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The United States Public Interest Research Group (U.S. PIRG) is a federation of 27 state-based public interest advocacy organizations with a citizen membership across the country. Our mission is to stand up to powerful interests whenever they threaten our health and safety, our financial security, or our right to fully participate in our democratic society.

U.S. PIRG has long supported measures to halt corporations' ability to avoid paying their U.S. tax on U.S. profits through the abuse of offshore tax havens and other corporate tax loopholes. We thank Chairman Hatch and Ranking Member Wyden for launching a critical bipartisan effort to gather ideas from the public and interested stakeholders on how best to reform our tax code. In our following comment, we offer important principles for our international and corporate tax system that must be considered in any comprehensive tax overhaul, followed by specific actions that can be taken to address corporate tax avoidance.

Problems that a corporate tax overhaul should address.

Our loophole-ridden corporate tax code creates winners and losers. The winners are a narrow set of large multinationals that boast armies of tax lawyers and accountants, and the losers are average taxpayers and small business owners who are left to foot the bill.

Offshore tax avoidance

Corporate tax haven abuse costs the federal government $90 billion in lost tax revenue every year, according to academic experts. Large American corporations – such as American Express, Apple, Dell, Eli Lilly, Microsoft, Nike – hold their profits in offshore tax havens because they are taxed very little or not at all. As a result, ordinary taxpayers have to pick up the tab through cuts to public priorities, higher taxes or an increased federal debt. In fact, to make up for that lost revenue, every small business in America would need to pay an additional $3,244 in federal taxes.

All told, U.S. companies have almost $2 trillion in profits booked offshore, much of it in tax havens where they conduct no real business, but have set up a shell company that is often nothing more than a P.O. Box. In fact, 18,857 corporate entities are registered at one modest five-story building in the Cayman Islands. An example of an egregious tax haven loophole used by tech companies like Google is what tax lawyers have dubbed the "Double Irish" and the "Dutch Sandwich." For Google, this involves shifting profits to two Irish subsidiaries and one in Bermuda, a tax haven. Before going to Bermuda, the profits take a pit stop at a P.O. Box shell company in the Netherlands that has no employees. These gimmicks helped shrink Google's tax bill by $3.1 billion from 2008 to

2010. Apple so deftly exploited similar loopholes that it was able to book $30 billion in profits to a phantom subsidiary that had no employees and was not considered a tax resident of any country in the world.

Further examples of companies exploiting offshore tax havens:

- **General Electric** maintained 18 tax haven subsidiaries in 2014 and parked $119 billion offshore for tax purposes. With the help of offshore subsidiaries, General Electric paid a federal effective tax rate of *negative* 7.3 percent between 2008 and 2014 despite being highly profitable all of those years. GE's tax rate was *negative* during that period because the company received money back from the U.S. government even though it reported billions of dollars of U.S. profit.[i]
- **Microsoft** maintains five tax haven subsidiaries and reported a total of $92.9 billion overseas according to its 2014 10-K filing with the Securities and Exchange Commission. If this money had not been shifted offshore, Microsoft would have owed an additional $29.6 billion in taxes.
- **Bank of America** reported operating 21 subsidiaries in 2014, a peculiar drop from its declared 257 subsidiaries in tax havens in 2013, which might reflect the Security and Exchange Commission's (SEC) lax disclosure standards pertaining to subsidiaries. It reported $17.2 billion offshore for tax purposes. If the money had not been shifted offshore, Bank of America would have owed an additional $4.5 billion in taxes.

Corporate inversions

Over the past year, well-known companies such as Burger King, Walgreens and Pfizer considered or followed through with the idea of changing the address of their corporate headquarters abroad on paper to avoid U.S. taxes -- a tax avoidance gimmick called an "inversion." By merging with a smaller foreign company that is often based in a tax haven, companies that "invert" don't move abroad in any real sense, and continue to benefit from America's infrastructure, education system, security and large consumer market. Even if their official address on paper is abroad, their executives typically stay right here, according to a Bloomberg investigation. While the Treasury Department issued a ruling that curbed some ways companies can invert last year, it is not enough. Unless meaningful legislation exists to restrict this practice, companies will continue to use this tax loophole to shift their tax burden to the public, whether through higher taxes, more debt, or cuts to essential public programs.

There are many tax incentives for American companies to invert. Inversion allows companies to maximize the benefits of exploiting offshore tax loopholes. Many multinationals use accounting tricks to make profits earned in the U.S. appear on the books of subsidiaries in tax havens like the Cayman Islands. An American company must pay U.S. tax on those profits it claims were made offshore if it wants to use the money to pay dividends to shareholders or make certain U.S. investments. However, once a corporation is characterized as foreign, the profits it books offshore are exempt from U.S. tax, increasing the reward for exploiting offshore loopholes.

Corporate inversions are often followed by "earnings-stripping," in which companies load the American part of the company with debt owed to the foreign part of the company. The interest payments on the debt are tax deductible, officially reducing American profits, which are effectively shifted to the foreign part of the company.

We urge Congress to address the tax benefits of inverting, including the ability of American corporations to use deferral to avoid paying U.S. taxes they owe on the profits that have been "booked" offshore. Those earnings should subject to U.S. tax when companies invert, which would be similar to the tax that individuals pay on their unrealized capital gains when they renounce their U.S. citizenship. Corporations should be held to the same standard when they too renounce their "citizenship", change their headquarters, and reincorporate in another country by requiring them to pay the taxes that they owe.

Congress should also prohibit the federal government from awarding contracts to an American corporation that has performed an inversion. It would be a terrible misuse of tax dollars for the federal government to contract with such firms. Congress has also shown support for this step by passing bipartisan amendments to appropriations bills that barred companies from receiving federal contracts if they have reincorporated in Bermuda or the Cayman Islands.

Please see Appendix A and B of this comment for further information, which includes a comment by U.S. PIRG to the Treasury Department following its first guidance on anti-inversion rules as well as our 2014 report, Picking Up The Tab, which quantifies how much an average taxpayer in each state would have to pay in additional taxes to make up for corporate abuse of offshore tax havens.

Write-offs for Wrong-doing

Federal government agencies are charged with holding individuals and corporations accountable when they break the law. While federal law forbids companies from deducting public fines and penalties from their taxes, companies that instead negotiate out-of-court legal settlements to dismiss charges of wrongdoing can typically deduct those payments as a tax write-off, unless specifically forbidden from doing so by the agency they negotiate with. In essence, companies are allowed to receive a tax break for their wrongful conduct. This dilutes the deterrence against harming the public. Moreover, ordinary taxpayers must pick up the tab for every dollar these companies receive in tax benefits from this loophole – in the form of cuts to public programs, high tax rates, or higher federal debt.

Due to a lack of required transparency, critical details of these settlements are not reported to the public and scrutiny of these deals is often impossible. Federal agencies report overinflated final settlement amounts that do not account for whether the corporations were able to write the payments off as a tax deduction or include "credits" for routine conduct that as a result, dramatically reduce the actual value of the settlement.

It is difficult to hold agencies accountable for diluting public protections this way. Too often the true value of settlements can also be smaller than it appears because it includes performing actions that a company would do anyway or which it previously agreed to. Agencies typically make it too difficult for the public to know the true value of a settlement.

For example, in the 1990s three wholly-owned subsidiaries of Fresenius Medical Care Holdings, a German dialysis provider, were accused by authorities of falsely billing Medicare for unnecessary blood tests and using illegal kickbacks – including bear-hunting excursions in Alaska – to encourage healthcare providers to partner with the company. In January 2000, Fresenius' lawyers cut a deal with the federal government to settle criminal and civil charges by paying $468 million, $385 million of which went toward the civil claims. Fresenius deducted most of the civil payment from its tax liability, but the IRS launched a legal challenge which temporarily blocked the deduction while the case moved through the courts. Once the ruling came down in Fresenius' favor, the company claimed a $50 million tax refund equal to the tax savings it would have enjoyed had it initially made the full tax write-off.

Bank of America Corporation was able to pay roughly $4 billion less to the government after tax than the $16.65 billion settlement it agreed to with the Justice Department over the summer. Standard & Poor's Ratings Services announced a record $1.5 billion payout to resolve crisis-era lawsuits with the Justice Department, states and a pension fund over inflated residential mortgage deals, and will be able to claim nearly $300 million in tax deductions as a result.

Solutions

With corporate tax loopholes costing American taxpayers close to $90 billion every year, it is imperative that the federal government stops corporations from being able to avoid paying U.S. taxes on profits they earn here. Congress, and more specifically, the Senate Finance Committee, is a crucial actor in this process. These steps would help restore fairness and accountability to our long-standing convoluted and loophole-ridden tax code.

The recommendations below include comprehensive reforms to the tax code to put an end to tax avoidance, actions Congress can take to close the most egregious tax loopholes that companies exploit, and reforms to end write-offs for wrongdoing and increase transparency in government settlements. We urge you to include these reforms in your tax reform proposal.

Comprehensive reforms

- Move to a worldwide tax system by ending deferral: End deferral of taxes on income multinational companies earn overseas. Companies should instead pay U.S. taxes on overseas income as soon as it is earned, and continue to receive foreign tax credits to offset taxes paid to foreign governments. This option would raise nearly $600 billion in new revenue, according to the Joint Committee on Taxation.

- Enact a formulary apportionment corporate tax system in which a company's worldwide income is apportioned for tax purposes to the jurisdictions where it does business, based on considerations such as sales, assets, and employees. Often referred to as "combined reporting," at the state level, 23 states have successfully implemented such a system with respect to a company's U.S. (not worldwide) income. A formulary apportionment system would ensure that multinational companies are taxed based on where they actually do business, preventing them from artificially shifting income made in the U.S. to a low tax jurisdiction where little to no business is being done to avoid taxes.

Legislation to close the most egregious loopholes

The following are specific, concrete methods to stop multinational corporations from avoiding their taxes on U.S. profit, many of which are included in the *Stop Tax Haven Abuse Act* (S. 174, H.R. 297) and the *Stop Corporate Inversions Act* (S. 198, H.R. 415).

- End transfer-pricing abuses and reduce the incentive for corporations to license intellectual property (for example, patents and trademarks) to shell companies in tax haven countries before paying inflated – and tax-deductible – fees to use them in the United States. For example, immediately taxing income to foreign affiliates receiving U.S. intellectual property, limiting income shifting through U.S. property transfers offshore, and tightening the rules related to the valuation of "goodwill" and other intangibles.

- Defer the deduction of interest expense related to deferred income. Right now, an offshore subsidiary of a U.S. company can defer paying taxes on interest income in collects from the U.S. based parent, even while the U.S. parent claims those interest payments as a tax deduction. This reform would save $51.4 billion over ten years, according to the Joint Committee on Taxation.

- Determine foreign tax credits on a pooled basis to stop companies from manipulating foreign tax credits to avoid taxes. This reform would save $58.6 billion over ten years according to the Joint Committee on Taxation.

- Require multinational companies to report employees, revenues, and tax payments on a country-by-country basis. This information would allow U.S. tax authorities to crack down on tax haven abuse.

- End the so-called "check-the-box" rules for foreign entities. 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.

- Eliminate the "Controlled Foreign Corporation (CFC) Look-Through Rule", 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. Eliminating this rule would stop multinational companies from manipulating how they define the corporate status of their offshore subsidiaries to minimize their taxes and would save taxpayers $20 billion over ten years according to the Congressional Budget Office and the Joint Committee on Taxation.

- End the "active financing exception" to subpart F of the tax code. A U.S. company generally cannot defer paying tax on the income of its foreign subsidiaries that is considered "passive," such as interest, dividends, rents, and royalties. Congress has determined that this deferral is not appropriate for this type of income because it is highly fungible and the entities that earn it are very mobile, making it a prime vehicle for making profits show up on the books of tax haven subsidiaries regardless of where actual business activity is happening. The active financing exception exempts income generated by financial and banking services from this general rule that such "passive" income earned by a foreign subsidiary must be taxed right away. Ending this tax break would save $58.8 billion over ten years according to the **Joint Committee on Taxation.**

- End the ability of U.S. multinationals to reincorporate abroad for tax purposes by acquiring a smaller foreign competitor – a maneuver referred to as an inversion. Inversion allows companies to maximize the benefits of exploiting offshore tax loopholes. Many multinationals use accounting tricks to make profits earned in the U.S. appear on the books of subsidiaries in tax havens like the Cayman Islands. An American company must pay U.S. tax on those profits it claims were made offshore if it wants to use the money to pay dividends to shareholders or make certain U.S. investments. However, once a corporation is technically foreign, the profits it books offshore are exempt from U.S. tax, increasing the reward for shifting profits offshore. This reform would save $33.6 billion over the next ten years according to the Joint Committee on Taxation.

- Prevent companies that are managed and controlled in the U.S. from claiming foreign status. The profits of "foreign" corporations that are managed and controlled in the U.S. should be treated as domestic for tax purposes.

- 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.

- Strongly implementing the Foreign Account Tax Compliance Act (FATCA), which was passed by Congress in 2010 but has since been stalled by multinational companies in a protracted stakeholder process.

Legislation to end write-offs for wrongdoing

- Pass the *Truth in Settlements Act* (S. 1898, H.R. 4324) has bipartisan sponsorship in both chambers and has passed through the Homeland Security and Governmental Affairs Committee in the Senate. The legislation calls for transparency and clear public information in federal settlement agreements over $1 million. By requiring that the tax status of settlement payments be explicitly stated and that settlement agreements be published online, the Truth in Settlements Act would increase public oversight of government agencies and the deals they sign behind closed doors to resolve charges of wrongdoing against the public.

- Pass the *The Government Settlement Transparency and Reform Act* (S. 413), which would restrict the ability for corporations to reap massive tax write-offs from payments made to settle allegations of misconduct or criminal wrongdoing.

Government agencies should:

- Make all settlement payouts non-deductible by default, including standard language in all agreements to that effect. The Environmental Protection Agency often does this and the Securities and Exchange Commission increasingly does as well.
- Publicly disclose all settlements on agency websites and include information about any portion that corporations have not been barred from deducting on their taxes.
- Require corporate filings to the Securities and Exchange Commission to explain whether any settlement payments were written off.
- Ensure "truth in advertising" by requiring regulators and corporations to disclose the after-tax amounts of settlements, a more accurate portrayal of the penalty a company actually pays.

Policies to avoid that would exacerbate offshore tax avoidance

Do not adopt a "territorial" tax system, which incentivizes corporations to further shift profits abroad and avoid taxes on U.S. income. A "territorial" tax system is akin to a permanent "get out of taxes free" card. Under this system, all profits booked to tax havens would be permanently exempt from U.S. tax by allowing companies to temporarily shift profits to tax haven countries, pay minimal tax under those countries' laws, and then bring the profits back to the United States tax-free. The U.S. already loses approximately $90 billion in federal tax revenues every year due to corporations booking their profits to offshore tax havens. These abusers benefit from our markets, infrastructure, workforce and security, but pay next to nothing for these benefits. Shifting to a territorial tax system would put small businesses and larger domestic companies at a competitive disadvantage.

Corporate lobbyists argue that, since other countries have adopted a territorial system, the U.S. should follow suit. A look at the UK should provide a cautionary tale. Despite rules intended to prevent tax haven abuse, Starbucks paid no corporate taxes in the UK from 2009 to 2012. Starbucks was able to shift profits abroad by paying premiums for coffee beans and roasting to offshore subsidiaries, and as a result were able to make it look like it was operating at a loss in the UK. Because the UK levies corporate tax on domestic profits, this income shifting eliminated Starbucks' UK corporate tax bill. Other multinational companies, such as Amazon and Google, engage in similar practices.

Do not pass a temporary corporate tax "repatriation" holiday. A tax holiday would reward the most aggressive tax dodgers by giving companies a massive tax discount on the profits they've booked offshore for tax purposes. In 2011 a Senate report analyzing a tax repatriation holiday in 2004 found that much of the profits some multinational corporations were supposedly holding offshore were actually sitting in U.S. bank accounts and other assets, undercutting the very premise that 'bringing the money back' would be a boon to the economy. Following 2004's corporate tax holiday, many of the companies that touted these economic benefits used the extra cash to enrich shareholders or pay down corporate debt rather than to create jobs. The Senate also found that the 15 firms that repatriated the most money that year -- approximately $150 billion collectively -- actually shed nearly 21,000 jobs, while increasing executive pay and slightly decreasing investment in research and development.

A few legislative proposals introduced in Congress would give companies a temporary (and voluntary) tax holiday, letting corporations bring back their money on paper at an extremely low rate to fund infrastructure projects here at home. As seen from the 2004 experience, tax holidays incentivize even more corporate tax dodging in the future, and would ultimately undermine efforts to make badly needed infrastructure investments.

The President calls for a 14 percent mandatory tax on all profits companies have booked offshore for tax purposes (known as a "deemed repatriation", which is quite different from a voluntary "repatriation tax holiday"). While it is a huge improvement over a temporary tax holiday because it mandates that companies pay the taxes they already owe on U.S. profits they've booked offshore, it still rewards large multinationals with armies of tax lawyers – giving them a massive discount at the expense of responsible small business owners and ordinary taxpayers. All of the offshore profits of U.S. multinationals should be taxed at the statutory tax rate, as established by the U.S. tax code.

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[i] Matthew Gardner, Institute on Taxation and Economic Policy, *Imagination at Work? GE Once Again Pays Less Than 1% in Federal Taxes,* March 2015.