April 15, 2013

The Honorable Devin Nunes
Chair
International Working Group
Committee on Ways and Means
U.S. House of Representatives
1013 Longworth House Office Building
Washington, DC 20515

The Honorable Earl Blumenauer
Vice-Chair
International Working Group
Committee on Ways and Means
U.S. House of Representatives
1111 Longworth House Office Building
Washington, DC 20515

Dear Representatives Nunes and Blumenauer:

Thank you for your leadership on the House Ways and Means Committee International Working Group and your work on tax reform. As the Working Group considers these important issues, Starbucks respectfully submits the following comments.

About Starbucks

Starbucks, a US company, has stores in every state, with over 12,900 (company- owned and licensed) locations and over 200,000 partners (employees) throughout the country. In addition, we also make an important contribution to the US manufacturing sector. Currently, we employ more than 800 people at four large roasting plants in Kent, WA; Sandy Run, SC; York, PA and Carson Valley, NV; and we are in the process of opening two new facilities that will employ more than 300 people once complete (one in Augusta, GA and one in Rancho Cucamonga, CA). In 2012, the four roasting plants blended, roasted, packaged, and shipped nearly 300 million pounds of coffee. Over 90% of the coffee we sell globally is roasted in the United States. In addition, we have over 3,000 partners (employees) at our Starbucks Support Center (headquarters) in Seattle.

Starbucks is a relatively young global company. We opened our first stores outside North America in Japan less than 20 years ago. At the time we had a little over 1,000 stores. Today we have over 18,000 stores in over 62 countries.

We have built our brand by delivering the "Starbucks experience" to each customer store by store. Our unique business format, including the "look and feel" of our stores, enables us to deliver this experience. We have not relied on typical business models or heavy media advertising to build our brand intangible. At our Support Center in Seattle, we invest heavily in nurturing and enhancing our business format using an integrated, holistic approach. This includes developments in store operations, store design concepts, in-store marketing, innovative products and packaging, loyalty programs and social media platforms.

As we grow throughout the world, we are building our brand by delivering the "Starbucks experience" customer by customer, store by store, just as we do in the United States. We must be located where our customers are located. We cannot serve a latte to a customer in Tokyo from Seattle. In addition, we must customize the Starbucks experience for the local customer. Not only do we need to establish our brand in each country in which we operate, we must also continuously nurture and enhance our brand intangible. As in America, we do not rely on typical business models or heavy media advertising. Instead, we establish our brand and earn customers by continuously enhancing customer experience through localization and creativity in store operations, store design concepts, in-store marketing, innovative products and packaging, loyalty programs and social media platforms.

<u>Starbucks is a coffee company.</u> In Lausanne, Switzerland, a global hub for commodity trading, we operate a global coffee buying business. Coffee beans are currently the second most traded commodity in the world and we achieve major economies of scale from centralizing this activity in one place. It is also important to note that 75% of the world's coffee is traded through Switzerland and Starbucks represents less than 5% of the annual coffee trade.

<u>Starbucks stores throughout the world are a mix of related and unrelated operations.</u> We have over 20 unrelated third party operators in over 40 different countries. We charge a consistent, market-based royalty to each of our operators. Both our related and unrelated operators pay the same royalty. These unrelated operators provide a strong comparable for our transfer pricing of our royalties with related operators.

Tax Reform

Starbucks welcomes the discussion about tax reform. We believe that every citizen, including every corporate citizen, should pay an appropriate share of tax to provide revenue to support the common good. Starbucks' global effective tax rate exceeds 32%.

As a general matter, Starbucks supports the following policies::

- Lower marginal corporate tax rates and broaden tax base
- Adopt territorial system
- Retain Subpart F with exceptions for:
    - Income derived from active trade or business that are currently exempt from Subpart F
    - Income from sale of agricultural commodities
- Expand Subpart F active royalty exception to related parties
- Include Starbucks intangible income in Option C of Camp proposal
- Retain direct foreign tax credits

A lower marginal corporate tax rate coupled with a territorial system would allow US companies, like ours, to expand their domestic and international presence and sales as well as create jobs in the United States. Starbucks understands that comprehensive tax reform entails the review of tax expenditures, including provisions that have benefited the company such as the domestic manufacturing deduction and accelerated depreciation. We support the review of such provisions, as long as it is done in a fair and comprehensive way. Further, we understand base erosion proposals must be part of the tax reform discussion; however, such proposals should be considered only in the context of comprehensive reform and not be utilized as stand-alone revenue raisers.

Lower rates, a broader tax base, and a territorial international tax system have been the focus of the tax reform discussion to-date. In addition to these important policies, however, several other tax issues are of priority interest to Starbucks, as described below.

As noted above, our business requires us to locate where our customers are located. Our stores necessarily are located in the same neighborhoods and business centers as those of our foreign competitors. A territorial system that does not subject foreign active trade or business income to US taxation will allow US companies like Starbucks to compete with local competitors on a level playing field, paying the same taxes that they pay.

Similarly, we must provide the necessary proximal support to our foreign operators so they can deliver the "Starbucks experience" to our customers in each and every market in a locally relevant fashion. This is how we build, maintain and grow our brand. As discussed above, income from the active conduct of a business should continue to be excluded from Subpart F income. In the case of royalties earned in the active conduct of business outside of the US, this exclusion from Subpart F should cover not only royalties received from unrelated parties but also be expanded to include arm's length royalties received from related parties. The current rules for the treatment of royalties favor active royalties received from an unrelated franchisee over similar active royalties received from a related franchisee. This discourages Starbucks from employing its core business model, which is to own and operate its stores. Reform that provides consistent treatment of active royalties received from both unrelated parties and related parties, with appropriate safeguards to prevent abuse, would be good tax policy, would increase Starbucks' ability to compete in markets outside the US, and would facilitate further growth of our company.

Under the current rules, an exclusion from Subpart F is also available for foreign income from the procurement and sale of coffee beans ("agriculture commodity exception") and this exception should be retained. Procurement of the highest quality coffee beans by working directly with farmers and cooperatives in coffee growing countries continues to be the critical foundation for the "Starbucks experience". The agriculture commodity exception to Subpart F allows us to purchase the highest quality beans competitively and ethically in the global coffee marketplace. In 1978, coffee was added to this exception in recognition of the fact that coffee cannot be grown in the US in commercially marketable quantities. The agricultural exception also applies to cocoa, another primary ingredient in many of our products. Subjecting income from this activity to current Subpart F taxation would put Starbucks at a severe competitive disadvantage compared to our counterparts.

We welcome a lower US tax rate on intangible income (i.e., royalty income) to create an incentive for intangible development activity in the United States. The definition of intangible income under Option C of the Camp proposal should be broad enough to include the types of intangibles that are at the core of Starbucks' business model. As discussed, the value of the Starbucks brand is driven by the "Starbucks experience" that is the result of our significant and ongoing investment in an integrated series of intangibles, including our trademark, innovative marketing, store operation processes, store design concepts, etc. Each of these intangibles is integral and interdependent in creating and sustaining the Starbucks experience. The reduced rate of taxation under Option C should apply to the income earned in the United States from foreign licensees who pay royalties in exchange for the right to use these valuable intangibles outside the United States.

To avoid double taxation, we ask that foreign tax credits remain available for all foreign withholding tax imposed on intangible income earned by US companies. Starbucks receives royalties from foreign operators for the intangible activity carried on in the United States, and these royalties may be subject to foreign withholding tax. Allowing US foreign tax credits for these withholding taxes will avoid double taxation and maintain the incentive to carry on income producing activities in the United States.

Again, we thank you for the opportunity to provide input into the tax reform process. Please do not hesitate to contact us with any questions you may have about these comments.

Sincerely,

Brian Ugai
Vice President, Tax and Customs
Starbucks Coffee Company