Statement of

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House Committee on Ways & Means
Hearing on the Global Tax Environment in 2016 and Implications for International Tax Reform

February 24, 2016

Chairman Brady, Ranking Member Levin, and Members of the Committee on Ways and Means, thank you for the opportunity to submit testimony on these important issues.

My name is Andrew Quinlan, and I am the president of the Center for Freedom & Prosperity (CF&P). The primary mission of the Center for Freedom & Prosperity is to defend tax competition as an important principle that helps ensure a prosperous global economy.

As Congress considers long overdue reforms to the U.S. corporate tax code, it needs to be recognized that corporate flight – such as through inversion – is just a symptom of the disease. The fundamental problem is the uncompetitive tax code.

To that end, I have included a recent editorial explaining why efforts to demonize corporations for responding to current tax incentives are misguided.

Politicians Pointing Fingers Over Corporate Inversions Should Look in the Mirror

Andrew F. Quinlan, Center for Freedom and Prosperity

Originally published February 4, 2016 by *The Blaze*

With the presidential campaign season in full swing, no one should be surprised to find politicians using hyperbole and demagoguery to energize supporters while vastly oversimplifying complex policy problems.

However, when it comes to a recent example of yet another so-called “corporate inversion,” the knee-jerk political response of attacking and shaming the company reveals a political class that is dangerously out of touch with global economic reality.

An inversion occurs when a U.S.-based company merges with a foreign corporation and relocates its headquarters overseas. This allows the company to compete in foreign markets without being held back by the anchor that is the U.S. corporate tax code.

The last decade has seen around 50 inversions and 20 since just 2012. One of the most recent examples is a proposed merger of major pharmaceutical company Pfizer with the Ireland-based Allergan, news of which prompted swift denouncements from the two current leading Democratic candidates. Bernie Sanders called it a “disaster,” while Hillary Clinton alleged that Pfizer was attempting to “shirk its United States tax obligations.”

Little could be further from the truth.

Many have also slammed those that invert as “unpatriotic” or called them “Benedict Arnold” companies, as if corporations exist solely to fill the coffers of the U.S. Treasury, or that their first duty is to politicians and tax collectors instead of shareholders.

In reality, it is the latter to whom any CEO must answer.

They have a fiduciary duty to shareholders, meaning it is a legal responsibility to put their interests first. And contrary to popular rhetoric, shareholders aren’t primarily found on Wall Street, but among the half of all Americans with pension ties or investment portfolios in the stock market.

It’s worth noting that, contrary to the impression given by opportunist politicians, inverted companies still pay U.S. taxes – just only when they’re actually operating in the U.S. market. It is the unreasonable demand, unique to America’s worldwide tax system, that companies also pay up to the excessive 39 percent U.S. corporate rate even for products entirely made and sold overseas which has forced their hands on inversions.

Under the current system, U.S. companies are put at a huge disadvantage compared to foreign competitors. A French-owned company with an affiliate selling in Ireland, for instance, would only be subject to Ireland’s low 12.5 percent because they use a territorial system that taxes only within their borders, whereas an American-owned company looking to sell the same goods in the same market would not only pay Ireland’s rate, but also the remaining difference up to the much higher U.S. corporate rate. With the U.S. rate so much higher than the OECD average of 25 percent, that creates a serious impediment.

It’s fair to point out that after various deductions are made the total corporate tax bill will come in below the statutory rate. However, business decisions are made on a marginal basis – meaning the tax on the next dollar earned is what determines whether or not an activity occurs. According to the

Tax Foundation, the U.S. has not only the highest statutory rate among developed nations, but also the highest marginal effective rate.

The overseas tax handicap for American companies doesn't only hurt shareholders, but also workers by reducing opportunities for expansion and growth. The system also discourages investment in the U.S. because companies are incentivized to keep profits overseas due to what's known as deferral. Specifically, the U.S. tax is only applied when the money is brought home, which encourages it to be kept abroad where it cannot be put to work growing America's domestic infrastructure and creating jobs.

While the incentives it creates are a problem, simply ending deferral would be even worse than the current system because American companies would then have no release valve for dealing with the economic pressure imposed by an uncompetitive tax code. They would simply invert or find other ways to leave American shores faster than ever before.

Attempting to rig the rules to prevent inversions is also not a viable solution. It's been tried before and has never worked. So long as cross border economic mobility is an option – a given in the globalized economy – companies will flee from uncompetitive and confiscatory tax regimes. Nor should we wish to stop them even if it were possible, as the threat of capital flight is an important mechanism for keeping politicians from trying to extract too much from the productive sector of the economy.

If U.S. companies don't invert or leave on their own accord, they will simply be bought out by foreign corporations. The tax code makes assets currently owned by American companies more valuable to foreign conglomerates who face lower tax burdens, which is why foreign takeovers last year doubled in terms of dollar value. With these takeovers come a greater likelihood of research and development or jobs moving overseas.

Ironically, even the government is harmed by the current burdensome tax code by driving productivity and investment overseas. In contrast, Canada has both a lower corporate tax rate – having reduced it from 43 percent in 2000 to 26 percent today – and collects more corporate revenue as a share of GDP than the U.S.

Rather than publicly shaming companies for making responsible economic decisions, politicians bemoaning inversions need to look in the mirror. It has been 30 years since the last major corporate tax overall. In that time the rest of the world has left us behind by reforming their own systems and reducing corporate tax burdens. It's time for the U.S. to be a leader again by shedding the worldwide tax system and lowering corporate rates to help unleash innovation and growth, while keeping American companies at home.

Statement of

Brian Garst
Director of Policy and Communication
Center for Freedom and Prosperity

House Committee on Ways & Means
Hearing on the Global Tax Environment in 2016 and Implications for International Tax Reform

February 24, 2016

Chairman Brady, Ranking Member Levin, and Members of the Committee on Ways and Means, thank you for looking into these important issues.

My name is Brian Garst, and I am the Director of Policy and Communication for the Center for Freedom & Prosperity (CF&P). The primary mission of the Center for Freedom & Prosperity is to defend tax competition as an important principle that helps ensure a prosperous global economy.

The need for U.S. corporate tax reform is by now well established. Yet as members of Congress turn their attention toward building a more competitive and pro-growth tax code, international organizations are pushing in the other direction.

The OECD's work on Base Erosion and Profit Shifting is merely the organization's latest assault on U.S. interests. The failure of the U.S. to lead on the international stage has resulted in the interests of tax collectors being placed above those of taxpayers and economic growth.

To explain why BEPS poses a greater threat to U.S. interests than even many of its opponents realize, I have included an abridged version of my paper, “Making Sense of BEPS: The Latest OECD Assault on Tax Competition,” as well as a related coalition letter from representatives of 22 free-market and taxpayer protection organizations.

BEPS Has Tax Competition in the Crosshairs

Brian Garst, Center for Freedom and Prosperity
Originally published October 2015 by *Offshore Investment*

The OECD's work on Base Erosion and Profit shifting is completing after what can only be described as an extremely rushed process by global policy standards. In an effort to understand the broader implications of the project and what it means for the future of international taxation, I authored a study published June 2015 by the Center for Freedom and Prosperity titled, "Making Sense of BEPS: The Latest OECD Assault on Tax Competition."[1] The following is an abridged version of the paper:

Introduction

Under direction of the G20, the Organization for Economic Cooperation and Development (OECD) began two years ago a major initiative on "base erosion and profit shifting" (BEPS). The project has garnered little interest from U.S. policymakers to date, yet its ever expanding scope and profound implications for the global economy should demand their attention.

In February 2013 the OECD released a report titled, "Addressing Base Erosion and Profit Shifting" (BEPS Report), declaring that, "Base erosion constitutes a serious risk to tax revenues, tax sovereignty and tax fairness for OECD member countries and non-members alike." The OECD followed up with a plan in July 2013, "Action Plan on Base Erosion and Profit Shifting" (Action Plan), that identified 15 specific areas to address.

Through the BEPS project, the OECD is continuing its war against tax competition. Its proposals would enable endless global fishing expeditions and provide cover for governments to choke the economy with new taxes.

The Threat to the Economy

The OECD and other supporters of the BEPS initiative argue that there are economic benefits to preventing legal tax avoidance techniques. Namely, they contend that activity undertaken in response to tax policy represents a market distortion. In the narrow sense this is accurate, but as a justification for the OECD's current activities it falls short.

Typically ignored in the BEPS discussion are the broader implications of proposed reforms on the political economy. If all differences in tax policy were successfully minimized, to some extent it would indeed reduce profit-shifting aimed at suppressing tax burdens. So too would reducing taxes to zero, but policymakers have a variety of objectives to weigh and ought not elevate ending profit-shifting above all other national interests.

BEPS would lead to an overall higher tax environment as politicians freed from the pressures of global tax competition inevitably raise rates to levels last seen in the early 1980s, when reforms by Reagan and Thatcher sparked a global reduction in corporate tax rates that has continued to this day. Through tax competition, the average corporate tax rate of OECD nations declined from almost 50% in 1981 to 25% in 2015.

Taxes themselves distort the market by shifting resources away from market driven activities and toward politically driven activities, and higher rates, all else being equal, increase the effect of the distortion. Poorly designed tax systems – the global norm – introduce yet more distortions through the common practice of double taxing capital, which is of particular importance when discussing BEPS given that corporate taxes are often identified as the most destructive form of capital taxation, as even OECD affiliated economists have acknowledged.

Governments necessarily need taxes to fund essential functions, but ideally should seek to minimize the economic footprint of taxation as much as possible. Political incentives, however, often work in opposition of this goal. Politicians face pressure to demonstrate to constituents that they are performing and to please the interests that support their campaigns, and that in turn encourages taxes to rise above and beyond the level of optimum growth, or where new spending no longer provides net economic benefits.

Tax competition thus provides one of the main sources of push-back against the drive to spend and tax.

Tax collectors and finance ministers have inordinate say in the activities of the OECD, so it's expected that the BEPS initiative would represent their views above all else. The Action Plan thus considers the benefits of tax competition to be the real problem, explaining that “there is a reduction of the overall tax paid by all parties involved as a whole.” The prospect of there being less money to be spent by politicians is perceived as a problem to be solved, rather than as a positive for the global economy.

The Threat to Privacy

Several BEPS action items raise serious privacy concerns. Proposed recommendations for transfer-pricing documentation and country-by-country reporting, for instance, feature broad reporting requirements that go far beyond what is required for purposes of immediate tax assessment.

Guidance for Action 13 recommends a three-tiered approach to transfer-pricing documents consisting of a master file, a local file, and a country-by-country (CbC) reports. Information contained in the local and master files are particularly vulnerable, since it would take a breach in only a single jurisdiction for it to be exposed. The OECD makes assurances for the confidentiality of these reports, but they are empty promises. Such government assurances of privacy protection are contradicted by experience and the long history of leaks of taxpayer information. In the United States alone tax data has frequently been exposed thanks to inadequate safeguards, or even released by officials to attack political opponents.

Even without malicious intent, governments are ill equipped to protect sensitive information from outside access. According to the U.S. Treasury Inspector General for Tax Administration, 1.6 million American taxpayers were victimized by identity theft in the first half of 2014, up from just 271,000 in 2010. Chinese hackers were blamed for a breach that exposed the data of four million current and former federal employees, and the massive new collection effort and reporting system being established to enforce the Foreign Account Tax Compliance Act has also been faulted for its insufficient privacy safeguards.

As poor as the United States has proven at protecting privacy, there are likely to be nations even more vulnerable. Through the master file and other reporting mechanisms, BEPS will demand of corporations propriety information and other sensitive data that they have every right to keep private and out of the hands of competitors. When it takes a breach of only a single national government to expose this information, there will no longer be such expectation of privacy.

Is BEPS a Serious Problem?

The OECD's website describes BEPS as “tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid." The BEPS Report further claims that, "it may be difficult for any single country, acting alone, to fully address the issue." Or as the website more succinctly describes, BEPS "is a global problem which requires global solutions."

No significant evidence for these assertions is provided, however. The OECD's BEPS Report itself undercuts the argument that there is a pressing need for a global response when it acknowledges that "revenues from corporate income taxes as a share of GDP have increased over time."

Academic research on the impact of BEPS is far less certain than the rhetoric of the G20 and the OECD. The strongest analysis yet to date comes from Dhammika Dharmapala, whose survey of the literature reports that recent studies tend to find lower levels of shifting than earlier works. It also challenged arguments that "point to the fraction of the income of MNCs that is reported in tax havens or to various similar measures as self-evidently demonstrating ipso facto the existence and large magnitude of BEPS." Simply identifying money in other jurisdictions, even those with low tax rates, is not evidence of a BEPS problem. It should be expected to see more money being earned where tax policy is less hostile.

Part of the reason there exists little evidence of a significant global BEPS problem is that domestic policy solutions are already available to address legitimate areas of concern when they arise. More importantly, the best solution available for preventing base erosion is the adoption of a competitive tax code. Pro-growth tax policy that eschews double and worldwide taxation not only won't cause capital flight, but will attract investment instead.

Broader Aims of the OECD

To fully understand the significance of the BEPS effort, it's necessary to place the current agenda within the broader context of the OECD's work in recent decades. In 1998 the OECD declared war on tax competition with a report entitled, "Harmful Tax Competition: An Emerging Global Issue." Its authors worried that, among other things, tax competition "may hamper the application of progressive tax rates and the achievement of redistributive goals."

The organization was eventually forced by political opposition to back away from explicit condemnations of all tax competition, but has not abandoned its views. Rather, it has adopted new tactics toward the same end. To make this point clear, the Action Plan favorably references *Harmful Tax Competition* as justification for its recommendations. It also repeats a popular but baseless theory among left-wing academics and politicians about tax competition – that it promotes a 'race to the bottom.'

The 'race to the bottom' theory has claimed for decades that tax competition would force zero rates on mobile capital. It hasn't happened. One review of common such claims finds: "there can be little doubt that history has proven wrong the prediction of a complete erosion of capital tax revenue. Comparative data on corporate and capital tax rates demonstrate that governments in all economies continue to tax mobile sources of capital, effective capital tax rates have not changed much compared with the mid-1980s, when tax competition was triggered by the 1986 US tax act, and tax systems are as varied as countries and political systems themselves, with no visible sign of converging."

Nevertheless, the BEPS report notes: "In 1998, the OECD issued a report on harmful tax practices in part based on the recognition that a 'race to the bottom' would ultimately drive applicable tax rates on certain mobile sources of income to zero for all countries, whether or not this was the tax policy a country wished to pursue." Reality, essentially, is an unwarranted intrusion on the desire of policymakers to act without consequence. The BEPS report goes on: "It was felt that collectively agreeing on a set of common rules may in fact help countries to make their sovereign tax policy choices." Unless, that is, their sovereign choice involves something other than raising taxes.

Nations that opt for little to no taxes on capital are a problem for this quixotic theory of sovereignty – where the rest of the world must be brought to heel in order to ensure that politicians ought not have to consider the economic consequences of their policies – hence why the primary indicator for determining whether a nation is to be identified as "potentially harmful" is that it has "no or low effective tax rates."

Other factors are said to be considered, but without clear indication of how they are to be weighted any calculation will be arbitrary and open to excessive emphasis on the "gateway criterion" that is a low tax rate. When a low-tax scourge is identified, the OECD benevolently provides that, "the relevant country will be given the opportunity to abolish the regime or remove the features that create the harmful effect." To make perfectly clear that this is the sort of offer a nation cannot refuse, they warn: "Where this is not done, other countries may then decide to implement defensive measures to counter the effects of the harmful regime, while at the same time continuing to encourage the country applying the regime to modify or remove it."

The OECD's previous aggressions against low-tax jurisdictions in pursuit of its quest to abolish tax competition make clear just what "defensive measures" it has in mind, and how its members will go about trying to "encourage" compliance. In the years that followed release of *Harmful Tax Competition*, the OECD used threats of blacklists, peer pressure, and intimidation to cajole low-tax jurisdictions into adopting various policies presented under the auspices of increasing tax transparency and combating evasion. In practice the changes were intended to undermine the attractiveness of low-tax jurisdictions and protect high-tax nations from base erosion due to capital flight.

Of particular relevance for understanding the BEPS initiative is the pattern demonstrated by the OECD during the course of this campaign. After each recommendation was widely adopted – typically under duress in the case of low-tax jurisdictions – the OECD immediately pushed a new requirement that was more radical and invasive than the last.

The fact that the OECD is always ready with a new policy after one is implemented suggests either that the organization's goal is not merely what is stated, or that it is horribly ineffective. In either case it should serve as a blow to its credibility and a reason to question its work on BEPS.

Conclusion

Were the OECD merely a research institution, its work could be dismissed simply as a bad idea that no nation need adopt. Unfortunately, Europe's dominant welfare states use the OECD's work as a benchmark when coercing other nations through use of political and economic leverage. For the low-tax jurisdictions, and now multinational businesses, caught in the OECD's crosshairs, the ride truly never ends. The BEPS project is a continuation of the OECD's well-documented effort to eliminate tax competition, and will likely follow the same pattern of consistently moving goalposts.

The BEPS project began at the behest of a tiny few, without open and public debate regarding the assumptions motivating the effort, its goals, or the most appropriate methods to achieve them. There is a lack of accountability, reflected in the activities of the BEPS initiative, that can only be rectified through real public debate and more direct political oversight.

END NOTES:

1. The full version is available at www.freedomandprosperity.org/2015/publications/making-sense-of-beps.

Coalition for Tax Competition

July 14, 2015

Dear Senators and Representatives:

The Organization for Economic Cooperation and Development (OECD) is rapidly working to rewrite global tax rules in the name of combating base erosion and profit shifting (BEPS). We the undersigned organizations are deeply concerned that this process lacks oversight and will result in onerous new reporting requirements and higher taxes on American businesses, and are urging Congress to speak up for U.S. interests by adding its voice to the process.

The OECD has a history of supporting higher tax burdens and larger government, and the BEPS project represents just the latest salvo in a long-running campaign by global bureaucrats to undermine tax competition and its restraining force on political greed.

Because the OECD is populated by tax collectors and finance ministers, new rules being drafted through the BEPS initiative are necessarily going to be skewed in their favor. Businesses are given only a token voice, while other interests are not considered at all. Consumers, employees, and everyone that benefits from global economic growth are not able to make their preferences known.

The inevitable prioritizing of tax collection over every other political or economic interest ensures that the result of the BEPS project will be economic pain. And based on the OECD's own acknowledgement that corporate tax revenues have not declined in recent years, that pain will provide little to no real gain to national treasuries.

BEPS recommendations already released further show a troubling trend toward excessive and unnecessary demands on taxpayers to supply data not typically relevant to the collection of taxes. This includes proprietary information that is not the business of any government, and for which adequate privacy safeguards are not and likely cannot be provided.

The Treasury Department should not be the only voice representing U.S. interests during this critical process. We urge members of Congress to get involved before it is too late, and to protect American interests by ensuring that the voices of tax collectors are not allowed to speak for everyone.

Sincerely,

Andrew F. Quinlan, President
Center for Freedom & Prosperity

Grover Norquist, President
Americans for Tax Reform

Pete Sepp, President
National Taxpayers Union

Michael A. Needham, CEO
Heritage Action for America

Tom Schatz, President

Council for Citizens Against Government Waste

Seton Motley, President
Less Government

Wayne Brough, Chief Economist and Vice President of Research
FreedomWorks

J. Bradley Jansen, Director
Center for Financial Privacy and Human Rights

Phil Kerpen, President
American Commitment

David Williams, President
Taxpayers Protection Alliance

Bob Bauman, Chairman
Sovereign Society Freedom Alliance

Karen Kerrigan, President
Small Business & Entrepreneurship Council

Sabrina Schaeffer, Executive Director
Independent Women’s Forum

James L. Martin, Chairman
60 Plus Association

Heather Higgins, President
Independent Women's Voice

George Landrith, President
Frontiers of Freedom

Lew Uhler, President
National Tax Limitation Committee

Terrence Scanlon, President
Capital Research Center

Tom Giovanetti, President
Institute for Policy Innovation

Andrew Langer, President
Institute for Liberty

Eli Lehrer, President
R Street Institute

Chuck Muth, President
Citizen Outreach

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

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.[1] In total, more than $2 trillion in profits are booked offshore.[2] 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.[3]

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.[4]
- **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.[5]
- **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.[6]
- **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.[7]

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[1] 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).
[2] 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.
[3] *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.
[4] 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/1CHFl3l.
[5] *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.
[6] Id.
[7] 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.[8]

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.[9] 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.[10] 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[11] and 2015[12] 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

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[8] Scott, Jeremy, "Check the Box for Tax Avoidance", *Forbes,* (Feb. 19, 2014). http://onforb.es/1yj9hHY.
[9] *CNN Money,* "America's Debt: Wall Street's $11 Billion Windfall In the Fiscal Cliff Deal", (Jan. 22, 2013), http://cnnmon.ie/1kVYRRN.
[10] *Bloomberg News*, "Tracking Tax Runaways", (Updated on Apr. 13, 2015), http://bloom.bg/1ohNlYz.
[11] *U.S. Department of the Treasury*, "Fact Sheet*: Actions to Rein In Corporate Tax Inversions*", (Sept. 22, 2014), http://1.usa.gov/1oeeM02.
[12] *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.[13] 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.[14]

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

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[13] *Center for American Progress*, "Offshore Corporate Profits: The Only Thing 'Trapped' Is Tax Revenue", (Jan. 9, 2014), http://ampr.gs/1IRrEUt.

[14] 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.[15]

Another shortsighted change would be a "repatriation holiday" that has been proven to be a revenue loser in the long run.[16] 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."[17] 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.[18]

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.

Thank you for considering our views.

Sincerely,

American Sustainable Business Council

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[15] *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
[16] 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.
[17] 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/1cjhqlJ.
[18] Id.

Americans for Tax Fairness

Citizens for Tax Justice

FACT Coalition

Fair Share

Global Financial Integrity

Jubilee USA Network

Main Street Alliance

New Rules for Global Finance

Oxfam America

Public Citizen

Tax Justice Network USA

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Financial Executives International's Committee on Private Company Policy
Statement for the Record
House Ways & Means Committee
Hearing on International Tax Reform
February 24, 2016

Financial Executives International (FEI) appreciates the opportunity to submit a statement for the official hearing record on international tax reform. FEI represents more than 10,000 Chief Financial Officers, Vice Presidents of Finance, Corporate Treasurers, Controllers and other senior financial executives from 74 chapters across the United States. Nearly 60% of our members work for private companies, and FEI's Committee on Private Company Policy (CPC-P) focuses on these members' policy concerns.

Pass-Through Entities

In 2011, pass-through entities, including sole proprietorships, partnerships, LLCs, and S-corporations, accounted for 94% of all businesses, 64% of total net business income, 55% of all private sector employment, and paid more than $1.6 trillion in wages and salaries[i]. In 2010, private companies generated 53% of fixed non-residential investment, and are, on average, 4 times more responsive to investment opportunities than public companies[ii]. In 2012, pass-through entities contributed nearly $840 billion in business AGI to individual returns[iii].

Territorial Tax System Access

Increasingly, large and medium-sized pass-throughs are net exporters, i.e. they have real business activity offshore. International tax reform legislation should create a territorial system that puts U.S. companies on an even footing with their foreign competition, removes disincentives for capital mobility and earnings repatriation, and brings U.S. rates in line with other developed countries.

Territorial tax proposals should not be limited to C-Corporations. Congress should grant pass-throughs access to any new territorial tax regime if they are willing to pay tolling charges on retained foreign earnings.

Pass-throughs have very complex international structures because they do not get 902 indirect credits even though they have exposure to Subpart F income. Some have CFCs for offshore deferral, but most use a combination of check the box and hybrid entities to manage tax exposure. A territorial system could reduce the need for this complexity.

Under a territorial system, pass-throughs could establish specified accumulated adjustment accounts (AAA) for offshore earnings and the entity could make distributions comprised of proportionate shares of foreign and domestic earnings as disclosed in the K-1.

Private Companies Need Comprehensive Tax Reform

While FEI supports efforts to address international tax issues for U.S. companies, we urge Congress to enact comprehensive tax reform that provides fair treatment of pass-through entities so that they may compete on a level playing field. If tax reform is to have a meaningful impact on business investment, productivity growth and job creation, privately-held businesses cannot be left out of the equation. FEI recommends that any efforts to reform the U.S. Tax Code should include the following:

Tax rate equivalency: Because corporate-only tax reform would put privately-held and family-owned businesses which operate as pass-throughs at a competitive disadvantage, any reform legislation should include provisions that permit the bifurcation of business and other income on an individual's tax return, and the application of a business rate equivalent to the highest corporate rate.

S-Corp gains recognition period: Make permanent the reduced recognition period for built-in gains for S corporations.

Estate Tax: Repeal is the best solution to protect all family-owned businesses from the serious transition challenges posed by estate taxes

<u>For Additional Information please contact:</u>

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[i] Kyle Pomerleau, "An Overview of Pass-through Businesses in the United States", Tax Foundation, January 2015.
[ii] John Asker et al., "Corporate Investment and Stock Market Listing: A Puzzle?", NBER, October 4, 2014.
[iii] Joseph Rosenberg, "Flow-Through Business Income as a share of AGI", *Tax Facts*, Urban Institute, Sept. 29, 2014.

SUBMISSION TO

COMMITTEE ON WAYS AND MEANS

FEBRUARY 23, 2016

THE FOLLOWING IS ATTRIBUTABLE TO

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February 23, 2016

Chairman Kevin Brady
Committee on Ways and Means
301 Cannon Building
Washington, DC 20515

Sent by email to: waysandmeans.submissions@mail.house.gov

Dear Chairman Brady:

Re: International Corporate Tax Reform – Why a Residence-Based System Is Far Better for our Country Than a Territorial System that Provides a Continuing Preference to Foreign Income

I respectively submit the attached memorandum.

* * * * * *

I would be please to respond to any questions that you might have.

Yours very truly,

Jeffery M. Kadet

MEMORANDUM
CONCERNING
INTERNATIONAL TAX REFORM

Public discussion and what one sees in the press imply that some form of territorial tax system, perhaps with some safeguards to hold back profit shifting, is the only tax reform option to replace our present dysfunctional "deferral" system for taxing U.S. based multinational corporations. Maybe that's because 99% of the few folks who understand what "deferral" and "territorial" really mean work for the multinationals (MNCs) that would benefit from adopting territoriality or for the law, accounting and lobbying firms that are well paid to service the MNCs.

As for the other 1%, those are mostly law school professors without lobbyists. (Full disclosure: The writer provided international tax advice for more than 30 years to MNCs and is now an adjunct faculty member teaching lawyers how to do likewise within a graduate Tax LLM program within a law school.)

Some of the 1% strongly believe that a residence-based system for active business income is far far superior to the territorial system, even with safeguards built in.

There are various terms that are used for residence-based systems. They include worldwide consolidation and worldwide full-inclusion. In short, the idea is to tax any U.S. headquartered group on all of its income currently at the home country tax rate, no matter in which country or in which subsidiary that income is earned. There are a few different approaches regarding how such a system could be implemented (e.g. through subpart F income inclusions or through a consolidation computation), but that is not the purpose of this letter. Rather, the purpose of this letter is to set out in brief terms why a residence-based system is vastly superior to a territorial system.[1]

The chart on the next page summarizes the content of this letter.

[1] This memorandum is intentionally short and concise. For more detailed discussion, please see "U.S. Tax Reform: Full-Inclusion Over Territorial System Compelling", 139 Tax Notes 295 (April 15, 2013), available at SSRN: http://ssrn.com/abstract=2275488.

Chart Contrasting Territorial and Residence-Based Systems

Policy Issue	Territorial System	Residence-Based System	System Best Accomplishing Policy Objective
Competitiveness: U.S. MNCs vs Foreign MNCs	A more level playing field but differences will persist due to varying CFC rules among countries	Competitive disadvantage for a few U.S. MNCs versus Foreign MNCs	Territorial System
Competitiveness: U.S. MNCs vs Pure U.S. Domestic Corporations	Advantages of U.S. MNCs over domestic corps increase further	More level playing field	Residence-Based System
Neutrality (including the export of jobs)	Strong encouragement to move jobs, activities, and ownership of IP from the U.S. to overseas	Neutrality achieved	Residence-Based System
Simplification	CFC rules and subjective areas like transfer pricing critical due to exemption of foreign earnings	Real simplification through elimination of some problematic subjective areas (e.g. no subpart F and TP less important)	Residence-Based System
Broadening the Tax Base (ability to generate tax revenues)	Narrowing the tax base by exempting foreign earnings from any federal tax	True broadening of the tax base by making currently taxable all foreign earnings whether repatriated or not	Residence-Based System This base broadening can pay for corporate rate reduction
Encouragement of "Game Playing" to Shift Profits from U.S. to Low-Tax Countries	Even stronger encouragement than presently exists under our deferral system	Eliminated or significantly curtailed	Residence-Based System
Lock-Out Effect	Not fully solved if 95% Dividend-Received Deduction Mechanism Used	Totally Solved	Residence-Based System

What will a residence-based system accomplish?

It promotes fair competition—"We need a level playing field with our foreign competitors." This is the rallying cry of the 99% as they argue for not only a lower corporate rate but also a territorial tax system. Yet an even more important competition issue is seldom mentioned. That is the present non-level playing field between U.S. corporations that operate solely domestically within the U.S. and those that operate internationally.

Say two U.S. companies manufacture a widget. One does it in Poughkeepsie while the other does it through a subsidiary in Singapore. The first has its profits taxed at 35% plus NY State tax, while the second is taxed by Singapore at a much lower rate…maybe even zero. This unfairness will be much worse under a territorial system. A residence-based system would eliminate it. And frankly, *this domestic-international fairness issue is the tax policy issue that is more important to make sure we get right.*

But what about the competition issue with foreign-based MNCs? Without meaning to be unkind, the continued whining of MNCs that competition justifies their paying little or no tax is simply a *red herring*. The over $2 trillion of accumulated overseas profits is powerful proof of this. And after the U.S. corporate tax rate is reduced to something within G20 norms, the competition issue will be completely put to rest.

It broadens the tax base, allowing for a reduced rate—This is a "no brainer". A territorial tax system eliminates billions from the tax base and puts more pressure on the remaining U.S. taxpayers. Sure, take away more depreciation and other benefits from domestic U.S. taxpayers to give tax-free treatment to MNCs that conduct substantial activities outside the U.S.

A residence-based system broadens the base since foreign income now going untaxed becomes currently taxable. A broadened tax base supports the lower corporate tax rate that both political parties say they want. And, as noted above, this lower rate would make clear that there is no disadvantage faced by our MNCs from their foreign competitors.

It reduces the incentive to export jobs—Remember those widgets manufactured in Poughkeepsie? The tax incentive to move those jobs to Singapore under our current deferral system would become even stronger under a territorial system. Under a residence-based system, this incentive to move operations and jobs overseas virtually disappears.

It is neutral as to physical location and legal ownership—A tax system should not affect business decisions regarding the physical location of assets, personnel, and operations. Business factors such as being close to raw materials and/or customers, labor and transportation costs, etc. should govern such decisions. The same can be said for the legal ownership of business operations and assets, importantly including high value intangibles (intellectual property).

The deferral system we have now strongly encourages companies to transfer actual or economic ownership of valuable intangible property created in the U.S. to tax havens. It also encourages supply chain and other structures that allow MNCs to move the bulk of their operating profits to foreign subsidiaries in zero or low tax locations that assume business risk and hold rights to the MNC's intellectual property. "Transfer pricing" concepts and rules are aggressively used to maximize profits in these tax haven locations and minimize profits in the countries where actual R&D, manufacturing, and sales activities take place.

A territorial system will simply increase the motivation for the game playing that creates these convoluted legal and tax structures. A residence-based system, on the other hand, really approaches true neutrality. Under most circumstances, it should eliminate U.S. tax as a factor and allow business decisions to be made solely on the basis of relevant business factors.

It can promote simplification—Simplification is a mixed bag. Depending on how a residence-based system is implemented, it could eliminate some very troublesome areas of the tax law (e.g. fewer transfer pricing issues and elimination of subpart F). A territorial system, for the most part, will leave in place the current complications and likely make them much worse.

It completely solves the "trapped cash" problem—Under the deferral system, returning foreign earnings to the US via dividends triggers the up to 35% U.S. tax (and sometimes foreign withholding taxes as well). As is well known, many MNCs have stockpiled billions of such low or zero-taxed foreign earnings outside the U.S. and often maintain that those earnings are permanently invested outside the U.S. to provide higher earnings-per-share, higher stock prices, and higher equity-based compensation for CEOs and other executives.

A territorial system *"should"* eliminate the trapped cash issue. However, a territorial system such as those presented in prior years[2] unbelievably fails to do this. *The mechanism chosen (a 95% dividend-received deduction) would continue to cause actual dividends to trigger tax to the extent of the 5% taxable portion.* This may seem small. It will, though, impede dividend payments and continue the trapped cash problem. This issue is fixable, but whether it will be changed in future legislation is unknown.[3]

A residence-based system totally eliminates the trapped cash problem.

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[2] E.g. the October 2011 Discussion Draft from House Ways and Means Committee Chairman Dave Camp (R-MI) and the February 2012 proposal from Senator Mike Enzi (R-Wyo).

[3] See suggested approach to fix this issue in "Territorial W&M Discussion Draft: Change Required", 134 Tax Notes 461 (January 23, 2012), available at SSRN: http://ssrn.com/abstract=1997515.

Conclusion

Territorial system vs residence-based system…it is not a toss-up. Without doubt, for the benefit of our country and from virtually all tax policy perspectives, a residence-based system is vastly superior.

The 99% downplay the above concerns (export of jobs, etc.) and explain that strong anti-avoidance rules will of course accompany any territorial system. Such rules, it is argued, would prevent many of these terrible results.

Yes, truly strong anti-avoidance rules could prevent some of the worst excesses. But, frankly, it is naïve to think that such strong rules would be put in place. First, the rules under consideration would be understood by few and attacked viciously by corporate lobbyists. So, whatever gets enacted will be very weak. Second, even if something halfway strong were to be enacted, our high-powered tax consulting community has a century-long tradition of working around anti-avoidance rules. So, I have little faith that any strong or effective anti-avoidance rules will accompany a territorial system. And this will mean continued and accelerated erosion of the U.S. tax base and export of jobs.

SUBMISSION TO

COMMITTEE ON WAYS AND MEANS

FEBRUARY 25, 2016

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February 25, 2016

Chairman Kevin Brady
Committee on Ways and Means
301 Cannon Building
Washington, DC 20515

Sent by email to: waysandmeans.submissions@mail.house.gov

Dear Chairman Brady:

Re: International Corporate Tax Reform – Taxation of Accumulated Deferred Foreign Income

I respectively submit the attached memorandum.

* * * * * *

I would be please to respond to any questions that you might have.

Yours very truly,

Jeffery M. Kadet

MEMORANDUM
CONCERNING
INTERNATIONAL TAX REFORM

<u>Taxation of Accumulated Deferred</u>
<u>Foreign Income as of the Transition Date</u>

The Committee's planned international tax reform draft (Draft) will undoubtedly suggest some transition from the present deferral system to some other system. As an integral part of that transition, it is expected as well that the Draft will impose taxation on all "accumulated deferred foreign income" existing as of the transition date.

Tax Rate to Apply to Accumulated Deferred Foreign Income upon Transition

At one end of the spectrum, some such as Citizens for Tax Justice say all such earnings should be taxed at the full 35%.[1]

At the other end of the spectrum, a number of the prior transition proposals would apply various rates far lower than 35%, some of them being in the single digits with Representative Camp's Tax Reform Act of 2014 bottoming out at 3.5% on earnings reinvested into non-liquid assets.

Under the CTJ approach, we would, so to speak, clobber every multinational (MNC) that has actually conducted real and legitimate activities in foreign countries in accordance with a consistent Congressional intent that goes back almost forever.

Under the prior transition proposals, we would grant an unbelievable windfall to every MNC that has engaged in aggressive profit shifting in which they moved 35% profits out of the U.S. and into tax havens. They are waiting for this windfall with their tongues hanging out.

The Committee's Draft clearly needs an administratively workable mechanism that neither clobbers the former nor rewards the latter.

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[1] "…Instead of rewarding corporations for dodging U.S. taxes, lawmakers should end the system of deferral that encourages them to do so, while taxing their offshore profits at the full 35 percent rate (while still allowing for a foreign tax credit)." See "$2.1 Trillion in Corporate Profits Held Offshore: A Comparison of International Tax Proposals", Citizens for Tax Justice (July 14, 2015), available at: http://ctj.org/pdf/repatriation0715.pdf

Two Approaches for an Administratively Workable Mechanism[2]

1. "Camp" Approach. In his 2014 discussion draft, Camp broke CFC earnings into two portions by imposing a higher 8.75% rate on earnings being held in cash and cash-equivalent forms. The remaining earnings would be subject to the lower 3.5% rate. This approach is administratively easy to apply, objective, and definitely a workable solution. However, it focuses on the form in which CFC earnings are held on the transition date and not on any measure of aggressive profit shifting. But having said this, the existence of earnings that have been subjected to relatively little or no foreign tax and that are held in cash or cash-equivalent form is pretty good evidence of tax avoidance planning. So, it will generally be a very fair and administratively workable approach.

With this in mind, *the first suggested approach is to use Camp's solution with all CFC previously untaxed foreign income — on transition to a new tax system — being subject to 35% but with an FTC offset to the extent of cash and cash equivalents. All remaining previously untaxed foreign income would be taxed on transition at whatever favorable less-than-35% rate Congress chooses.*

2. Tax-Structured Vehicle Approach. *This approach defines ''tax-structured vehicle.'' For any such vehicle, its previously untaxed foreign income — on transition to a new tax system — would be subject to 35% with an FTC offset. The previously untaxed foreign income within all other CFCs would be taxed on transition at whatever favorable less-than-35% rate Congress chooses.*

As a first step to identifying tax-structured vehicles, Treasury would publish a listing of countries that can be used as the place of incorporation of CFCs that earn low- or zero-taxed foreign income through profit-shifting arrangements. Treasury would also provide examples of structures meant to achieve low- or zero-taxes.

A presumption of tax-structured vehicle status would be applied to each CFC established in the listed countries. A U.S. shareholder MNC involved with the vehicle could attempt to rebut this presumption by establishing to the satisfaction of the Treasury secretary or his delegate, based on a facts and circumstances review, that the establishment and operation of the specific CFC involved no tax-motivated structuring. If this presumption is not successfully rebutted, any previously untaxed foreign income within the CFC would be subject to the 35% tax, with an FTC offset.

If the Committee chooses this "tax-structured vehicle" approach over the "Camp" approach, it is strongly suggested that applicable committee reports include a clear statement of the principles behind the definition of tax-structured vehicle and numerous examples.[3] Clear legislative instructions would not only provide necessary guidance to

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[2] See more detail in "Fair Approaches for Taxing Previously Untaxed Foreign Income", 146 Tax Notes 1385 (March 16, 2015), available at: http://ssrn.com/abstract=2587103

[3] See a partial listing of such structures in "BEPS: A Primer on Where It Came From and Where It's Going", 150 Tax Notes 793 (Feb. 15, 2016).

Treasury and the IRS, but also should importantly limit taxpayer presumption-rebuttal efforts to situations that truly deserve consideration. Further, the rules should be clear that the burden of proof is on the taxpayer to support any effort at rebuttal of the presumption.

Application of Interest

The various proposals and discussion drafts released over the past five years have all provided for installment payments but have been inconsistent regarding interest. Several have been silent concerning any interest charge.

This section's discussion assumes that the Committee will include in its Draft the above suggestion for application of a 35% tax rate to all previously untaxed foreign income that results from profit shifting, as determined under the "Camp" approach, the "tax-structured vehicle" approach, or any other approach that the Committee adopts.

For any previously untaxed foreign income that will qualify for a favorable less-than-35% rate, any interest charge is economically only an adjustment of the favorable tax rate. (This, of course, ignores any effect if the interest were tax deductible; in this context, if the Committee requires an interest charge, it should specifically be nondeductible.) It also seems likely that most taxpayers would choose to pay in installments to defer those tax payments. Given that earlier payment would be beneficial to our country's finances, perhaps discounts for early payment could be considered if there is no separate interest charge.

The previously untaxed foreign income that would be subjected to the 35% tax rate has resulted from aggressive profit shifting. Therefore, the applicable taxpayer has already had the real economic benefit of deferral for years. There is no reason for extending the deferral period even more by allowing an interest-free installment payment scheme. Accordingly, the Committee's Draft should include an interest charge to the extent of any installment payments.

Statement for the record of Matthew Lykken, international tax attorney
Before the House Committee on Ways and Means
hearing on international tax reform

Thank you for the opportunity to provide input on this subject. Having practiced corporate international tax for some 27 years I am well aware of the dysfunctions in the current tax system that mathematically impel U.S. corporations to locate high-value operations abroad and to resist repatriating cash, and which make our corporations easy targets for foreign takeover. Based on my experience, tweaking the U.S. international tax system, switching to territorial taxation, and implementing a patent box will not solve these problems. However, there is a solution that would be entirely effective, simple, revenue-positive, and would shift the balance of the American economy back in favor of productive effort and away from destabilizing financial speculation. That solution is the Shared Economic Growth Act. The draft text of this act follows, together with an explanation of the provisions. I hope that the Committee will give consideration to this sweeping solution to the games that have plagued tax writers and enforcers for decades.

A Bill

To amend the Internal Revenue Code of 1986 to remove incentives to shift employment abroad, and to remove hidden taxes on retirement savings and provide equitable taxation of earnings.

SECTION 1: SHORT TITLE

This Act may be cited as the "Shared Economic Growth Act of 2016".

SECTION 2: PROVIDING INCENTIVES TO LOCATE HIGH-VALUE JOBS IN AMERICA AND TO INJECT CASH INTO THE AMERICAN ECONOMY

(a) Part VIII of Subchapter B of Chapter 1 of Subtitle A of the Internal Revenue Code of 1986 is amended by adding the following new section:

"251. (a) General Rule. In the case of a corporation, there shall be allowed as a deduction an amount equal to the amount paid as dividends in a taxable year of the corporation beginning on or after January 1, 2017.
(b) Limitation of benefit to tax otherwise payable.

1) The deduction under this section may not exceed the corporation's taxable income (as computed before the deduction allowed under this section) for the taxable year in which the dividend is paid, decreased by an amount equal to 2.85 times any tax credits allowed to the corporation in the taxable year.
2) Where the deduction otherwise allowable under this section in a taxable year exceeds the limitation provided in paragraph 1 of this subsection, the excess may be carried back and taken as a deduction in the two prior taxable years or forward to each of the 20 taxable years following the year in which the dividends were paid. However, the total deduction under this section for dividends paid during the taxable year plus carryovers from other taxable years may not exceed the limit provided in paragraph 1 of this subsection. Rules equivalent to those provided in paragraphs 2 and 3 of subsection 172(b) of this subchapter shall govern the application of such carryover deductions.
3) No amount carried back under paragraph 2 of this subsection may be claimed as a deduction in any taxable year beginning on or before December 31, 2016.

(c) Consolidated groups. In the case of a group electing to file a consolidated return under section 1501 of this Subtitle, the deduction provided under this section may be claimed only with respect to dividends paid by the parent corporation of such consolidated group."

(b) Subparagraph (b)(1)(A) of Section 243 of Part VIII of Subchapter B of Chapter 1 of Subtitle A of the Internal Revenue Code of 1986 is amended to read as follows:

"(A) if the payor of such dividend is not entitled to receive a dividends paid deduction for any amount of such dividend under section 251 of this Part, and if at the close of the day on which such dividend is received, such corporation is a member of the same affiliated group as the corporation distributing such dividend, and".

(c) Section 244 of Part VIII of Subchapter B of Chapter 1 of Subtitle A of the Internal Revenue Code of 1986 is repealed for tax years beginning after December 31, 2016.

(d) Subparagraph (a)(3)(A) of Section 245 of Part VIII of Subchapter B of Chapter 1 of Subtitle A of the Internal Revenue Code of 1986 is amended to read as follows:

"(A) the post-1986 undistributed U.S. earnings, excluding any amount for which the distributing corporation or any corporation that paid dividends, directly or indirectly, to the distributing corporation was entitled to receive a deduction under section 251 of this Part, bears to".

(e) Subsection 1(h) of Part I of Subchapter A of Chapter 1 of Subtitle A of the Internal Revenue Code of 1986 is repealed for tax years ending after December 31, 2016.

(f) Subsection (a) of Section 901 of Part III of Subchapter N of Chapter 1 of Subtitle A of the Internal Revenue Code of 1986 is amended to read as follows:

"(a) Allowance of credit

If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under sections 902 and 960. However, in the case of a corporation, no credit shall be allowed under this section or under section 902 for foreign taxes paid or accrued, or deemed to have been paid or accrued, in tax years beginning after December 31, 2016. Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year. The credit shall not be allowed against any tax treated as a tax not imposed by this chapter under section 26(b)."

This amendment shall override any contrary provision in any existing income tax convention.

SECTION 3: PREVENTING WINDFALL BENEFITS FOR FOREIGN INVESTORS

(a) Subchapter A of Chapter 3 of Subtitle A of the Internal Revenue Code of 1986 is amended by adding a new Section 1447 to read:

"1447(a) **General rule**. In the case of dividends paid to any non-resident individual or corporation by a United States corporation that claims a deduction under Section 251 with respect to such dividend, the payor shall deduct and withhold from such dividends the tax shall be equal to 30 percent of the gross amount thereof, in addition to any other tax withheld with respect to such payment under this subchapter. The imposition of this

30 percent withholding tax on dividends shall override any contrary restriction in any income tax convention.

(b) **Alternative additional tax**. In lieu of the withholding tax provided under subsection (a), a payor corporation may instead elect to forego the benefit of the dividends-paid deduction under Section 251 with regard to so much of the dividends as would otherwise be subject to withholding under subsection (a), and instead to withhold from such dividends an amount of tax equal to the top rate of corporate income tax under Section 11 multiplied by the amount of such dividends, and to apply the tax thus withheld as a prepayment of the payor corporation's tax liability. Any tax so withheld under this subsection (b) shall act as an incremental final tax on the relevant shareholder that may not be reduced.

(b) Section 871 of Subchapter N of Chapter 1 of Subtitle A of the Internal Revenue Code of 1986 is amended by redesignating subsection (n) as subsection (o) and adding a new subsection (n) to read:

"(n**) Additional 30 percent tax on deductible dividends paid to nonresident alient individuals**.

(1) **General rule**. In the case of dividends paid to any non-resident alien individual by a United States corporation that claims a deduction under Section 251 with respect to such dividend, there is hereby imposed for each taxable year a tax equal to 30 percent of the gross amount thereof, in addition to any other tax imposed with respect to such payment under this subchapter. The imposition of this 30 percent tax on dividends shall override any contrary restriction in any income tax convention.

(2) **Exception**. In the case of any dividend for which the payor corporation elects the alternative final tax under Section 1447(b), the 30 percent tax under paragraph (1) of this subsection shall not apply.

(3) **Alternative election to pay individual income tax at the highest individual rate**. If the non-resident alien taxpayer elects to treat the dividend income otherwise taxable under paragraph (1) of this subsection as income connected with a United States business, and further agrees to pay tax thereon at the highest rate provided under Section 1, then the 30 percent tax under paragraph (1) of this subsection shall not apply."

(c) Section 881 of Subchapter N of Chapter 1 of Subtitle A of the Internal Revenue Code of 1986 is amended by redesignating subsection (f) as subsection (g) and adding a new subsection (f) to read:

"(f**) Additional 30 percent tax on deductible dividends paid to foreign corporations**.

(1) **General rule**. In the case of dividends paid to any foreign corporation by a United States corporation that claims a deduction under Section 251 with respect to such dividend, there is hereby imposed for each taxable year a tax equal to 30 percent of the gross amount thereof, in addition to any other tax imposed with respect to such payment under this subchapter. The imposition of this 30 percent tax on dividends shall override any contrary restriction in any income tax convention.

(2) **Exception**. In the case of any dividend for which the payor corporation elects the alternative final tax under Section 1447(b), the 30 percent tax under paragraph (1) of this subsection shall not apply.

(3) **Alternative election to pay income tax at the highest icorporate rate**. If the foreign corporate taxpayer elects to treat the dividend income otherwise taxable under paragraph (1) of this subsection as income connected with a

United States business, and further agrees to pay tax thereon at the highest rate provided under Section 11, then the 30 percent tax under paragraph (1) of this subsection shall not apply."

SECTION 4: FAIR FUNDING FOR RETIREMENT SECURITY

(a) Section 1 of Part I of Subchapter A of Chapter 1 of Subtitle A of the Internal Revenue Code of 1986 is amended by adding the following new subsection:

"1(h) (1) (a) Tax imposed. There is hereby imposed a tax of 7.65 percent on so much of the adjusted gross income for the taxable year of that exceeds--

(A) $500,000, in the case of
- (i) every married individual (as defined in section 7703) who makes a single return jointly with his spouse under section 6013;
- (ii) every surviving spouse (as defined in section 2(a)); and
- (iii) every head of a household (as defined in section 2(b)), ;

(B) $250,000, in the case of
- (i) every individual (other than a surviving spouse as defined in section 2(a) or the head of a household as defined in section 2(b)) who is not a married individual (as defined in section 7703); and
- (ii) every married individual (as defined in section 7703) who does not make a single return jointly with his spouse under section 6013;
- (C) $7,500, in the case of every estate and every trust taxable under this subsection.

(b) Credit for hospitalization tax paid. There shall be allowed as a credit against the tax imposed by this subsection so much of the amount of hospitalization tax paid by the individual with respect to his wages under subsection 3101(b) and to his self-employment income under subsection 1401(b) of this Title as exceeds the following amounts:
- A) In the case of individuals described in subparagraph (1)(A) of this subsection, $14,500; and
- B) In the case of individuals described in subparagraph (1)(B) of this subsection, $7,250.

SECTION 5: REINVESTING IN AMERICA

Subsection (k) of Section 168 of Part I of Subchapter A of Chapter 1 of Subtitle A of the Internal Revenue Code of 1986 is amended by adding the following new paragraph:

"168(k)(8) **Expensing of investments made from post-2016 earnings**. In the case of a corporation subject to tax under Section 11, any qualified U.S. property purchased or constructed from the reinvestment of taxable income accrued in taxable years beginning after December 31, 2016, which income was not offset by a dividends-paid deduction under section 251 or by tax credits, the allowance under subsection (k)(1)(A) of this section shall be 100 percent rather than 50 percent. The Secretary shall prescribe regulations providing for the creation and maintenance of eligible reinvestment accounts, such that taxable income not offset by the Section 251 deduction or credits shall be an addition to the account and investments qualifying for the 100 percent allowance shall be a subtraction from the account, and corporate taxpayers may treat otherwise eligible investments as funded by such earnings to the extent of the positive balance in the reinvestment account."

The Shared Economic Growth bill allows a corporate dividends paid deduction, restricted to taxable income otherwise reported decreased by 2.85 times any credits claimed, so that the deduction may only reduce tax to zero. Excess reductions could be carried back 2 years and forward 20, so there would be incentive to pay out earnings with 2 years. Subsection 2(a) of the bill makes this change, with Subsections 2(b), (c) and (d) making certain conforming changes to the existing corporate dividends received deduction provisions.

In 2010 corporations paid tax of $223 billion, so offsets of up to $223 billion would be required for static revenue neutrality. The first and most natural offset is individual tax payable on the dividends paid. In order for the proposal to work, special rates for dividends and for capital gains on equity would need to be eliminated, so that these dividends would be taxed at full 2017 individual rates. Subsection 2(e) repeals these special rates, but does not otherwise upset the incentives provided for certain special categories of capital gains. This would have provided an offset of $74 billion without altering the various special capital gains exemption and rollover provisions. As a practical matter, this offset is only feasible in conjunction with the allowance of a dividends paid deduction, since such a deduction eliminates double taxation on the corporate side and thus eliminates any legitimate argument in favor of the capital gains rate benefits. Subsection 2(f) provides an offset mechanism that is only possible in conjunction with enactment of a dividends paid deduction. Because the deduction would effectively eliminate taxation of corporate income, including foreign income, it would no longer be necessary to allow a corporate credit for foreign taxes paid. A deduction could be permitted instead with the same bottom line effect. However, allowance of a deduction would impel corporations to pay out more dividends in order to eliminate the corporate level tax on the foreign income, which in turn increases the offset at the individual level. With this provision, the individual level offset from full 2011 rate taxation of the dividends needed to reduce corporate tax to zero would be some $54 billion, after factoring out shareholders not subject to tax.

Section 3 provides another offset only feasible in conjunction with a dividends paid deduction. Foreign investors are effectively paying the 35% U.S. corporate level tax on their investment earnings. Congress would not have to let them have the benefit of the dividends paid deduction, since U.S. resident shareholders would have to pay full rate tax on such dividends. So, Section 3 imposes a 30% incremental withholding tax on dividends paid to foreign shareholders. This offset amounts to some $33 billion. The provision provides certain alternative elections that would be unlikely to be used but which would establish that the incremental tax would be appropriate under the principles of America's tax treaties, essentially leaving the foreign shareholders in the same economic position that they are in now and keeping them on a level with U.S. shareholders.

Section 4 provides the final offset, subjecting individual income over $500,000 a year to an Adjusted Gross Income tax equivalent to the individual portion of the FICA taxes that ordinary wage earners pay. At a 7.65% level, with an allowance crediting the Obamacare taxes that were implemented since the first version of this proposal was explained to Congress, this levy would offset the revenue attributable to dividends paid to non-taxable retirement plans, so in effect this levy is requiring high income individuals to pay a supplemental tax similar to FICA taxes that supports non-social security private and state pension savings, thereby taking pressure off of the social security system. This is an optional element of the proposal, but it seems like good and fair policy. This provides an offset of $57 billion. **Moreover, because these retirement savings will ultimately be paid out and taxed, this would increase revenue by at least some $22 billion per year on a static basis as the pension income is paid out (after accounting for Roth IRAs etc.)** This additional revenue will be important as the baby boomers move through retirement and the government is looking for revenues to pay off the deficit in social security funding.

Section 5 provides an optional add-on. Because Shared Economic Growth would make it attractive for corporations to invest in U.S. operations, it would also be desirable to allow them to retain some of their earnings to make such U.S. investments rather than squeezing out too much in dividends, so that we could encourage the most rapid rebuilding of the U.S. economy. Section 5 therefore allows corporations to take a 100% immediate deduction for their investment in qualified U.S. property made from their post-2016 taxable earnings not paid out as dividends. While prior investment expensing initiative were not notably successful in increasing investment, they were in the context of an overall U.S. climate that made investments unattractive. Expensing could be expected to be much more successful at encouraging investment under Shared Economic Growth, and given that it is a relatively short-term timing benefit, the cost to the government would be low (essentially interest on 35% of the investment amount over less than 7 years at the U.S. Treasury borrowing rate). Further, because Shared Economic Growth could be expected to encourage accumulated foreign earnings to be brought home, either producing taxable income that neutralizes this expensing benefit at the corporate level or incurring additional shareholder-level tax when paid out as dividends, there should be more than enough incremental revenue to offset the cost of the timing item.

NATIONAL ASSOCIATION OF
Manufacturers

Leading Innovation. Creating Opportunity. Pursuing Progress.

Statement for the Record by
Dorothy Coleman

For the

Hearing of the House Ways and Means Committee

on “The Global Tax Environment in 2016 and Implications for International Tax Reform”

February 24, 2016

Chairman Brady, Ranking Member Levin and members of the committee, thank you for the opportunity to submit a statement about the Global Tax Environment in 2016 and Implications for International Tax Reform. I appreciate the chance to highlight on behalf of the National Association of Manufacturers (NAM) our concerns about some of the recent developments in Europe that will have a negative impact on U.S. manufacturers. In particular, NAM members are deeply concerned about proposals in the European Union (EU) and the Organisation for Economic Cooperation and Development (OECD) on disclosure of tax, financial and other sensitive business information that would both impose substantial and unnecessary compliance costs on companies and, in some cases, force release of sensitive, confidential U.S. taxpayer information. These and other recent developments will create a new set of challenges for manufacturers and stand to harm our competitiveness in an already difficult global economic environment.

The NAM is the nation’s largest industrial association and voice for more than 12 million women and men who make things in America. Manufacturing in the United States supports more than 17 million jobs, and in 2014, U.S. manufacturing output reached a record of nearly $2.1 trillion. It is the engine that drives the U.S. economy by creating jobs, opportunity and prosperity. The NAM is committed to achieving a policy agenda that helps manufacturers grow and create jobs. Manufacturing has the biggest multiplier effect of any industry and manufacturers in the United States perform more than three-quarters of all private-sector R&D in the nation – driving more innovation than any other sector.

Manufacturers know first hand how critically important it is for U.S. companies to invest and compete effectively in the global marketplace. Indeed, 95 percent of the world’s customers are outside the United States. Investment by U.S. global companies has paid off for the U.S. economy: U.S. global companies employ 35.2 million workers and are responsible for 20 percent of total U.S. private industry employment[1]. Moreover, U.S. companies that invest abroad export more, spend more on U.S. research and development performed by U.S. workers and pay their workers more on average than other companies.

<u>OECD’s Base Erosion and Profit Shifting (BEPS) Project</u>

In 2012, representatives from the G-20 asked the OECD to develop a comprehensive approach to address aggressive global tax planning that resulted in inappropriate corporate tax avoidance. The final recommendations, released by the OECD in October 2015, were approved by the G-20 Finance Ministers and by the G-20 Leaders later last year.

[1] Bureau of Economic Analysis, August 2014.

The BEPS Plan includes Action 13, "Re-examine Transfer Pricing Documentation," to develop rules to require multinational companies (MNEs) "to provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template." Action 13 adopts a three-tiered approach to achieve transfer pricing documentation: a country-by-country report (CbCR) containing aggregated financial and tax data by tax jurisdiction; a master file containing information to provide a complete picture of the MNE's global operations, including an organizational chart, consolidated financial statements, and analyses of profit drivers, supply chains, intangibles, and financing; and a local file providing more detailed information relating to specific intercompany transactions of the MNE group impacting the specific tax jurisdiction.

According to the OECD, the two documents that provide group-wide information – the CbCR and the master file – are intended to provide governments with information necessary to conduct high-level transfer pricing risk assessment.

Action 13 does require that countries adhere to certain confidentiality, consistency, and appropriate use standards in order to obtain CbCRs. In the case of the United States, the Treasury Department plans to collect CbCRs from U.S. multinationals and transfer them to other countries through treaty information exchange. Treasury officials have indicated that if a foreign tax authority does not comply with these standards, they would suspend transmitting CbCRs to that tax authority[2].

Unfortunately, the master file, which individual countries will require directly from companies, would not be covered by the confidentiality, consistency, and appropriate use standards that apply to CbCRs. While countries have agreed that confidentiality "should be taken into account"[3] when it comes to the master file, there are insufficient safeguards to protect against misuse of the information.

Manufacturers believe that putting this sensitive information into the hands of foreign tax authorities, without any clear safeguards to protect confidentiality, could put critical commercial information at substantial risk of public disclosure. At a time of widely reported corporate espionage and high profile data hacks, there is no guarantee that other countries would not inadvertently compromise companies' information, a risk that U.S. businesses should not have to face.

In addition, manufacturers do not agree with assertions that companies already include the master file information in filings with the U.S. Securities and Exchange Commission (SEC). Private companies, for example, do not file with the SEC. Thus, requirements to provide foreign tax authorities with a global organizational chart and consolidated financial statements constitute an unprecedented level of disclosure to foreign governments.

The master file also presents problems for publicly traded companies. Since most of the required information is descriptive in nature, it will have to be compiled with substantial input from across the MNE group and some of the information could be considered confidential or proprietary. For example, information about global supply chains could well be considered

[2] See proposed regulations to implement the new country by country reporting requirements issued 12/21/15
[3] See Action 13: Final Report, OECD 2015, p. 20

sensitive commercial information that, if disclosed, would be of high value to the MNE's market competitors.

Moreover, even if there are individual pieces of information that, taken alone, may not be sensitive, the master file requires companies to pull it all together as a "blueprint of the MNE group," which could reveal competitively important strategic information that would be valuable to competitors. We also believe that, like the information in the CbCR, the global nature of information required in the master file will lead to more aggressive foreign audits and tax assessments that are inconsistent with international tax norms, and U.S. MNEs are likely to be the primary targets.

In the past, companies had the ability to push back on specific information requested by a foreign tax authority during an audit. This is particularly true with respect to global information that has little or no connection with a MNEs operations within a particular country. Action 13 however, would make local filing of master file information part of the international standard, making it much more difficult for U.S. companies to push back on specific information requests.

On numerous occasions, Treasury officials have taken the position that since taxpayers have control over what they include in the master file, confidentiality concerns are manageable. In reality however, the fact that taxpayers have some level of control over what information is included in the master file does little to address confidentiality concerns because, as noted above, it is not clear how much flexibility taxpayers have to exclude sensitive information.

Specifically, the "prudent business judgment" standard in Action 13 to determine the level of information to include in the master file is vague and subjective, and provides little comfort for taxpayers that wish to omit sensitive information and avoid penalties. For example, a taxpayer could reasonably take the position that omitting a global organizational chart or consolidated financial statements would not "affect the reliability of the transfer pricing outcomes" within any particular jurisdiction, yet be concerned that such omissions would constitute non-compliance.

Recent developments in the EU

Manufacturer's concerns about protecting the confidentiality and preventing the misuse of sensitive business information under the BEPS recommendations are exacerbated by recent reports that the European Union is working on legislation to require global companies to publically disclose tax and other financial information.

The latest information disclosure proposal – coming on the heels of the new information requirements in the BEPS plan described above – would both impose additional compliance costs on companies and force disclosure of sensitive taxpayer information. While the EU initially indicated that tax information reported to national tax authorities in Europe would not be made public, it appears that they have changed this position. Indeed, the EU proposal contradicts the assertion by the OECD that CbCRs would not be made publically available, "to protect the confidentiality of potentially sensitive information."[4]

[4] BEPS: Frequently Asked Questions, 2015 Final Reports, Question #80

From the NAM's perspective, the forced public disclosure of large amounts of company tax and financial information likely will lead to even more aggressive foreign audits and tax assessments. Furthermore, given the rhetoric surrounding these discussions, U.S. global companies likely will be the primary targets. Moreover, public disclosure of this detailed financial information will substantially increase the likelihood that this information will be used for reasons far beyond determining a companies' tax liability, raising additional and significant competitiveness and security concerns for U.S. companies.

The NAM also shares many of Treasury's concerns[5] about the continuing EU "state aid" cases involving ex post facto and novel application of non-tax European law to effectuate tax policy changes that lead to retroactive taxation. It is a long-standing position of the NAM that the retroactive imposition or increase of taxes is fundamentally unsound, unfair and punitive.

We also believe that, in substance, the state aid cases appear to reach results that are inconsistent with the internationally accepted standards in place at the time the income was earned. In addition, these cases appear to disregard the level of economic activity within the EU member state under investigation, a contradiction of the underlying premise of BEPS to align taxing rights with underlying value-creating activity. Finally, we believe that that the state aid cases potentially undermine U.S. rights under our bilateral tax treaties with EU member states.

Addressing Confidentiality Concerns

Even though the BEPS recommendations were finalized this fall, the NAM strongly believes that taxpayer confidentiality concerns can and should be addressed during the BEPS implementation phase.

While manufacturers recognize that there is a compliance burden associated with the CbCRs, we support efforts by the Internal Revenue Service (IRS) and Treasury to issue CbCR guidance so U.S. global companies can file once with the IRS and have their information confidentially exchanged via tax treaty or tax information exchange agreements with countries that agree with these confidentiality protections. Other countries already have announced that they will require CbCRs, and our members have some level of comfort in exchanging information under a standard process that offers data protection.

Moreover, if the United States does not collect and remit CbCRs, other countries may require local subsidiaries of U.S. MNEs to file a CbCR in a much less controlled and confidential manner under the "secondary mechanism" laid out in the BEPS report. This approach would be more costly for U.S. global companies and provide less protection for confidential taxpayer information than if the IRS requires CbC reporting.

In addition, we believe that Treasury should link master file information to its agreements to provide the CbCR to other countries through information exchange. To that end, the NAM supports legislation (H.R. 4297) introduced by House Ways and Means Committee member Charles Boustany (R-LA) that would require the federal government to withhold CbCRs from countries abusing master file documentation requirements or failing to keep master file information confidential.

[5] See testimony of Assistant Treasury Secretary Robert Stack before the Senate Finance Committee on 12/1/15

The legislation, which clearly describes potential abuses of the master file requirements, provides the federal government with a tool to protect U.S. businesses from being forced to disclose sensitive and confidential taxpayer information to foreign tax authorities – the same tool that that protects CbCRs.

The Need for Comprehensive Tax Reform

Longer term, the NAM strongly supports a comprehensive overhaul of our tax system. It is abundantly clear to NAM members that our current tax system is fundamentally flawed and discourages economic growth and U.S. competitiveness. Indeed, a key objective for the association is to create a national tax climate that promotes manufacturing in America and enhances the global competitiveness of manufacturers in the United States. To achieve these goals, we need a comprehensive tax reform plan that both reduces the corporate tax rate to 25 percent or lower and includes lower rates for the nearly two-thirds of manufacturers organized as flow-through entities. We also believe that comprehensive tax reform must include a shift from the current worldwide system of taxation to a modern and competitive international tax system, a strengthened research and development (R&D) incentive and a strong capital cost-recovery system.

While enactment of a pro-growth tax reform plan will strengthen our economy and ensure vibrant economic growth in the future, our economy is suffering right now because of inaction on tax reform. ***A Missed Opportunity: the Economic Cost of Delaying Pro-Business Tax Reform***, a study released by the NAM in January 2015, takes a close look at the economic impact of enacting a five-prong pro-business tax package similar to NAM's priorities and concludes that lack of action on pro-growth tax reform is costing the U.S. economy in terms of slower growth in Gross Domestic Product (GDP), investment and employment. In contrast, the report finds that over a ten-year period, a pro-growth tax plan would increase GDP over $12 trillion relative to CBO projections, increase investment by over $3.3 trillion and add over 6.5 million jobs to the U.S. economy.

Conclusion

Manufacturers believe that the OECD's focus on global profit shifting, along with other recent developments in the EU, highlight the critical need for a comprehensive overhaul of the U.S. tax system to reflect the global marketplace of the 21st century. Indeed, policy makers in the United States should focus on the underlying problems of the U.S. business tax system – including the high business tax rates and the double tax burden faced by U.S. global manufacturers and other U.S. multinationals because of our outdated worldwide tax system. Most of our competitor nations – including most of the countries that participated in the BEPS project – have much lower rates and territorial tax systems that only tax income earned within their borders.

At the same time, an appropriate balance needs to be struck between transparency and confidentiality of the proprietary information that enables companies to compete and prosper in a global economy. In contrast, requests for much more information than needed to assess a company's tax liability, coupled with the public disclosure of this tax and financial information will threaten economic growth and competitiveness on a global basis.

February 23, 2015

The Honorable Kevin Brady
Chairman
Committee on Ways and Means
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Sander Levin
Ranking Member
Committee on Ways and Means
1106 Longworth House Office Building
Washington, DC 20515

Dear Chairman Brady and Ranking Member Levin:

The Organization for International Investment (OFII) appreciates the opportunity to submit comments for the Ways and Means Committee hearing, "The Global Tax Environment in 2016 and Implications for International Reform."

OFII is a business association representing U.S. subsidiaries of global companies – a sector of the economy that employs more than 6.1 million Americans and pays compensation 33 percent above the national private sector average.[1] Foreign direct investment (FDI) provides the types of jobs America needs and OFII applauds your goal of keeping the United States economically competitive.

OFII believes the high U.S. corporate tax rate creates an artificial barrier to inward investment and harms overall U.S. competitiveness. In a challenging global environment, it is critical for the Ways and Means Committee to pursue pro-growth tax reform that will ensure the United States remains the top destination for employers to invest and grow. Foreign direct investment is a vital component of the investment and growth story in the United States, and OFII encourages the Committee to attach the same high priority to FDI as to domestic business investment. OFII also urges the Committee to avoid any punitive action against inbound companies or policies that have a discriminatory effect and discourage FDI.

Global companies are highly invested in American manufacturing, accounting for nearly 20 percent of all manufacturing jobs in the United States. These inbound manufacturers increasingly support local domestic suppliers. A recent economic study on the impact of FDI by economist Dan Ikenson demonstrated that these manufacturers increased their purchase of local intermediate inputs by 48 percent over a ten-year period. [2] During the same period, U.S. manufacturers increased their purchases of local intermediate inputs by just 13 percent.[3] The study highlights how FDI helped support the manufacturing sector in a very critical way during the economic recession.

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[1] U.S. Department of Commerce, Bureau of Economic Analysis (BEA). (Released January 2016).
[2] Organization for International Investment. (2013). *Insourcing companies: how they raise our game.* Washington, DC: Ikenson, Daniel J. Web site: http://www.ofii.org/sites/default/files/OFIIRaisingOurGame_FULL.pdf.
[3] Ikenson 2013.

The data makes clear that U.S. subsidiaries of global companies are strongly committed to the United States. They innovate in the United States – supporting more than 16 percent of all private sector research and development activity in the United States; they export from the United States – producing 23 percent of U.S. exports; and they reinvest in the United States – annually putting $100 billion of their earnings back into U.S. operations and spending an additional $232 billion on expansion, plant construction and new equipment.[4]

Most importantly, these employers support the communities in which they sustainably operate. Over the past decade, insourcing companies increased U.S. charitable contributions by 44 percent, at a time when there was an economy-wide contraction in charitable giving.[5] In addition, insourcing companies are investing in workforce training and education programs, partnering with schools at various education levels to ensure students and U.S. workers have the knowledge and skills they need to be successful. Insourcing companies bring innovative solutions, based on global expertise, to address challenges like the skills gap in the United States.

Foreign direct investment is a critical component of American economic strength, innovation, and job creation. In light of this, I ask the Committee to remain mindful of the impact that policy changes may have on the 6.1 million U.S. workers whose livelihoods depend on global investment. The Committee has an important opportunity to ensure that reforms embrace an open investment environment that will attract more FDI in the United States, creating more high-paying jobs.

OFII looks forward to our continued work with the Committee in advancing policy that will spur economic growth and opportunities for American workers through increased foreign direct investment.

Sincerely,

Nancy McLernon
President & CEO
Organization for International Investment

[4] BEA 2016.
[5] Ikenson 2013.

ORGANIZATION for INTERNATIONAL INVESTMENT
Global Investment Grows America's Economy

March 2, 2016

The Honorable Kevin Brady
Chairman
Committee on Ways and Means
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Sander Levin
Ranking Member
Committee on Ways and Means
1106 Longworth House Office Building
Washington, DC 20515

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OFII believes the high U.S. corporate tax rate creates an artificial barrier to inward investment and harms overall U.S. competitiveness. In a challenging global environment, it is critical for the Ways and Means Committee to pursue pro-growth tax reform that will ensure the United States remains the top destination for employers to invest and grow. Foreign direct investment is a vital component of the investment and growth story in the United States, and OFII encourages the Committee to attach the same high priority to FDI as to domestic business investment. OFII also urges the Committee to avoid any punitive action against inbound companies or policies that have a discriminatory effect and discourage FDI.

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Foreign direct investment is a critical component of American economic strength, innovation, and job creation. In light of this, I ask the Committee to remain mindful of the impact that policy changes may have on the 6.1 million U.S. workers whose livelihoods depend on global investment. The Committee has an important opportunity to ensure that reforms embrace an open investment environment that will attract more FDI in the United States, creating more high-paying jobs.

OFII looks forward to our continued work with the Committee in advancing policy that will spur economic growth and opportunities for American workers through increased foreign direct investment.

Sincerely,

Nancy McLernon
President & CEO
Organization for International Investment

[4] BEA 2016.
[5] Ikenson 2013.

ORGANIZATION for INTERNATIONAL INVESTMENT
Global Investment Grows America's Economy

OFII is the only business association in Washington D.C. that exclusively represents U.S. subsidiaries of foreign companies and advocates for their non-discriminatory treatment under state and federal law.

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ABB Inc.
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Kering
Kia Motor Corporation
LafargeHolcim
L'Oréal USA, Inc.
Louisiana Energy Service (LES)
Louis Dreyfus Commodities
Louisville Corporate Services, Inc.
LVMH Moet Hennessy Louis Vuitton
Macquarie Aircraft Leasing Services
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Marvell Semiconductor
McCain Foods USA
Medtronic, Inc.
Michelin North America, Inc.
Morton Salt, Inc.
National Grid
Nestlé USA, Inc.
Nissan
Nokia
Nomura Holding America, Inc.
Novartis Corporation
Novo Nordisk Pharmaceuticals
Oldcastle, Inc.
ORIX USA
Panasonic Corp. of North America
Pearson Inc.
Pernod Ricard USA
Philips Electronics North America
QBE the Americas
Randstad North America
RELX Group
Restaurant Brands International Inc.
Rexam Inc
Rio Tinto America
Roche Holdings, Inc.
Rolls-Royce North America Inc.
Royal Bank of Canada
SABIC
Safran USA
Samsung
Sanofi US
SAP America
Sasol Chemicals (USA) LLC
Schlumberger
Schneider Electric USA
Schott North America
SCOR
Shell Oil Company
Shire Pharmaceuticals
Sibelco Group
Siemens Corporation
Smithfield
Smith & Nephew, Inc.
Solvay America
Sony Corporation of America
SSAB Americas
Sumitomo Corp. of America
Swiss Re America Holding Corp.
Syngenta Corporation
Takeda North America
Tate & Lyle
TE Connectivity
Teva Pharmaceuticals USA
Thales USA, Inc.
The Nielsen Company
The Tata Group
Thomson Reuters
ThyssenKrupp North America, Inc.
Toa Reinsurance Company of America
TOTAL Holdings USA, Inc.
Toyota Motor North America
Transamerica
Tyco
UBS
UCB
Umicore
Unilever
Vivendi
Volkswagen of America, Inc.
Volvo Group North America
Westfield LLC
White Mountains, Inc.
Wipro Inc.
Wolters Kluwer U.S. Corporation
WPP Group USA, Inc.
XL Global Services
Zurich Insurance Group

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Phone: 919-226-3200
Patheon.com

August 31, 2015

The Honorable Paul Ryan
Chairman
Ways and Means Committee
US House of Representatives
Washington DC 20515

Re: Comments of Gary Shope, Patheon Pharmaceuticals Inc.

Dear Mr. Chairman:

I am very pleased to present my comments on behalf of Patheon Pharmaceuticals Inc. with respect to the discussion draft authored by Congressmen Boustany and Neal. My name is Gary Shope and I serve as Chief of Staff to the President of Patheon Pharmaceuticals Inc., James C. Mullen.

Patheon Pharmaceuticals Inc. is headquartered in Durham, North Carolina and through our integrated global network of 26 facilities is one of the largest providers of contract drug development and manufacturing (CDMO) services in the world.

With over 9,000 employees worldwide, Patheon serves more than 400 clients from large global providers to small emerging players in the pharmaceutical and biopharmaceutical sectors.

Because of the nature of our business Patheon closely follows tax and financial trends worldwide, as is common practice in most companies in our field.

We are well aware of the innovation schemes authored by many of the countries comprising the European Union and similar schemes created by other nations such as China.

As I understand the many patent box/innovation box regimes in other countries, these regions have been successful in enticing capital intensive and knowledge based industries such as ours to their shores.

I can tell you from my personal experience that these countries offer an attractive integrated package of low corporate tax rates, a permanent research and development tax credit, a user-friendly regulatory approval process, and well-designed patent/innovation box incentives.

As patriotic as we are at Patheon being a North Carolina based Company, these "innovation schemes" are very compelling to us and I am not surprised that many U.S. companies have selected foreign jurisdictions, rather than the U.S. to locate plants and other facilities that require highly skilled, knowledge-based jobs that offer attractive compensation.

An average worker at any one of our U.S. facilities, whether in North or South Carolina, Missouri, New Jersey, Ohio, or Oregon earns a salary of $54,000 not counting normal fringe benefits which taken together provide another third in real benefit. This is our average wage with many in our company earning well above this and a number of our employees earning into the "six figures".

Although wage scales in Europe are somewhat less, the knowledge base of the workers we hire in Europe and in other locales around the world are comparable to the education levels of workers in our U.S. facilities.

Most of our workforce have earned at least a certificate or two-year degree from a community college and a significant portion have earned college bachelor's degrees with many having advanced degrees at the master's and doctoral levels.

Tax and other financial factors as well as the educational and skill of the local work force are key determinative factors in the location of Patheon facilities worldwide.

The draft discussion legislation prepared by Congressmen Boustany and Neal is, in our opinion, timely as global companies like Patheon are constantly seeking opportunities for growth and expansion.

We at Patheon urge the U.S. Congress to rapidly enact a version of a patent box as a down payment on other needed reforms such as a lower corporate tax rate and a permanent research and development tax credit.

My comments regarding the discussion draft really boil down to two levels. First, I believe the most basic issue is to determine the public policy objective underlying the patent box and, second, determine whether in fact the allocation of tax benefits is consistent with achieving that objective.

If the objective is to reward the patent/IP holder for their "invention" I suggest that the draft discussion document amply does that through the provision of a 10% rate on the income derived from that patent or intellectual property.

If the public policy objective is to reward and to further incentivize research, again I believe that the discussion document amply does that as well in the calculation of "innovation box profit" under proposed section 250 (b) (1) (a).

If the public policy objective is to reward and incentivize companies to locate high value jobs in the U.S., then the discussion draft only partially achieves that objective as the definition in the draft limits "5 year research and development" as research and development expenditures …for which a deduction is allowed under section (a) or (b) of section 174.

That section of the internal revenue code provides for a deduction for expenses incurred for "research and experimentation". In this context research and experimentation is generally defined as research conducted to resolve a scientific or technical uncertainty in the development or improvement of an invention, patent, formula or similar product.

Experimentation is understood to be research conducted to develop or to discover something new in the laboratory or experimental sense. It does not apply, as I understand this section, to develop an invention that has already been patented or to discover information that is not scientific or technical in nature.

Patheon serves the entire pharmaceutical and biotechnology industry. We claim the top twenty pharmaceutical companies as customers as well as those companies that concentrate on specialty drugs and emerging companies. I understand that over 70% of patents in the pharmaceutical sector are discovered by these emerging companies that employ less than 50 people. For these companies we test their "molecule" to make sure that the results that are claimed are in fact verified. Once we have accomplished this task we prepare the "molecule" for the stringent and multiple reviews conducted by the food and drug administration (FDA).

In many instances the molecule that responds favorably in the laboratory will need further refinement when taken out of the laboratory and subjected to the many tests and verifications required by the FDA. Once this scientific, time intensive and complicated process is complete, the molecule can then move to the clinical materials stage (CTM) then possibly receive FDA approval. A roadmap for a molecule at this stage often receives toxicity, efficacy, and solubility analysis along the way toward FDA approval. This process occurs within our pharmaceutical development services (PDS) and can often lead to scale-up within a larger commercialization effort.

In commercialization or drug product services, our company must "scale" the molecule for production and finally we initiate the commercialization aspect of the process through one of our plants in the US or abroad. In essence then, Patheon has taken, a patented "molecule" that by itself has no or nominal value and through an expensive, complicated, and highly regulated effort Patheon has now created a product that can be manufactured, sold commercially and, ultimately delivered to the patient. The same process and protocols need to be met on legacy products (i.e. Big Pharma) that are tech-transferred into one of our global sites.

Although some of this value added process may be deductible under the provisions of IRC, section 174, a significant part may not be. The Internal Revenue Code does not provide a definition of "commercialization". In fact, the only reference to commercialization at all in the IRC is in IRC Section 54D (f) (1) (D). The Courts, as in IIR Research v. US 56 AFTR 2d 85-6023, Code Sec(s) 501, (CICT), generally define "commercialization" as the process of "introducing a new product or production method on the market".

I, therefore, suggest to the Committee and to Congressmen Boustany and Neal that the definition of "5-year research and development expenditures under subparagraph (3) be broadened to include all costs that are "commercially" reasonable; that add value to a product or invention and that may be required, especially in the life sciences industry, by the appropriate regulatory body.

If research and costs, including attorney's fees are deductible under IRC section 174 for purposes of obtaining a patent, by extension it seems appropriate to me for purposes of calculating the "innovation box profit" that costs that add value to the product or invention and that actually produce the "qualified gross receipts" as defined under subsection (b) of the draft discussion bill be included as qualified expenditures under subparagraph (b).

To further incentivize manufacturing in the United States, the Committee may also want to consider coordination with IRC Section 199 whereby businesses with "qualified production activities" are eligible for a deduction equal to 3% of net income.

The draft does not impose any "nexus" requirement for the products resulting from qualified IP to be manufactured in the United States. To the extent that products relating to the IP are manufactured in the United States, businesses should be granted an additional incentive in lieu of the very complicated domestic production activities deduction. For example, the cost relating to domestically produced products under the Innovation Box scheme could be entitled to an additional "deemed" percentage that could be added into the numerator and utilized to further reduce the net income subject to tax.

My second major point has to do with the allocation of benefits under the discussion draft. The definition of "qualified gross receipts" as provided in the draft under subsection (b) (i) is in my opinion unclear as to whether a corporation such as Patheon, which earns income from the creation of value to a patent, may be able to access the tax benefits available under the proposed discussion draft.

Patheon is a "Fee for Service Company". That is, Patheon does have some "process patents" within our Pharmaceutical Product Development business, but generally Patheon is paid a fee to create a marketable and safe pharmaceutical that is then sold to the public with the income from such sales inuring to the benefit of the patent holder.

As a rule, Patheon does not own nor is Patheon the licensee of the intellectual property. If it is the intent of the legislation to "encourage U.S. companies to invest in American workers" and "to keep research and development as well as high paying jobs in the United states" then it seems appropriate to us that the value creators, that is, the companies that sponsor these high paying jobs be incentivized to keep or locate these jobs in the United States by allowing them to share in the associated tax benefits. I therefore recommend that the terms "Development and Commercialization" be added to the definition of "qualified gross receipts" under section (b) (i).

In addition, I suggest that a safe harbor rule be integrated into such innovation box calculation whereby if the IP holder contracts out its development, commercialization and/or manufacture that it may claim no more than 65% of the tax benefit. In such case, the "value creator" may claim the remaining 35% of benefit.

For example the development, commercialization and manufacturing work done by Patheon for its clients is precisely outlined in a contract. It is very easy therefore to track costs, expenses and profit. In a case where Patheon earns a $10 million dollar profit from a particular transaction, $3.5 million of income would be taxed at the innovation box rate and the rest would be subject to the regular corporate income tax. The ratio I have proposed is similar to the ratio currently utilized with the calculation of Qualified Research Expenditures (QRE) for the R&D tax credit whereby an entity that contracts out its research under IRC Section 41(b)(1) may only claim 65% of the cost.

The discussion draft under subsection (4) (b) provides for an exception for certain foreign testing that is conducted outside of the United States because there is an insufficient testing population in the United States or is required by law to be so conducted. This particular subsection is included as part of the definition of "5-year total costs" which is in turn part of the ratio that is provided by the discussion draft in its calculation of the "innovation box profit" under subsection (b) (1) (b). Given the heavily regulated and world –wide nature of the pharmaceutical sector we very much support this exception.

A complementary approach might include a broadening of the proposed exception by allowing testing of drugs in foreign jurisdictions WITHOUT LIMITATION. However, the IP resulting from such testing must be located in the United States and all profits from the IP be mandatorily included in the US tax base on a current and not deferred basis.

Finally, Patheon fully endorses the definition of the "United States" as provided under subsection (6). As "nexus " to a location in the United States is a key element of the draft, we commend the Congressman for ensuring that qualified research and development expenditures include Puerto Rico and all of the U.S. territories. Research and development activities conducted in Puerto Rico and other U.S. territories are key elements of the U.S. supply chain.

In sum, Patheon is very supportive of the efforts of Congressmen Boustany and Neal as well as you Mr. Chairman in creating an innovation box that is intended to incentivize U.S. corporations to further invest in U.S. workers and will also provide affirmative financial reasons for U.S. corporations to retain or relocate high paying jobs as well as intellectual property back to the United State

Thank you again for allowing me the opportunity to submit comments and I look forward to discussions with you and the Members of your Committee in the near future.

Sincerely,

Gary Shope
Chief of Staff to the President
Patheon

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WRITTEN STATEMENT OF MR. GARY SHOPE, CHIEF OF STAFF TO THE PRESIDENT PATHEON, INCORPORATED BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS.

HEARING ON INTERNATIONAL TAX REFORM

FEBRUARY 24, 2016

I am very pleased to present my comments on behalf of Patheon Pharmaceuticals Inc. with respect to the hearing today on international tax reform. My name is Gary Shope and I serve as Chief of Staff to the President of Patheon Pharmaceuticals Inc., James C. Mullen.

Patheon Pharmaceuticals Inc. is headquartered in Durham, North Carolina and through our integrated global network of 26 facilities is one of the largest providers of contract drug development and manufacturing (CDMO) services in the world.

With over 9,000 employees worldwide, Patheon serves more than 400 clients from large global providers to small emerging players in the pharmaceutical and biopharmaceutical sectors.

The CDMO industry has substantial operations in the United States, Europe, the Far East, and other parts of the globe. Although headquartered in Durham, Patheon has a substantial presence in Ohio, South Carolina, Missouri, Massachusetts, New Jersey and Oregon. World -wide Patheon plays a key role in delivering a 21st Century health care supply chain.

Let me first identify with the comments of Chairman Brady and other members of the Committee. It is clear to all of us that the current system of US taxation with respect to US international operations is antiquated, non-competitive and is causing key industries like the CDMO sector to expand jobs and operations outside of the US. The CDMO represents a $40 billion industry.

Yes, we would rather invest in jobs and opportunities here in the US but the return on investment (ROI) in Europe and other locations with their lower corporate tax rate; responsive regulatory structure, permanent research and development tax credit and a well designed patent/innovation box structure compels those of us charged with the financial success of our Company to seriously entertain commercial locations outside the United States.

The longer this country takes to significantly change this non-competitive tax structure, the more companies and jobs will be lost to foreign locations. I fully agree with the comments of Congressman Boustany (R-LA) ,Congressman Neal (D-MA) and other members of your Committee who eloquently described the loss of indirect jobs as well as the direct loss of jobs associated with the closure of facilities in the US in favor of more financial hospitable locations outside of the US, the so called inversions.

Congressman Holding (R-NC) spoke of the significant presence of the life sciences sector in his home state (which happens to be my own state) of North Carolina. He spoke of the numerous jobs and economic opportunities sponsored by this one sector. An average Patheon worker in Greenville NC earns a salary of approximately $54,000 along with an additional third of compensation in fringe benefits. This is almost 2.5 times the income of an average worker in Greenville. When the Congressman visited our facility in Greenville he was told by Patheon's finance manager that for every $1 invested by our company in Greenville, the multiplier effect of this investment generate $5-$7 dollars to the community. This ratio is typical for all of Patheon's locations in the United States. Our site in Greenville, NC is a large part of the economic ecosystem of this region of the state, much like we are in other locations with the U.S.

We in the international corporate community are well aware of the action led by this Committee under your leadership Chairman Brady of the permanent extension of the Research and Development tax credit (IRC Section 41). We take this as an indication of this committee's intention to significantly and drastically replace the current system of US international taxation with one that is pro-growth and that is consistent with America's 21st Century economy.

We at Patheon believe that the Patent/Innovation Box such as that suggested by your colleagues Congressman Boustany and Congressman Neal is a viable starting point for that objective and with some technical but critical revision can be a significant incentive for the life sciences industry to locate plants, jobs and economic opportunities here in the United States rather than elsewhere.

Our thoughts in this regard were well summarized by the recent bipartisan North Carolina Congressional Delegation letter sent to you Mr. Chairman and Cong.
Levin which said:

We also understand the significant budgetary pressures posed by any changes to the Innovation Box proposal that would expand benefits to include additional companies. In the instances where the IP development and commercialization has been contracted out to a separate U.S.-based company, we suggest structuring the benefit in a manner similar to the research and development tax credit allocation for parallel scenarios *where certain activities have been contracted out. More specifically, in the context of the current Innovation Box proposal, this would mean a reduced tax deduction for the company that produced the IP, allowing for some level of deduction to be assumed by the company contracted to develop and commercialize the IP.*

I have appended a copy of that letter, as well as my correspondence to then Chairman Ryan, on suggested changes to the draft legislation to make it more responsive to the needs of the life sciences sector.

Thank you for the opportunity to submit this testimony.

Gary Shope
Chief Of Staff
Patheon Pharmaceuticals

INDUSTRIALES
PUERTO RICO
MANUFACTURA ■ SERVICIO ■ COMPETITIVIDAD ■

Carlos Rivera-Vélez
President

Francisco García
Executive Director

Statement of the Puerto Rico Manufacturers Association
By Mr. Carlos Rivera Vélez, PhD, PE, President

For the Hearing Record
of the
Committee on Ways and Means
U.S. House of Representatives

Hearing on International Tax Reform

February 24, 2016

Mr. Chairman, Ranking Member Levin, and Members of the Ways & Means Committee, it is my pleasure to submit this written statement on behalf of the Puerto Rico Manufacturers Association; Puerto Rico's largest business organization comprised of 1200 members.

We have had the privilege to meet with you, Mr. Chairman, as well as with Ranking Member Levin and a number of your colleagues both on this Committee and throughout the Congress. We have also had the opportunity to express our views regarding a long and short-term solution to the current fiscal crisis faced by the Government of the Commonwealth of Puerto Rico to your colleagues in the Congress and the Administration. It's important to note that no long-term solution to Puerto Rico's fiscal crisis is possible without a healthy, vital private sector paying taxes and creating jobs.

Regardless, of the configuration of the final international tax reform legislation fashioned by your committee and policy makers here in Washington, rewarding investment in economic development, job creation and revitalization must be the cornerstone to that design. To this extent, U.S. tax policy particularly in the international arena will determine whether Puerto Rico's economy can be revitalized with an end result of more taxpayers and more jobs. I am therefore pleased to report that the PRMA in conjunction with the efforts of our leadership in the public and private sector has designed a tax incentive based initiative that we strongly urge this Committee to adopt as part of the overall legislation being fashioned by the House of Representatives under the direction of Speaker Ryan to address the current fiscal crisis in Puerto Rico. We believe that our strategy is pro-growth and is consistent with the principles outlined by your colleagues during the course of today's hearings.

Before getting into the general outlines of our proposal, I think that it is useful to summarize for the Committee the history, background and results of U.S. tax policy as it affects the economy of Puerto Rico.

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BACKGROUND AND HISTORY:

The Commonwealth of Puerto Rico has been a U.S. territory since 1898. Puerto Rico today is comprised of approximately 3.5 million U.S. Citizens who pay taxes, actively defend our freedom in the U.S. military and comply with U.S. law and regulation in their daily lives and businesses. We are America's largest Territory and larger than 20 States in population.

We listened with great interest and agreement to the comments made by Congressman Boustany, Congressman Neal and others on your Committee as they vividly described the economic ecosystem that grows up around communities with U.S. based corporate headquarters and manufacturing facilities.

In like manner, manufacturing is the largest single private sector employer in Puerto Rico employing 78,000 people directly and is responsible for an estimated 350,000 jobs locally in total. Our estimates show that for every direct manufacturing job in Puerto Rico, one additional job is created on the mainland making Puerto Rico an integral component of the U.S. values and supply chain.

This is extremely important to note as manufacturing generates 49% of Puerto Rico's GDP and represents one third of local tax revenues in comparison to tourism which comprises only 6% of our GDP. In fact, manufacturing provides the highest paying jobs in Puerto Rico at salary levels 2-3 times our island's per capital household income.

The success of manufacturing in Puerto Rico is not an accident but rather is the direct outcome of carefully structured Federal tax and economic policy enacted by Congress since the 1920's. From "Operation Bootstrap" to the enactment of Internal Revenue Code (IRC) Section 936, the economic incentives put in place by both Democrat and Republican Administrations and Congresses have created a unique economy heavily dependent on manufacturing.

Most U.S. companies currently operate in Puerto Rico through subsidiaries that are Controlled Foreign Corporations (CFCs) under the terms of the IRC. As with U.S. CFCs located in foreign countries, Federal income tax is deferred until corporate profits are repatriated to the United States. It is important to note, however, that it is only in Puerto Rico and the other U.S. territories where CFCs employ U.S. citizens and comply with U.S. law and regulation; an important reminder that international tax reform could have real consequences on U.S. Citizens.

While U.S. manufacturing in recent years has experienced renewed growth, manufacturing and employment in Puerto Rico continues to decline. In 1996, for instance, Puerto Rico's manufacturing sector employed 165,000 Americans in direct jobs on the island while today only half of that number is directly employed.

The real GDP of Puerto Rico—the measure of the economy's total output of goods and services—declined 12.6% between 2005 and 2014—, equivalent to an annual decline of 1.5% per year during nine years. Few countries in the world have experienced such a prolonged and deep contraction in output. In contrast, the US economy as a whole enjoyed growth of 12.1% in those nine years, even though there was a major recession in 2009. So, Puerto Rico's economy has been shrinking at a rate of 1.5% per year at the same time that the U.S. economy has been expanding at 1.3% annual pace.

The decline in job opportunities for Puerto Rico's highly skilled workforce has resulted in Puerto Rico losing almost 10% of its population as younger better educated workers leave with their families in search of better opportunities. Notably, the public school system has seen a drop by one-third in enrollment with 250,000 fewer children in local schools than five years ago.

As a result of outward migration trends the remaining population is becoming increasingly elderly and, as a result, a higher percentage of the population is outside the labor force. Persons 60 years and older represent more than 20% of the population (the highest in the United States) and children aged five years or less have decreased from 295,406 in 2000 to approximately 187,371 in 2014, a reduction of 37%(6). Clearly, unless economic prospects change significantly; resulting from the addition to the economy of high value jobs in order to reverse outward migration trends of younger people, the future of Puerto Rico will be very bleak.

This continuing trend is caused by a number of factors including the conversion of our manufacturing sector from a labor intensive to a knowledge based economy, the repeal of IRC Section 936 and the increased competition from other countries, not only in the Caribbean Basin but around the world. These are countries that are not faced with the additional energy, labor, maritime transportation, compliance and regulatory costs that Puerto Rico based manufacturing is compelled to assume. It's important to remember that CFCs in Puerto Rico compete directly for expansion and new investment with foreign jurisdictions around the world.

We in the private sector are determined to reverse this trend. In spite of these hurdles, my colleagues and I in the PRMA are actively looking for ways to improve efficiencies, cut costs, enhance our competitive posture and attract and maintain our highly skilled and educated workforce. The resurgence of Puerto Rico from the current fiscal crisis will depend on many factors, including the continued growth of a dynamic and productive private sector.

As the U.S. Congress moves forward with respect to international tax reform we respectfully request that any tax law changes do no harm to our economy. We also urge that Congress provide U.S. companies operating in Puerto Rico a significant competitive differential so that we can continue to grow our economy out of the current fiscal crisis and to allow us to effectively compete against foreign jurisdictions in the Caribbean Basin and globally. The further loss of these highly skilled jobs to these foreign jurisdictions is the loss of U.S. jobs; both to our island and to the United States as a whole.

OUR RECOMMENDED SOLUTION:

The PRMA has requested in our meetings here in Washington, that Federal policy makers give us the tools to help ourselves. This perspective also applies to tax policy. Based upon on the advice and expertise of many of you in the Congress, we have developed a tax proposal in cooperation with our government that we believe will assist in the resurgence of an active and competitive Puerto Rico economy. We recommend a pro-growth strategy that, at its base, establishes a targeted manufacturing tax incentive designed to grow high wage jobs in Puerto Rico and expand the U.S. values and supply chain. Our proposal is consistent with several of the principal policies under discussion by Congress and Federal policy makers as you move forward with international tax reform. We in Puerto Rico agree with the statements of many Members of Congress that the current Federal tax code is not competitive in today's global economy.

The outline of our proposal is as follows:

- Establishes a dividend exemption system for repatriation for CFC's operating in Puerto Rico.
- Requires CFC's to maintain or increase their capital investment and research and development in order to qualify for some of the most significant tax benefits of the proposal.
- Provides rules to limit base erosion while providing recognition of U.S. and Puerto Rico tax bases in a unified manner.
- Recapitalizes local financial institutions thus providing capital for expansion of the small business and entrepreneur sector.
- Provides the option for mandatory repatriation of CFC income from Puerto Rico, which could significantly reduce the cost of the proposal. .

The bottom line is that our proposal is designed to provide a competitive differential for Puerto Rico to compete with foreign jurisdictions while providing the opportunity for growth in private investment, job creation and new tax revenues. Many in Congress have always urged that the private sector play a greater role in solving many challenges. In our case, the local government's fiscal crisis can best be solved when more local taxpayers are working, more taxes are being collected and young people want to return home to Puerto Rico to work and raise their families.

Our proposal has been reviewed by the respected economist, Dr. Juan Lara, who has reviewed this plan with a focus on its job generating impact. He projects that this proposal could boost Puerto Rico's GDP by 6.2% and increase employment through high value manufacturing and related service jobs throughout the entire manufacturing ecosystem.

Some have suggested that Congress should wait until enactment of international tax reform to create a growth incentive to revitalize Puerto Rico's economy, create more jobs and increase the number of taxpayers. Once again, we reinforce the sense of urgency for action and urge inclusion of this key growth initiative as a central component of the package being assembled to address Puerto Rico's fiscal crisis.

We have proposed a pro-growth strategy with this initiative that conforms with the approach to international tax reform under discussion within the tax writing Committees which will revitalize America's largest Territory and provide opportunity for its 3.5 million U.S. Citizens. The solution to Puerto Rico's fiscal and economic crisis is dependent on creating more taxpayers and more job creators.

Mr. Chairman, thank you for the opportunity to share our statement before the Ways & Means Committee. We look forward to your leadership and the opportunity to collaborate on meaningful tax reform that revitalizes our struggling economy and puts Puerto Rico on the path towards fiscal and economic recovery.

TIE COALITION
Working Together for Tax Innovation Equality

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U.S. House of Representatives

Committee on Ways and Means

Hearing on the Global Tax Environment in 2016 and
Implications for Tax Reform

February 24, 2016

Submission of the Tax Innovation Equality (TIE) Coalition

The Tax Innovation Equality (TIE) Coalition is pleased to provide this statement for the record of the hearing in the Ways and Means Committee on The Global Tax Environment in 2016 and Implications for Tax Reform.[1] As the witnesses' testimony made clear, our current tax code is out of step with all the other major industrial countries and as a result is having a detrimental effect on U.S. companies, encouraging inversions and the acquisition of U.S. companies by foreign competitors. We support Chairman Brady's objective to modernize the U.S. tax system and help American businesses compete in a global market. The TIE Coalition believes that the U.S. must: (i) implement a competitive territorial tax system; (ii) lower the U.S. corporate tax rate to a globally competitive level; and (iii) not pick winners and losers in the tax code by discriminating against any particular industry or type of income – including income from intangible property (IP).

Recognizing the importance of IP to the U.S. economy, some of the Members and witnesses at the hearing expressed concern about the adoption of so-called "innovation boxes" by OECD countries, raising questions about whether these measures will result in the movement of IP jobs from the U.S. to other countries and asking whether the U.S. should adopt similar measures. The TIE Coalition does not have a position on adoption of a U.S. "innovation box", but we are very concerned that in prior international tax reform proposals income from intangible property (IP) would be singled out for harsher tax treatment than income from other assets. By discriminating against IP income compared to income from other types of assets, these prior proposals would create an unfair advantage for companies who don't derive their income from IP and significantly disadvantage the most innovative U.S. companies, especially compared to their foreign competition.

For example, the "Tax Reform Act of 2014" (H.R. 1), as introduced by former House Ways and Means Chairman Camp, would seriously disadvantage innovative American companies. Under

[1] The TIE Coalition is comprised of leading American companies and trade associations that drive economic growth here at home and globally through innovative technology and biopharmaceutical products. For more information, please visit http://www.tiecoalition.com/.

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that proposal, Chairman Camp chose to use what is now widely known as "Option C."[2] The problem with "Option C," is if it became the law of the land, its adverse tax treatment of IP income would significantly hinder U.S. companies who compete globally, and it would result in more inversions of U.S companies. The TIE Coalition is opposed to "Option C" because it would have a devastating impact on both innovative technology and biopharmaceutical companies.

In an effort to understand the full scope of "Option C," the TIE Coalition commissioned a study by Matthew Slaughter, the Dean of the Tuck School of Business at Dartmouth University. The January 2015 study, entitled "Why Tax Reform Should Support Intangible Property in the U.S. Economy" can be found at http://www.tiecoalition.com/why-tax-reform-should-support-intangible-property-in-the-u-s-economy. We urge the Ways and Means Committee to consider its findings when examining options for international tax reform.

As Dean Slaughter emphasizes, "Policymakers should understand the long-standing and increasingly important contributions that IP makes to American jobs and American standards of living – and should understand the value of a tax system that encourages the development of IP by American companies." The study finds that "Option C" in the Camp legislation would fundamentally change the measurement and tax treatment of IP income earned by American companies abroad. The study finds that "Option C" of the proposal would disadvantage IP income earned abroad by U.S. companies in three ways. First, it would tax IP income at a higher rate than under current law. Second, it would tax IP income more than other types of business income. Third, it would impose a higher tax burden on the IP income of U.S. companies compared to their foreign competitors. The likely outcome of using "Option C" as proposed in the Camp legislation would be to increase corporate inversions and incentives for foreign acquisitions of U.S. based IP intensive companies.

The Slaughter study finds that the "United States, not abroad, is where U.S. multinationals perform the large majority of their operations. Indeed, this U.S. concentration is especially pronounced for R&D, which reflects America's underlying strengths of skilled workers and legal protections such as IP rights that together are the foundation of America's IP strengths, as discussed earlier." The Slaughter study concludes that the overseas operations of these companies complement their U.S. activities and support, not reduce, the inventive efforts and related jobs of their U.S. parents. So it is increasingly important to America's IP success that these companies continue to operate profitably overseas and any tax reform proposals do not impose discriminatory taxes on income from intangible assets located there.

[2] Please note that the TIE Coalition is opposed to both versions of "Option C" (version one of "Option C" in the Camp Draft and version two of "Option C" in H.R. 1 as introduced).

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IP jobs are essential to the U.S. economy and make up a large portion of the workforce. That is why it is important to have a tax code that supports the IP economy here in the U.S. To that point, the U.S. Chamber's Global Intellectual Property Center commissioned a study on the benefits of IP jobs to economic growth in the U.S. The study found that in 2008-09 that there were 16% or 19.1 million direct IP jobs and 30% or 36.6 million indirect IP jobs in the U.S. IP or IP related jobs account for 46% of the U.S. economy or 55.7 million jobs. With our modernizing economy it is likely that this number has grown.3

To be constructive and help the Committee find solutions that will allow American companies to succeed in a very competitive global market, the TIE Coalition has developed anti-base erosion solutions that do not target IP income. We would like to work with the Committee to develop alternative options that would apply to situations in which companies are simply trying to shift income to low tax jurisdictions with no substance or real business presence, but would not discriminate against income from intangible assets. Such options would apply to income from all goods and services, not just income from intangible assets.

In conclusion, the TIE Coalition supports tax reform that modernizes the U.S. tax system, allowing American businesses to compete in global markets in a manner that does not discriminate against any particular industry or type of income, including income from intangible property. As the witnesses at this hearing indicated, many other countries are lowering their corporate tax rates and adopting tax rules to attract IP companies to their shores. So, it would be especially harmful to the U.S economy to adopt a tax policy that will hurt, not help, American companies who compete globally. Now is not the time to drive high paying American jobs overseas.[4]

[3] See, http://image.uschamber.com/lib/fee913797d6303/m/1/IP+Creates+Jobs+-+Executive+Summary+Web+-+2013.pdf

[4] The U.S. Chamber study found that "IP-intensive companies added more than $2.8 trillion direct output, accounting for more than 23% of total output in the private sector in 2008-09" and that the "Output per worker in IP-intensive companies averages $136,556 per worker, nearly 72.5% higher than the $79,163 national average. Id.