56] Over four years that's a tab of $1.4 billion.

The report is based on four vital public benefits programs that provide assistance to working families at Burger King and nine other fast-food chains: Health insurance (Medicaid and Children's Health Insurance Program, or CHIP), the Federal Earned Income Tax Credit (EITC), food stamps (the Supplemental Nutrition Assistance Program, or SNAP) and basic household income assistance (Temporary Assistance for Needy Families, or TANF).

Burger King is the #1 Burger Chain Serving Members of the U.S. Armed Forces

Burger King is the dominant hamburger chain on U.S. military bases, with $175 million in annual sales to members of the military and their families.[57] Burger King restaurants serve the troops everywhere from the biggest bases in America to dangerous combat zones in Afghanistan.

Burger King's decision to change its corporate address to Canada will mean that while U.S. military families support Burger King by buying its food, Burger King will no longer support service members by paying its fair share of taxes.

Since 1982, Burger King has benefitted from a special relationship with the U.S. military,[58] with restaurants on iconic military bases (Hickam AFB at Pearl Harbor), on the largest bases (four separate locations at Fort Bragg in North Carolina), and in combat zones (four locations in Afghanistan).[59] There are 187 Burger Kings on military bases, which ranks Burger King as the largest burger chain serving the armed forces. By comparison, McDonald's, the second largest burger chain on military bases, has only 34 locations.[60] Burger King restaurants serve an estimated one in five meals sold in the military's main on-base food-service network, the Army and Air Force Exchange Service (AAFES).[61]

Over the next five years, Burger King restaurants on U.S. military bases will generate an estimated $875 million in revenue.[62] During this time the armed forces will pay an estimated $35 million to Burger King in royalties and will spend an estimated $17.5 million marketing the Burger King brand to service members and their families.[63] The agreement between the AAFES and Burger King can be renewed for up to 15 years.[64] If sales continue at the current rate, Burger King could receive more than $150 million from its military restaurants over this period.[65]

Conclusion

Burger King CEO Daniel Schwartz claims that his company's plans to renounce its U.S. citizenship and become a Canadian corporation "is not really about taxes." The media largely has accepted this assertion because until now little information has been publicly available to challenge it.

However, this report finds that by undergoing a corporate inversion Burger King and its shareholders could dodge an estimated $400 million to $1.2 billion in U.S. taxes between 2015 and 2018. By becoming a Canadian corporation, Burger King could dodge $117 million in U.S. federal taxes on the $499 million in profits that it had "permanently reinvested" offshore at the end of 2013. And because Canada doesn't tax worldwide profits like the United States does, Burger King may be able to avoid an additional $275 million in U.S. taxes between 2015 and 2018. Moreover, Burger King's top shareholders may avoid as much as $820 million in capital gains taxes because of the way the company has structured the inversion.

Burger King's inversion adds up to a "whopper" of a tax dodge. Time will tell whether it will diminish Americans' taste for the company's iconic burger.

Appendix A: Burger King's Justifications for Move to Canada Don't Stand up to Scrutiny

Burger King and Tim Hortons executives claim two non-tax-related reasons for locating the combined company's headquarters in Canada: It would have more revenues from Canada than the United States, and locating the headquarters in Canada would help win regulatory approval. Neither of these reasons stand up to scrutiny.

"The new company's headquarters will be located in Canada because that will be its largest market by revenue."

Tim Hortons President and CEO Mark Caira[66]

In franchised industries, system-wide sales (total sales by both franchised and corporate locations) and unit count (number of stores) are more important industry metrics than revenue. In fact, the joint press release issued by Burger King and Tim Hortons to announce the two companies' intention to merge does not mention a single figure for revenue, but touts the combined size of the companies in terms of system sales and number of stores.[67]

"Since Tim Hortons is considered a Canadian icon, the deal makers felt regulators were more likely to approve the merger if the company was based in Canada."

The Wall Street Journal[71]

By those measures, the United States would be the combined company's largest market. Subsequent to the merger, the company will have more than twice as many stores in America as in Canada.[68] Additionally, the combined company will have an estimated 40 percent more ($2.6 billion) in system-wide sales in America than in Canada.[69] Burger King has indicated that it intends to maintain a headquarters in the United States, perhaps due to the ongoing importance of America to its business. When Wendy's bought Tim Hortons in 1995, the combined company maintained its headquarters in the United States.[70]

The headquarters location of the new company formed by a merger is not one of the criteria for approval of the transaction under the Investment Canada Act,[72] which was the key regulatory hurdle facing the merger in Canada, before the Minister of Industry announced approval of the deal on December 4.[73] Given that in 1995, Wendy's bought Tim Hortons and relocated its headquarters to Ohio without Canadian regulators blocking the move,[74] it seems that Burger King could have chosen to remain an American company while purchasing a Canadian business. In fact, Tim Hortons only moved its headquarters back to Canada in 2009 and described the lower Canadian tax rates as one of the main factors in the decision.[75]

Appendix B: Comparison of Burger King's Untaxed Offshore Profits & International Capital Expenditures

Table 3.

	2011	2012	2013
		$ Millions	
Burger King undistributed foreign earnings (permanently or indefinitely reinvested)	**$222.9**	**$355.1**	**$499.0**
Capital Expenditures			
United States and Canada	56.5	41.9	10.3
EMEA (Europe, Middle East, Africa)	11.1	6.9	2.4
LAC (Latin America and Caribbean)	1.8	1.4	--
APAC (Asia and Pacific)	3.8	0.8	--
Unallocated	8.9	19.2	12.8
Total Capital Expenditures	**82.1**	**70.2**	**25.5**
Calculated Capital Expenditures allocated outside North America (U.S. and Canada)	**$16.7**	**$9.1**	**$2.4**

Undistributed Foreign Earnings Sources:
2011: Justice Delaware Holdco Inc. SEC Form 424B3, Final Prospectus, p. F-69.
2012: BKW, Inc. 2012 SEC Form 10-K, p.103
2013: BKW, Inc. 2013 SEC Form 10-K, p. 88

Capital Expenditures Sources:
BKW Worldwide, Inc. 2013 SEC Form 10-K, p. 106

Appendix C: Estimated U.S. Taxes on Burger King's Accumulated Offshore profits

Burger King discloses in its FY 2013 10-K the earnings it currently classifies as "permanently reinvested" overseas: "Deferred tax liabilities have not been provided on approximately $499.0 million of undistributed earnings that are considered to be permanently reinvested."[76] These funds are described as "undistributed earnings," implying that this amount is after any applicable foreign taxes have been paid.

Burger King's average tax rate paid on foreign earnings from 2011 to 2013 was 15.1 percent. (See Table 4) Assuming that the $499 million represents post-tax earnings, the company would have had pre-tax earnings of $588 million at the 15.1 percent average tax rate. Total foreign taxes paid on $588 million at the 15.1 percent rate are estimated at $89 million. Applying the U.S. corporate income tax rate of 35 percent to estimated total foreign taxable income yields $205.8 million in U.S. tax liability. This is then reduced by the $89 million in foreign taxes paid to reach an estimated U.S. tax liability of $116.8 million. (See Table 5)

Table 4. Burger King's Foreign Income and Taxes Paid

$ Millions | 2011-2013 Weighted Average Foreign Tax Rate

	2013	2012	2011	Total
Foreign Earnings Before Taxes (EBT)	$194.8	$164.4	$109.3	**$468.5**
Current Taxes - Foreign	$22.8	$13.0	$14.3	**$50.1**
Deferred Taxes - Foreign	$5.5	$8.3	$7.0	**$20.8**
Average Foreign Tax Rate	**14.5%**	**13.0%**	**19.5%**	**15.1%**

Source: Burger King 10-K, 2013, p. 85

Table 5. Estimated Burger King Taxes Owed on Offshore Permanently Reinvested Earnings (PRE) $ Millions

	2013
Permanently Reinvested Earnings (PRE)	$499.0
Average Foreign Tax Rate 2011-2013	15.1%
Estimated pre-tax earnings based on avg tax rate and PRE	$588.0
Estimated U.S. tax liability at 35% on $588 million	$205.8
Estimated foreign taxes paid on PRE based on avg tax rate	$89.0
Estimated U.S. Taxes Owed on PRE on Repatriation	**$116.8**

Source: PRE: Burger King 10-K, 2013, p. 88

This analysis does not take into account the following:

- Undistributed earnings may not be wholly representative of Burger King's 2013 foreign taxable income, as they may have been predominantly earned in countries with lower or higher tax rates.
- Some of the undistributed earnings are from prior years, in which Burger King had a different average foreign tax rate.

Appendix D: Estimates of Burger King's U.S. Income Taxes Avoided on Future Foreign Earnings

This estimate of the U.S. income taxes avoided by a Burger King inversion is based on foreign earnings models derived from these sources:

- Estimates from five investment bank analyst reports were first used to generate estimates of total future foreign sales; future foreign pre-tax income; and the potential U.S. tax bill on future foreign earnings. These reports are only available by subscription:

    - **Barclays**, *Burger King Worldwide: 3Q14 Solid… Focus Remains on THI Combination, With Details Limited* (Nov. 4, 2014)

    - **Morgan Stanley**, *Burger King Worldwide, Inc: With BK on Solid Footing, Looking North for Next Oppt'y* (Nov. 4, 2014); and Morgan Stanley, *Burger King Worldwide Inc: Strong Int'l Price in; Refi Less Understood: Initiating at EW* (May 27, 2014)

    - **Piper Jaffray**, *Burger King (BKW): Updating Model Following 3Q14 Results* (Nov. 4, 2014)

    - **Stephens Inc.**, *BKW: 3Q14 SSS Beat & In-Line EPS* (Nov. 5, 2014)

    - **UBS**, *Burger King Worldwide: Well Positioned w/ Consistency and Global Growth Ahead of THI Combination* (Nov. 4, 2014).

      Note that only UBS estimates are available for the entire time period.

- **Bloomberg**: Helped source total sales estimates and total pre-tax income estimates (accessed Dec. 1, 2014). Bloomberg did not provide consensus estimates for segmented earnings. Pre-tax earnings estimates may not fully take into account any extraordinary or one-off charges, which may affect tax rates in the future.

Table 6 displays the estimates of foreign sales, foreign pre-tax income and tax savings (i.e., additional taxes owed) if Burger King's earnings outside of North America were repatriated to the United States for 2015 through 2018 at a 15.1 percent tax rate, as calculated in Table 4.

The estimated amount of U.S. income taxes that would have to be paid on Burger King's future earnings outside North America were they repatriated to the U.S. would amount to:

- 2015: $53.3 – $60.5 million, or an average of $58.1 million
- 2016: $64.7 – $72.4 million, or an average of $67.8 million
- 2017: $72.0 million (one estimate)
- 2018: $77.6 million (one estimate)
- **2015-2018: $275.4 million in taxes lost to the U.S. Treasury**

Table 6: Estimates of Burger King's Tax Savings, Foreign Sales and Pre-tax Income

Summary of Tax Savings Estimates (2011-2013 Weighted Average Tax Rate of 15.1%) All $ Millions

Analyst	2015E	2016E	2017E	2018E	Total: 2015-2018
Barclays	$60.3	$72.4			NA
Morgan Stanley	$53.3	$64.7			NA
Piper Jaffray	$60.5				NA
Stephens	$59.2				NA
UBS	$57.3	$66.4	$72.0	$77.6	NA
Average	**$58.1**	**$67.8**	**$72.0**	**$77.6**	**$275.4**

Summary of Foreign Sales Estimates

Analyst	2015E	2016E	2017E	2018E	Total: 2015-2018
Barclays	$619.3	$701.4			NA
Morgan Stanley	$619.7	$702.4			NA
Piper Jaffray	$621.1				NA
Stephens	$607.9				NA
UBS	$588.5	$642.4	$696.6	$751.0	NA
Average	**$611.3**	**$682.0**	**$696.6**	**$751.0**	**$2,741.0**

Summary of Foreign Pre-Tax Estimates

Analyst	2015E	2016E	2017E	2018E	Total: 2015-2018
Barclays	$303.4	$364.7			NA
Morgan Stanley	$268.2	$325.5			NA
Piper Jaffray	$304.3				NA
Stephens	$297.9				NA
UBS	$288.3	$334.0	$362.2	$390.5	NA
Average	**$292.4**	**$341.4**	**$362.2**	**$390.5**	**$1,386.4**

Explanation of Foreign Sales and Pre-tax Income Estimates

Each investment bank analysis reported some combination of same store sales growth and store growth for Burger King's three foreign segments: Europe, Middle East and Africa (EMEA); Latin America and the Caribbean (LAC); and Asia-Pacific (APAC). The U.S. and Canada are the fourth segment and were not included in this analysis.

A similar methodology was used for each set of estimates, however each was slightly different as some reported segmented figures for all metrics, and some did not.

Barclays

- Reported sales estimates for 2014-2016.
- Reported store number estimates for the company overall (see Barclays report page 2).
- Reported same store sales (SSS) estimates for the company overall. Foreign SSS growth was assumed to be the same as company-wide SSS growth. Given that store growth estimates weren't broken down by segment, it was assumed that all store growth was foreign.
- The calculated foreign store growth figure was added to the SSS figure to provide an annual foreign sales growth rate. This was then applied to the base year 2013 figure of $481.1 million[77] to reach foreign sales estimates for 2014-2016.
- The Bloomberg consensus pre-tax income figures were divided by the Bloomberg consensus sales figures to create an implied consensus earnings before taxes (EBT) margin. This margin was then applied to the foreign sales estimate to reach a foreign EBT figure.

Morgan Stanley

- Reported sales estimates for 2014-2016 in May 2014 (see Morgan Stanley May 2014 report page 21), and reported sales estimates for 2014-2015 in November 2014 (see Morgan Stanley November 2014 report page 3).
- Reported store number estimates for EMEA, LAC and APAC.

- Reported SSS estimates for EMEA, LAC and APAC. SSS estimates per region were weighted by that region's prior year store numbers to reach a weighted average foreign SSS figure.
- The calculated foreign store growth figure was added to the weighted average SSS figure to provide an annual foreign sales growth rate. This was then applied to the base year 2013 figure of $481.1 million to reach foreign sales estimates for 2014-2016.
- Reported estimates of pre-tax income were used to estimate future margin changes. This overall company margin was applied to the foreign sales figure to reach a foreign EBT figure.
- Updated numbers from November 2014 were used where possible. Some estimates for 2016 were not updated in the most recent report, and so prior estimates from May 2014 were used.

Piper Jaffray

- Reported sales estimates for 2014-2015.
- Reported store number estimates for company overall (see Piper Jaffray report page 3).
- Reported SSS estimates for EMEA, LAC and APAC. SSS estimates per region were weighted by that region's prior year store numbers to reach a weighted average foreign SSS figure.
- The calculated foreign store growth figure was added to the weighted average SSS figure to provide an annual foreign sales growth rate. This was then applied to the base year 2013 figure of $481.1 million to reach foreign sales estimates for 2014-2015.
- The Bloomberg consensus pre-tax income figures were divided by the Bloomberg consensus sales figures to create an implied consensus EBT margin. This margin was then applied to the foreign sales estimate to reach a foreign EBT figure.

Stephens

- Reported sales estimates for 2014-2015.
- Reported store number estimates for company overall (see Stephens report page 4).

- Reported SSS estimates for EMEA, LAC and APAC.
- SSS estimates per region were weighted by that region's prior year store numbers to reach a weighted average foreign SSS figure. Given that the store growth estimates weren't broken down by segment, it was assumed that all store growth was foreign.
- The calculated foreign store growth figure was added to the weighted average SSS figure to provide an annual foreign sales growth rate. This was then applied to the base year 2013 figure of $481.1 million to reach foreign sales estimates for 2014-2015.
- The Bloomberg consensus pre-tax income figures were divided by the Bloomberg consensus sales figures to create an implied consensus EBT margin. This margin was then applied to the foreign sales estimate to reach a foreign EBT figure.

UBS

- Reported sales estimates for 2014-2018.
- Reported store number estimates for EMEA, LAC and APAC (see UBS report page 6).
- No SSS estimates.
- The calculated foreign store growth figure was used as the annual foreign sales growth rate. This assumes that sales only grow as a result of store growth in EMEA, LAC and APAC. This was then applied to the base year 2013 figure of $481.1 million to reach foreign sales estimates for 2014-2016.
- Reported estimates of pre-tax income were adjusted, so it couldn't be compared between analysts.
- The Bloomberg consensus pre-tax income figures were divided by the Bloomberg consensus sales figures to create an implied consensus EBT margin. This margin was then applied to the foreign sales estimate to reach a foreign EBT figure.

Estimated U.S. Income Taxes Avoided on Future Foreign Earnings

- In each case this estimate was calculated by applying a 19.9 percent tax rate to the estimated pre-tax foreign earnings. That is the difference between the U.S. statutory tax rate (35 percent) and Burger King's weighted average foreign tax rate for 2011-2013 (15.1 percent).

- This analysis does not take into account the fact that the future earnings may not be wholly representative of Burger King's 2011-2013 foreign taxable income. The balance of earnings from high-tax and low-tax countries may change in the future.
- If the earnings have had no or little foreign taxes paid on them, then the total owed in U.S. income taxes could be as high as $411 million over four years based on UBS data.

Some other limitations to be aware of:

- All the foreign estimates are really EMEA, LAC and APAC. They do not include Canada under the current structure, nor does it include the United States as potentially foreign in the future.
- It does not take into account any sales improvements not due to same store sales growth or growth in store numbers. Remodeling and reimaging for example may not be adequately taken into account as sales drivers.
- It does not take into account differences in margin changes between the United States and other regions. Currently the United States has the lowest margin of any region.
- Most analysts expect pre-tax margins to grow over the next few years. With refranchising some markets will have more margin growth than others. This is not taken into account in this model.

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[29] Victor Fleischer, "Overseas Cash and the Tax Games Multinationals Play," *The New York Times* (Oct. 3, 2012). http://dealbook.nytimes.com/2012/10/03/overseas-cash-and-the-tax-games-multinationals-play/

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[41] New Red Canada Limited Partnership, p. 2.

[42] Burger King Worldwide, SEC Form 13D (August 26, 2014). http://www.sec.gov/Archives/edgar/data/1421669/000119312514325397/d780881dsc13da.htm

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Tim Hortons reported $6.1 billion in franchise restaurant sales in Canada in 2013, and $586 million in the United States. In the same year Burger King had an estimated $8.5 billion in system-wide sales in the United States and approximately $321 million in sales in Canada (estimates generated by apportioning system-wide sales among the two countries in proportion to the number of stores).

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