March 21, 2016

The Honorable Jacob J. Lew
Secretary of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Dear Secretary Lew:

We write to urge you to take prompt regulatory action that would prevent two large American corporations – Pfizer and Johnson Controls – from using mergers with Irish companies to permanently dodge billions of dollars in U.S. taxes.

As you know, the Treasury Department is in the process of finalizing a regulation pursuant to notices issued in 2014 and in 2015, which reduced the tax benefits of corporate inversions and addressed certain instances of post-inversion tax avoidance. By clarifying the original notices in its pending regulation, Treasury could remove a major tax-avoiding incentive for these two mergers, and other likely future mergers and inversions. More details about the recommended remedies are in the “Explanation of Treasury Department Authority to End Tax Benefits for Pfizer’s Hopscotch Loan With Allergan” at the end of this letter.

Action is particularly urgent because the Pfizer merger is due to be finalized by the middle of the year.

A recent report by Americans for Tax Fairness found that Pfizer could permanently avoid up to $35 billion in residual U.S. taxes on some $150 billion in offshore profits it holds if it completes its proposed merger with fellow drug company Allergan, which is based in the tax haven of Ireland, and the Treasury notices do not change. Johnson Controls could similarly erase its residual U.S. tax obligations on $8 billion in untaxed offshore profits if it concludes its merger with Ireland-based Tyco under the existing Treasury notices.

Pfizer’s potential tax dodge is a huge sum of money – more than the $30 billion increase in domestic discretionary spending for the next fiscal year that was negotiated in the budget agreement last year, and which House Republicans are now demanding be paid for by cutting Medicaid and other health and low-income programs.

These companies can avoid paying the U.S. taxes they owe on their existing offshore profits through a so-called “hopscotch” loan, whereby the former U.S. firms can loan their offshore profits to their new foreign parent companies. Treasury prohibited such tax avoidance in its
2014 Notice when the new foreign company is at least 60% owned by the original shareholders of the former U.S. firm. But both Pfizer and Johnson Controls structured their mergers so that their shareholders own 56% of the new foreign company.

We know you are as concerned as we are by corporate inversions, which drain our Treasury of necessary revenue and create an uneven playing field for Main Street businesses that pay their fair share of taxes. By acting promptly, the Treasury can remove the principal tax-avoiding feature of two of these unpatriotic corporate maneuvers and discourage future ones.

Sincerely,

AFL-CIO
Agenda Project Action Fund
Alliance for a Just Society
Alliance for Strong Families and Communities
American Family Voices
American Federation of Government Employees
American Federation of State, County and Municipal Employees
American Federation of Teachers
Americans for Democratic Action
Americans for Tax Fairness, a coalition of 425 endorsing organizations
Asset Building Strategies
Brotherhood of Locomotive Engineers and Trainmen/Teamsters
Brotherhood of Maintenance of Way Employees
Campaign for America’s Future
Center for American Progress
Citizens for Tax Justice
Coalition on Human Needs
Communications Workers of America
Conference of Major Superiors of Men
Courage Campaign
CREDO Action
Daily Kos
Democracy for America
Economic Policy Institute Policy Center
Fair Share
Financial Accountability and Corporate Transparency (FACT) Coalition
Institute for Policy Studies - Program on Inequality
International Brotherhood of Teamsters
Jubilee USA Network
Lake Research
Main Street Alliance
National Committee to Preserve Social Security and Medicare
National Education Association
National Organization for Women
National People’s Action
National Priorities Project
NETWORK, a National Catholic Social Justice Lobby
New Rules for Global Finance
Oxfam America
Public Citizen
Racial and Ethnic Health Disparities Coalition
Responsible Wealth
RootsAction.org
Service Employees International Union
Sisters of Mercy of the Americas, Institute Justice Team
SOAR (Steelworkers Organization of Active Retirees)
Tax Justice Network USA
The Other 98%
UAW, International Union, United Automobile, Aerospace & Agricultural Implement Workers of America
United for a Fair Economy
United Steelworkers, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union (USW)
USAAction
USPIRG
Working America
Working Families Party
EXPLANATION OF TREASURY DEPARTMENT AUTHORITY TO END TAX BENEFITS FOR PFIZER’S HOPSCOTCH LOAN WITH ALLERGAN

The Treasury Department is in the process of finalizing a regulation pursuant to notices issued in 2014 and 2015, which reduced the tax benefits of corporate inversions and addressed certain instances of post-inversion tax avoidance. By clarifying Section 3 of the 2014 Notice in its pending regulation, Treasury could remove a major tax-avoiding incentive for two pending mergers between U.S. and Irish companies – Pfizer of New York with Allergan, and Johnson Controls of Wisconsin with Tyco International – and for other likely future mergers and inversions.

A recent report by Americans for Tax Fairness, found that Pfizer could avoid up to $35 billion in residual U.S. taxes on some $150 billion in offshore profits (reported in 2014) if allowed to merge under the current Treasury Notice with fellow drug company Allergan, based in the tax haven of Ireland. (Citizens for Tax Justice reports that Pfizer had nearly $194 billion in offshore profits at the end of 2015.) Johnson Controls could similarly erase residual U.S. tax obligations on $8 billion in untaxed offshore profits if it concludes its merger with Ireland-based Tyco under the existing Treasury Notice.

These U.S.-owned companies can avoid U.S. taxes on their existing offshore profits through a so-called “hopscotch” loan, whereby the controlled foreign corporation (CFC) of the former U.S. parent can loan their offshore profits to their new ultimate foreign parent company. Treasury appropriately used its authority under Section 956 to prohibit such post-inversion tax avoidance in its Notice but only applied the rule in the Notice to inversions under current Section 7874, effectively meaning when the new foreign parent company is at least 60% owned by the original shareholders of the former U.S. parent. Both Pfizer and Johnson Controls structured their mergers so that their shareholders own 56% of the new foreign company, thereby potentially allowing them to use their offshore profits without paying any U.S. tax.

The longstanding anti-abuse rationale that is the foundation of Section 956 in no way dictates that it be tied to Section 7874; in fact, the very purpose of Section 956 arguably could be thwarted through such an interpretation.

Harvard Law School senior lecturer Stephen Shay, who previously served as Deputy Assistant Secretary for International Tax Affairs in the Treasury Department, argued in a recent Tax Notes article that Treasury’s existing Section 956 anti-abuse regulation should apply to any use, direct or indirect, of the untaxed earnings of a CFC by a foreign parent group that holds U.S. property, including 25% or more of the voting stock of a U.S. shareholder of the CFC – regardless of
whether the existence of the foreign parent arises due to an inversion. Under this application of the *existing* regulation, Section 956 would not be linked to Section 7874 and would apply to the Pfizer-Allergan and Johnson Controls-Tyco International mergers and to other cases not within the scope of Treasury’s prior Notice.

Shay and his co-authors also pointed out that the existing 956 regulation could be avoided by “de-controlling” the CFC and urged Treasury to close this loophole in the forthcoming regulations, as well.

Treasury should confirm the broad scope of section 956 and eliminate the loopholes that Pfizer and Johnson Controls would like to use to avoid U.S. tax on their existing untaxed offshore profits through their mergers with Irish companies.