FACT COALITION
Financial Accountability & Corporate Transparency

The Honorable Ron Wyden
Chairman
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Orrin Hatch
Ranking Member
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

CC: Members of the Senate Finance Committee

Dear Senators,

Taxes are a means to provide resources needed to maintain the health of a nation. At all levels of government, tax revenues maintain our courts, education system and workforce, our military, and our roads and bridges; they support public safety, food safety, clean air and water; they provide benefits for families, veterans, and an aging population.

The questions surrounding who should be taxed, and to what degree, in order to support these basic functions have incited much debate. As you consider ways to reform our system of taxation, we propose the following principles to guide the process.

Simply citing the need for business tax reform without an understanding of the real problems and facts at hand will lead to 1) solving the wrong problems, 2) making the current problems even worse, and/or 3) deepening the economic problems facing our country and many others around the globe.
Elected officials represent everyone: *every* type of business and *every* person in their districts, states or countries. Those charged with reforming our business tax code should take into account the impact of the current business tax code accordingly.

A partisan process or closed-door process will only lead to special interests and their standard-bearers protecting the current flaws in the system. The final outcomes and results should be transparent and should hold every lawmaker accountable for their contributions.

There are plenty of specific loopholes that should be considered for closing that have been enumerated both in legislative proposals and in the President's budget (listed in the attached "options" document), that we have advocated for – but these guidelines and core principles should inform any changes to our tax code.

THE PROBLEM

1. Our current code is riddled with loopholes systematically inserted by special interests that result in large, multinational corporations shifting their tax responsibilities to small businesses, domestic businesses and average taxpayers.

2. Due to huge loopholes and other factors, dozens of big corporations paid no federal income taxes in the last four years, while reaping billions of dollars in profits. Overall, corporations paid an average effective tax rate of 25.6 percent between 1987 (the beginning of the last major corporate tax reform) and 2008. In 2011 corporations paid just a 12 percent effective income tax rate, according to the GAO.

3. Corporations benefit from the operation of government just as individuals do (and more so in some cases due to myriad tax benefits and lucrative contracts) and should be expected to contribute, but corporate share of federal revenue was just 8 percent in 2011, having declined by more than 60 percent in the last 50 years.

4. There are many reasons for this massive slide both in contributions to the federal revenues and effective tax rates, but a major contributing factor has been the incentives the current corporate tax code creates for large, multinational corporations to move jobs and profits offshore. Though many of the worst tax-avoiding corporations plead innocence, these loopholes weren't created by accident—the tax code has been the successful target of massive lobbying efforts to create and maintain loopholes that account for revenue loss.

5. While many American corporations have real operations in other countries, reports from non-partisan governing entities and agencies, both in the U.S. and internationally, have provided ample evidence that many corporations are using subsidiaries in low- and no-tax countries to greatly reduce their taxes through legal channels. Where companies book their profits often has little to do with where they are actually doing business. The CRS found that in 2008, American multinationals reported 43 percent of their foreign earnings in five small tax havens where they have few employees and make few foreign investments. Tax avoidance drains the treasuries of all countries, which struggle to provide the services and benefits that these same corporations, as well as the citizenry at large, need to function.

6. Offshore loopholes have provided a powerful incentive for companies to renounce their American corporate citizenship through "inversions." Some companies have booked such a large share of their profits to low-tax countries that they now have an especially powerful incentive to "invert" – a maneuver in which a U.S. company changes the address of its headquarters to reincorporate in a foreign country. Being a "foreign" corporation for tax purposes ensures that companies never have to pay U.S. taxes on profits they claimed were earned abroad, but were often really U.S. profits booked for tax purposes to tax havens.

7. The same system that enables financial services firms and corporations to shift money around the world with little or no accountability is also used for nefarious purposes by criminals. FACT's member organizations—whether focused primarily on corruption, corporate accountability, human rights, illicit capital flows or tax justice—are unified in our desire to see this shadow financial system dismantled.

THE SOLUTION

We need a business tax system that:

- Holds corporations accountable to report their profits and revenues in a consistent manner to government, shareholders and the public;

- Removes distortions that create incentives for companies to shift profits and jobs offshore;

- Encourages competition based on products, services, innovation and job creation rather than the ability to hire accountants and lawyers to employ tax strategies;

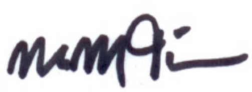
- Does not create unjustified tax/revenue deficiencies in other countries;

- Focuses on the public interest, and does not choose winners and losers based on their ability to lobby and contribute to campaigns;

- Provides for transparency across industries and countries as to transactions, economic activity, and taxes paid, giving investors, shareholders and governing bodies a holistic view of a corporations' activity; and

- Ensures that all businesses -- large and small, domestic and global,-- pay their fair share of taxes toward ensuring that adequate public investment is made to keep our economy strong and competitive.

Thank you for your consideration,



Nicole Tichon
Executive Director
FACT Coalition

For more information, contact Rebecca Wilkins of Citizens for Tax Justice (rwilkins@ctj.org) or Dan Smith of U.S. PIRG (dsmith@pirg.org)

OPTIONS FOR REFORMING BUSINESS TAX CODE

Reference

Deferral system — most foreign operating earnings of an MNC's foreign subsidiaries will be subject to U.S. taxation only when distributed as dividends, which often is never.

Territorial system — most foreign operating earnings, including those within an MNC's foreign subsidiaries, will never be subject to any U.S. taxation no matter whether distributed or not.

Worldwide full-inclusion system — foreign operating earnings, whether directly earned by a U.S. MNC group member or within an MNC foreign subsidiary, will be subject to U.S. taxation currently as earned.

Options: Change the System

a. Move to worldwide 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. (S.250, Corporate Tax Fairness Act, Senator Bernie Sanders).
b. 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.

Options: Within the System

a. End transfer pricing abuses. For example, tax immediately 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. (S.1533, Stop Tax Haven Abuse Act, Senator Carl Levin, Obama budget.)
b. 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 $19.5 billion according to the Joint Committee on Taxation.
c. 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. (S.1533, Stop Tax Haven Abuse Act, Senator Carl Levin, Obama budget.)
d. 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. (Obama FY2015 Budget, S.1533, Stop Tax Haven Abuse Act, Senator Carl Levin)
e. 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 (Obama FY15 Budget, S.1533, Stop Tax Haven Abuse Act, Senator Carl Levin)

f. 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 (S.1533, Stop Tax Haven Abuse Act, Senator Levin).

g. End the so-called "check-the-box" rules for foreign entities and the CFC look-through rule to stop multinational companies from manipulating how they define the corporate status of their offshore subsidiaries to minimize their taxes. 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. This reform would save $78 billion according to the Joint Committee on Taxation. (S. 1533, Stop Tax Haven Abuse Act, Senator Carl Levin)

h. 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.**

i. 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 $19.5 billion according to the Joint Committee on Taxation.