# A Taxing Problem for Investors

*Shareholders Increasingly at Risk from Lack of Disclosure of Corporate Tax Practices*

FACTCOALITION
Financial Accountability & Corporate Transparency

*September 2016*

# A Taxing Problem for Investors

## *Shareholders Increasingly at Risk from Lack of Disclosure of Corporate Tax Practices*


September 2016

## *Acknowledgements*

The FACT Coalition would like to thank the Ford Foundation and Open Society Foundations for supporting this report.

The FACT Coalition would also like to thank Clark Gascoigne (Deputy Executive Director), Jacob Wills (Communications and Operations Associate), Waiyan Tse (Advocacy Intern), and Yaroslav Pustarnakov (Advocacy Intern), for their contributions to the report.

**Cover Image Sources**: 1) KieferPix/Shutterstock and 2) thanosquest/Shutterstock
**Cover Design**: Clark Gascoigne and Jacob Wills



The recommendations are those of the FACT Coalition. The views expressed in this report are those of the Coalition and do not necessarilly reflect the views of our funders or those who provided review.
Founded in 2011, the *Financial Accountability and Corporate Transparency (FACT) Coalition* is a non-partisan alliance of more than 100 state, national, and international organizations working toward a fair tax system that addresses the challenges of a global economy and promotes policies to combat the harmful impacts of corrupt financial practices. More information about the coalition can be found at the back of this report or on the FACT Coalition website at www.thefactcoalition.org.

# Table of Contents

# Executive Summary

The role played by international tax strategies and rates on the operations and earnings of many public U.S. corporations is enormous and growing. In large part, this trend is due to many large U.S. issuers' increasing reliance on moving earnings offshore, cash balances, and tax benefits. For example, a recent report by Citizens For Tax Justice found that earnings held offshore by U.S. corporations had in 2015 reached an eye-popping total of $2.4 trillion.[1] Governments around the globe have begun to crack down on perceived tax abuses to increase corporate tax collections and reverse revenue losses.

As detailed in this report, multinational companies that depend too heavily on tax avoidance schemes for increasing shareholder value are putting investors in a potentially vulnerable financial position. Surprisingly, shareholders have little information on a company's tax strategy.

Profits held offshore and their attendant tax rates can have profound impacts on even the largest U.S. issuers. For example, in 2010, General Electric claimed a U.S. profit of just over $4 billion. The company's tax refund that year was $3.2 billion largely based on the company's ability to shift profits overseas to lower tax jurisdictions.

This report examines the type of information disclosed by publicly traded companies to the U.S. Securities and Exchange Commission (SEC) on their earnings held offshore, cash balances, and tax benefits. It finds that the information is currently insufficient to allow for a "reasonable investor" to conclude it may "significantly alter" the "total mix" of information—the SEC's long standing principles-based legal standard for what must be disclosed.

Tax liability can have a significant impact on company valuations. In one case, the difference over a company's offshore tax liabilities led "two highly distinguished scholars of valuation science, applying similar valuation principles," to generate opinions that "differed by 126%, or approximately $28 billion."[2] Almost none of the information needed to resolve the valuation dispute was previously disclosed to investors or the public.

The current disclosure obligations for companies allows management complete control over nearly all aspects of the determination of what to disclose, and provides no ability for investors to verify the accuracy of the financials related by the company. Essentially, a company may disclose some information related to its offshore assets and taxes, but that information—if any—is often so piecemeal that investors cannot reasonably determine if the judgments resulting from the data are accurate. There is reason for investors to be concerned. A 2004 paper found evidence that firms that had missed earnings targets manipulated overseas income to make up shortfalls in future periods.[3]

Many analysts are focusing on international tax strategies in their stock recommendations. For example, in May 2016, analysts at Goldman Sachs sent out a newsletter urging clients to "Buy stocks with high US sales and high effective tax rates and avoid firms with high foreign sales and low tax rates." This analysis and investment advice is presumably based on perceived risks associated with aggressive corporate tax practices subject to enforcement actions and tax policy changes at home and abroad.

Many large U.S. multinational corporations are stating that their offshore profits are "permanently reinvested" abroad, but the form of reinvestment of these billions of offshore dollars is in cash or cash equivalent instruments (with low returns). Thus, while aggressive international tax strategies may allow companies to

avoid payment of U.S. taxes on their income, the cost associated with those strategies may be that the income earned is then not put to its most productive uses, but is instead parked in extremely low yielding investments like U.S. Treasury securities. Some investors have begun to openly question whether this result is beneficial to investors or the company.[4]

To better inform investors, the SEC should revise its international tax disclosure framework to specifically require multinational corporations to disclose, on an annual, country-by-country basis:

- profit or loss before taxes;
- income tax accrued for the current year;
- revenues from unrelated parties, related parties, and in total;
- income tax paid (on a cash basis);
- effective tax rate;
- stated capital;
- accumulated earnings;
- number of employees; and
- tangible assets other than cash or cash equivalents.

In addition to country-by-country reporting, investors would have much greater ability to understand international taxes if the SEC further specified in modest rules changes or, if appropriate, guidance that U.S. corporate issuers should:

- provide their U.S. and foreign effective tax rates and explain any effective tax rate that is significantly lower than the statutory rate in the countries in which they do business;
- use the company's weighted average statutory rate based on geographic revenue mix instead of home country statutory rate in the tax rate reconciliation schedule;
- explain any large or increasing Unrecognized Tax Benefit balance;
- disclose for all non-de minimis intracompany debt transactions, the countries where the debt is held, the amount of the debt, and the average interest rate "paid" by the relevant subsidiary on that debt;
- disclose and explain any material tax incentives or benefits provided by a foreign jurisdiction, including the estimated tax savings, any conditions attached to the incentive or benefit, and the likelihood that the incentive or benefit may be lost; and
- disclose of any legal proceedings by foreign governments related to taxes paid to any such government, regardless of whether such matter is material to the financial position of the corporation.[5]

For markets to function properly, it is critically important for investors and the public to be armed with sufficient information to meaningfully assess the business operations, management, and risks of U.S. public companies. As multinational corporations have increasingly relied upon complex, international tax strategies to improve their bottom lines, the SEC’s disclosure framework has not kept pace.

# I. Introduction

With the adoption of the federal securities laws in the aftermath of the Great Crash of 1929,[6] Congress required large public companies to make comprehensive disclosures about their business, management, finances and operations,[7] while also establishing the U.S. Securities and Exchange Commission (SEC) to, amongst other things, "promulgate rules for registrant disclosure as necessary or appropriate in the public interest or for the protection of investors."[8]

Over the subsequent eight decades, two largely overlapping standards for what public U.S. companies must disclose have developed. First, the federal securities laws require companies to disclose information that a "reasonable investor" could conclude may "significantly alter" the "total mix" of information.[9] The principles-based legal standard for what must be disclosed has been relatively the same for decades.[10]

Second, the SEC has adopted further requirements for companies to make specific disclosures, much of which is now captured in Regulation S-K. In theory, these disclosures should be relatively close to the disclosures called for by the "reasonable investor." In reality, while investors and the public have increasingly sought more and better information from U.S. corporate issuers of securities, the SEC's specific disclosure requirements set forth in Regulation S-K have not kept pace.

Today, more than ever before, investors care about a number of issues that are un- or under- addressed by the existing regulatory framework. These areas range from executive compensation, worker training, corporate stock buybacks, sustainability efforts, and political spending, to, most importantly for our current purposes, international tax practices and subsidiaries.

The SEC should update its specific disclosure requirements to better reflect the reality that "reasonable investors" want to know more about how their companies' operate. Unquestionably, and as outlined below, information regarding a corporation's tax practices and subsidiaries, is extremely important to both sophisticated and retail investors. This information can better assist them in ascertaining the value of their holdings, assess numerous types of risks to their companies, and assess the judgment and integrity of corporate management.

The SEC should revise its specific disclosure requirements outlined in Regulation S-K, as well as offer guidance, calling for U.S. corporate issuers to disclose more information about these two basic, yet critically important, topics.

# II. Background

## *A. Increasing Corporate Reliance on Offshore Tax Strategies and Offshore Profits*

The role played by international tax strategies and rates on the operations and earnings of many U.S. corporations is enormous and growing. In large part, this trend is due to many large U.S. issuers' increasing reliance on offshore earnings, cash balances, and tax benefits. For example, a recent report by Citizens For Tax Justice found that offshore earnings held by U.S. corporations had in 2015 reached an eye-popping total of $2.4 trillion.[11]

Offshore profits and their attendant tax rates can have profound impacts on even the largest U.S. issuers. For example, in 2010, General Electric claimed a U.S. profit of just over $4 billion. The company's tax refund that year was approximately $3.2 billion, largely based on the company's ability to shift profits overseas to lower tax jurisdictions (See Table 1).[12]

*Table 1: GE's 10 Years of Negligible Total Federal Income Taxes[13] ($-millions)*

| Year | Pretax US Profit | Federal income Tax | Federal Tax Rate |
|---|---|---|---|
| **2002** | $ 11,998 | $ –33 | -0.3% |
| **2003** | 10,826 | 1,244 | 11.5% |
| **2004** | 9,103 | 629 | 6.9% |
| **2005** | 10,074 | 2,755 | 27.3% |
| **2006** | 9,911 | 513 | 5.2% |
| **2007** | 8,686 | 64 | 0.7% |
| **2008** | 4,638 | -651 | -14.0% |
| **2009** | 2,063 | -649 | -31.5% |
| **2010** | 4,714 | -3,027 | -64.2% |
| **2011** | 9,156 | 1,032 | 11.3% |
| **10 Years:** | **81,169** | **1877** | **2.3%** |

Note: At the end of 2011, GE had claimed $3.9 billion in cumulative tax breaks that are not reflected above because GE expects that the IRS will not allow them and GE will have to give the money back.

*Source: Citizens for Tax Justice, April 2012*

Apple is another U.S. company that is profoundly impacted by its offshore earnings and tax strategies. In 2013, the U.S. Senate Permanent Subcommittee on Investigations held a hearing examining Apple's aggressive offshore tax strategies. The Senate learned, for example, how Apple had established an offshore subsidiary that reported receiving dividends totaling $30 billion over four years, but paid no corporate income taxes on those dividends to any national government anywhere in the world. The Subcommittee also found that a lower-tier Apple subsidiary in Ireland received a total of $74 billion in "sales" income over the same four years, but paid almost no taxes on that income.[14] Since 2013, Apple's dependency upon its offshore earnings and tax strategies has become even more pronounced. In 2015, the company reported $53 billion in profits, and accumulated earnings of $200 billion which it is holding offshore, much of it in tax havens.

In fact, as shown in Table 2, U.S. corporations' reliance on tax havens has increased dramatically in recent years.

*Table 2. Earnings Parked Overseas as a Percentage of Book Value*[15]

| Sector | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|---|---|
| Consumer Discretionary | 6% | 7% | 9% | 17% | 14% | 14% | 19% | 23% | 23% | 24% |
| Consumer Staples | 20% | 21% | 24% | 32% | 36% | 36% | 42% | 47% | 49% | 56% |
| Energy | 22% | 23% | 24% | 26% | 21% | 19% | 20% | 21% | 22% | 19% |
| Financials | 4% | 5% | 7% | 8% | 8% | 8% | 8% | 9% | 9% | 9% |
| Health Care | 26% | 37% | 50% | 62% | 49% | 54% | 63% | 70% | 72% | 77% |
| Industrials | 16% | 21% | 25% | 36% | 36% | 37% | 43% | 50% | 47% | 54% |
| Information Technology | 14% | 18% | 27% | 34% | 38% | 42% | 49% | 55% | 60% | 66% |
| Materials | 33% | 35% | 34% | 46% | 42% | 40% | 42% | 45% | 45% | 55% |
| Telecommunication Services | 3% | 2% | 1% | 1% | 1% | 1% | 1% | 1% | 1% | 1% |
| Utilities | 1% | 1% | 1% | 1% | 2% | 2% | 2% | 2% | 3% | 2% |
| **S&P 500** | **12%** | **15%** | **18%** | **24%** | **22%** | **23%** | **26%** | **29%** | **31%** | **33%** |
| **S&P 500 (ex-Financials)** | **16%** | **19%** | **23%** | **31%** | **29%** | **30%** | **35%** | **39%** | **41%** | **33%** |

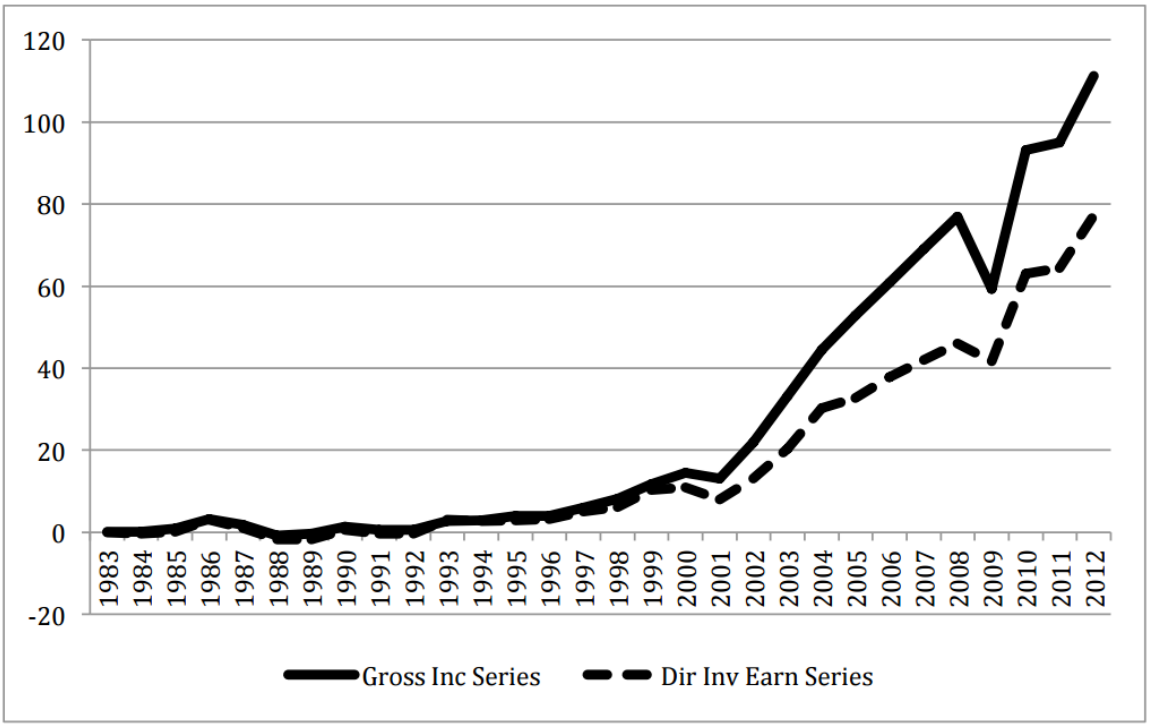
*Note: Analysis excludes Financials, REITs and Companies domiciled outside the U.S.*

*Source: Calcbench, Compustat, Company data, Credit Suisse estimates, 17.*

## *B. Government's Around the World Are Cracking Down*

Amidst the rise of offshore profits, complex offshore tax strategies, and lowering effective tax rates, governments around the globe have begun to crack down on perceived abuses to increase corporate tax collections and reverse revenue losses. According to the Organization for Economic Co-operation and Development (OECD), worldwide "[r]evenue losses from [some offshore tax strategies] are conservatively estimated at USD 100-240 billion annually."[16] The United States is one of the big revenue losers. A 2016 academic study estimated that offshore profit shifting by multinational companies jumped significantly in recent years—costing U.S. taxpayers between $77 billion and $111 billion in corporate tax revenues in 2012 alone (See Figure 1).[17]

*Figure 1: Estimates of Revenue Loss Due to Income Shifting, Billions USD*[18]




*Source:* Kimberly, Clausing, "The Effect of Profit Shifting on the Corporate Tax Base in the United States and Beyond," Jan. 11, 2016.

To combat this legal tax avoidance, but also tax evasion (which isn't included in the estimates above), tax authorities around the world have been investigating the tax practices of many of the largest U.S. issuers, and imposing significant revisions to past, current, and potential future tax liabilities. In 2015, Chevron was hit with a $269 million tax assessment by the Australian government. This preceded reports that the U.S. energy giant had paid a mere $248 Australian dollars in taxes on $1.7 billion Australian dollars in profits (less than 1/10,000 of a percent).[19] Similarly, Google, Starbucks, and Amazon have each faced withering scrutiny by European authorities following revelations of extremely low tax payments to governments. For example, in 2011, Amazon, had sales in the U.K. of 3.35 billion pounds, yet reported a "tax expense" of 1.8 million.[20] In May 2016, the Paris offices of Google were raided by tax officials, amid reports that the French government is seeking tax payments of 1.6 billion euro (about $1.8 billion).[21]

U.S. authorities are also investigating offshore tax abuses by large U.S. issuers. Caterpillar has reported, for example, that the IRS is seeking significant additional tax payments[22] and prosecutors are investigating its offshore tax practices.[23] Yet, its disclosures do not arm investors with sufficient information about which to assess the potential risks involved. Instead, they serve merely as a "heads up" notice that the company may face enormous tax risks—without articulating any of the details as to why or how much is really involved. For that information, investors and the public need to look elsewhere, such as Congressional hearings and press reports.[24]

Hewlett-Packard has also been investigated for its use of serial short-term loans financed with its offshore profits to run its U.S. operations, without paying any tax on the repatriated funds.[25] And it has fought the IRS

in a number of international tax-related matters, including its use of derivatives sold by AIG's infamous Financial Products Group to generate foreign tax credits and capital losses.[26]

While many other companies have been reported as being under investigation, their SEC filings do not appear to reflect the investigations, or provide only cursory information that is inadequate to assess the risks.

## *C. Tax Authorities Around the World Are Also Looking to Change the Rules*

In 2013, the OECD, which includes the United States, expressed concerns that "National tax laws have not kept pace with the globalization of corporations and the digital economy, leaving gaps that can be exploited by multi-national corporations to artificially reduce their taxes."[27] At the request of G-20 leaders, in 2015, the OECD released 15 detailed Action Plans to combat international tax avoidance strategies—many of which are used by large U.S. corporate issuers. As part of its efforts, the OECD has worked diligently with G-20 finance officials, including the U.S. Treasury Secretary, to develop consensus on how to tighten international tax treaties and agreements to stop abusive tax practices, and they are currently expanding their efforts.

Further, the European Commission has begun invalidating some tax arrangements as "illegal state aid" that disadvantage other corporations and is demanding additional tax assessments. The European community has begun to condemn secret sweetheart tax deals between individual countries and specific multinationals—some of which are publicly traded U.S. corporations.[28]

The United States Treasury Department is contributing to the revision of offshore tax rules. Earlier this year, the Treasury Department revised its rules to remove potential benefits from so-called corporate "inversions," which has already impacted corporate valuations and merger activity. For example, Pfizer's years-long effort to engage in a so-called corporate inversion strategy (which had progressed to a formal proposed merger with Dutch-based Allergan) was immediately abandoned once the U.S. Treasury Department revised tax rules that the strategy was intended to exploit.[29] The impacts were immediately felt by the companies involved and throughout the markets (See Figure 2).[30]

*Figure 2: Allergan Stock Plummets almost 22% Following Treasury Rule That Blocks Inversions*[31]


*Source: Michelle Cortez, Bloomberg, April 2016.*

Further, bipartisan legislation and several budget proposals seek to close what are perceived as corporate tax loopholes. Just one of those proposals, calling for the aggregation of foreign tax credits, would eliminate corporate tax benefits estimated at over $50 billion.

Disappointingly, none of these events are clearly reflected or discussed in any of the affected U.S. companies' disclosures.[32]

## *D. Increasing Importance to Investors*

When Congress adopted the federal securities laws in the 1930s, it specifically recognized the important role of disclosures in valuing securities and promoting the effective collection of tax.[33] In recent years, taxes, and particularly international taxes, have become increasingly critical in gauging a corporation's value, profitability, and risks—core areas of interest for the SEC.

# III. Salience to Investors

## *A. Investors Need Additional International Tax Information to Perform Even Basic Valuations*

International tax strategies play an increasingly central role in valuing some of the largest U.S. companies. One recent high-profile case involving the valuation of Dell Corporation demonstrates the key role that certain international tax information can play.[34]

The key dispute in the case involved valuing the company in connection with a potential management buyout. The court found that "two highly distinguished scholars of valuation science, applying similar valuation principles, thus generated opinions that differed by 126%, or approximately $28 billion. This is a recurring problem."[35] One of the key drivers of the difference between the two valuations was the scholars' assumptions and findings regarding the company's tax rates on its offshore earnings.[36] One expert concluded that the company would have to pay $2.24 billion in taxes on its offshore income, even though it was characterized as indefinitely deferred.[37] The other expert determined that, because the company had never paid high rates on its offshore income, and was extremely unlikely to do so in the future, the company warranted a higher valuation.[38]

Almost none of the information needed to resolve the valuation dispute was previously disclosed to investors or the public. After comprehensive discovery and analysis by offshore tax experts, one valuation expert determined his valuation on a projection that Dell would have an ongoing future effective tax rate of slightly over 35%, while the other projected a future tax rate of just 21%.[39] Their disagreement over the corporation's appropriate tax rate produced valuations that differed by billions of dollars, demonstrating investors' desperate need for improved disclosures on offshore profits, effective tax rates, potential tax liabilities, and related risks.

## *B. International Tax Strategies Pose Unique Opportunities for Financial Manipulation*

The current disclosure obligations for companies allows management complete control over nearly all aspects of the determination of what to disclose, and provides no ability for investors to verify the accuracy of the financials related by the company. Essentially, a company may disclose some information related to its offshore assets and taxes, but that information—if any—is often so piecemeal that investors cannot reasonably determine if the resulting judgments are accurate.

There is reason for investors to be concerned. Because company management can elect what is "permanently reinvested" overseas, and the impacts of that election is often dramatic on a company's tax bill (as could numerous other tax-related decisions), tax strategies provide ripe opportunities for corporate management to manipulate earnings.[40] Far from a theoretical concern, the academic research suggests this already occurs.[41] For example, a 2004 paper found evidence that firms that had missed earnings targets manipulated overseas income to make up shortfalls in future periods.[42]

The SEC has even appeared to at least somewhat recognize this concern, as evidenced by its reported efforts to examine Disney's decision to reclassify its tax risks, which had dramatic impacts on its earnings. As it was reported by Bloomberg News in March 2015:

> "In 2013, Disney nearly tripled to $1.5 billion the amount of foreign earnings exempt from U.S. taxes from a year earlier. Part of that was revenue from 2012. In a Feb. 2014 letter to Disney, the SEC questioned why the company had reclassified earnings from an earlier year and why the overall tax rate had declined even though the company had earned less money in lower-tax countries. In its reply, Disney said it made the moves because it needed more money for its media business, theme parks and resorts outside of the U.S. The company also said the decision to reclassify earnings from a prior year was appropriate under accounting rules. The regulator hasn't sought additional answers from the company. The media company announced a similar move Feb.3 [2015], when it again raised the amount of income it holds abroad. The move helped to lower its tax rate for the fiscal first quarter of 2015 to 33.3 percent from 35.2 percent a year earlier. **Once again, Disney didn't explain to investors why it made the move.**" (emphasis added).[43]

Further, a senior SEC official in the SEC's Division of Corporation Finance recently stated that companies' international tax disclosures "are not sufficient and certainly cannot be called transparent in that many of the items included in that foreign tax line are subject to different trends and uncertainties."[44]

## *C. Leading Research Analysts Focus on U.S. Companies' International Tax Strategies and Risks*

Leading research analysts are also increasingly focused on the implications of offshore tax issues for U.S. corporations.

Many analysts are focusing on international tax strategies in their stock recommendations. For example, a recent research report by Equity Research analysts at Credit Suisse found that for many major U.S. companies, including Mattel, HP, Xerox, and Western Union, potential offshore tax liabilities represented over 10 percent of the company's total market capitalization.[45] These analysts also found that for a whopping 68 U.S. issuers, their estimated foreign tax liabilities exceeded 5% of the companies' market capitalization.[46] Similarly, in May 2016, analysts at Goldman Sachs sent out a newsletter urging clients to "Buy stocks with high US sales and high effective tax rates and avoid firms with high foreign sales and low tax rates." This analysis and investment advice is presumably based on perceived risks associated with aggressive corporate tax practices subject to enforcement actions and tax policy changes at home and abroad.

Unfortunately, the facts that could best inform this analysis are generally not disclosed by issuers today, even though they would unquestionably "significantly alter" the "total mix" of information. As one analyst from Macquarie Capital USA put it, "there is very little transparency in tax," which "happens to be one of the most opaque areas of accounting."[47]

## *D. Investors Want to Assess U.S. Companies' Use of Funds Impacted by International Tax Strategies*

Separate and apart from the valuation concerns and risk assessments identified above, investors are increasingly seeking information about how U.S. companies are using their offshore funds. Many large U.S. multinational corporations are stating that their offshore profits are "permanently reinvested" abroad, but the form of reinvestment of these billions of offshore dollars is in cash or cash equivalent instruments (with low returns).

Thus, while aggressive international tax strategies may allow companies to avoid payment of U.S. taxes on their income, the cost associated with those strategies may be that the income earned is then not put to its most productive uses, but is instead parked in extremely low yielding investments like U.S. Treasury securities. Some investors have begun to openly question whether this result is beneficial to investors or the company.[48] Here's how one investor put it:

> Some multinationals have more than 50% of their assets 'permanently reinvested' offshore. According to a Wall Street Journal investigation, however, 93% of the money Microsoft has officially 'offshore' was invested in U.S. assets, like Treasuries. Arguably, this is not a productive use of 50% of one of the world's largest company's assets, and may represent significant opportunity costs to investors.[49]

Currently, Regulation S-K does not specifically require registrants to disclose how a company's offshore funds are invested, even when those funds represent a material portion of the company's assets. As a result, investors are not well-positioned to assess whether stockpiling what may amount to tens of billions of dollars in extremely low yielding securities or cash equivalent instruments is a wise allocation of the company's capital, which might otherwise be used for acquisitions, employee training, or capital investments to drive the company's business forward. This information should be provided to investors.

A related issue is whether the funds that a corporation declares to be offshore for tax purposes are, in fact, held outside of the United States. Many companies deposit their "offshore" earnings with foreign banks and direct those banks to keep the funds in the form of U.S. dollars. To do so, foreign banks typically deposit the corporate funds in U.S. dollar accounts opened by those foreign banks at U.S. financial institutions. The funds are then typically invested in certificates of deposit, U.S. Treasuries, or other secure capital instruments located in the United States. Investigations have determined that, on average, U.S. corporations keep nearly 50% of their "offshore" funds in U.S. dollars, U.S. bank accounts, and U.S. investments; at some corporations, the figure exceeds 75% (See Table 3).[50]

*Table 3. Percentage of Undistributed Accumulated Foreign Earnings Held in U.S. Bank Accounts or U.S. Investments at the End of FY2010*[51]

| 0 - 25% | 26% - 50% | 51% - 75% | 76% - 100% |
|---|---|---|---|
| Bristol-Myers Squibb | Coca-Cola | Oracle | Adobe* |
| CA Technologies | Devon Energy | Motorola | Apple* |
| Duke Energy | DuPont* | PepsiCo* | Broadcom |
| Eli Lilly | Intel | | Cisco |
| Hewlett-Packard | | | Google |
| Honeywell | | | EMC |
| IBM | | | Microsoft |
| Eastman Kodak | | | Johnson & Johnson |
| Merck | | | Qualcomm* |
| Pfizer | | | |
| Procter & Gamble | | | |

* Figures reflect their U.S. dollars and investments as a percentage of their foreign cash.

***Source***: Survey Data, U.S. Senate Permanent Subcommittee on Investigations Dec. 14, 2011.

That information is of interest to investors and the public in part because investments in U.S. dollars are more likely to retain their value, and cash deposited in U.S. banks is more likely to be more secure. For that reason, S- K disclosures should require registrants to disclose what percentage of their funds treated as "offshore" for tax purposes are actually being held within the United States.

## *E. Investors are Increasingly Focusing on Public Policy Considerations Related to Corporations' Tax Strategies and Practices*

Aside from needing this information to make basic investment decisions based on purely short-term financial considerations, investors are also increasingly concerned with the long-term social and economic impacts of their companies' tax strategies.

The shareholder advisory service ISS has reported that its "institutional investor clients have shown significant interest in the public policy debate swirling around inversions and other tax avoidance strategies."[52] Similarly, an organization of investors managing more than $45 trillion in assets found that over 100 of its members viewed tax as a significant concern.[53] As it's Managing Director articulated, "[Investors] are worried about the legal and regulatory environment and the risk of tax evasion, and they are starting to engage with the companies they invest in."[54]

Far from just expressing concerns, investors are working together to revise how they factor international taxes into their investment decision processes. For example, in November 2014, 45 union-affiliated organizations from 19 countries called upon pension funds to incorporate tax risks as a core part of responsible investment policies.

In the U.S., members of the Council of Institutional Investors have expressed concerns with aggressive international tax strategies and corporate inversions based on broad policy concerns, as has the Church of England abroad.[55] Thus, international tax strategies are now part of the investment-making decisions for many large investors. Again, the disclosures made by many U.S. corporate issuers, are simply inadequate for them to make sufficiently informed decisions.

## *F. Investors Are Engaging in Efforts to Obtain Additional Information from U.S. Corporations About Their Tax Strategies*

Investors have engaged in numerous initiatives to improve companies' disclosures, including:

- Engaging with companies to improve their disclosures;[56]
- Working through the 14a-8 process to require individual companies to enhance disclosures;
- Proposing new exchange listing standards that would require disclosure of key environment, social, and governance (ESG) factors, one of which related to "tax strategy/tax avoidance";[57] and
- Proposing revised disclosure obligations.

These efforts have involved dozens of organizations around the globe.[58] Unfortunately, these efforts have resulted in only limited improvements. Particularly disappointing, due to the SEC staff's strained interpretations and the limitations of the 14a-8 process, the 14a-8 efforts have been largely thwarted.[59] Collectively these efforts have yielded no broad-based reforms or enhancements for investors. Investors and the public still don't have what they want or need.

# IV. Recommendations

## *A. Investors Need Country-by-Country Reporting*

As described above, current SEC reporting by U.S. issuers is wholly inadequate to determine a company's tax practices, actual and projected tax liabilities, and potential tax problems. Existing tax disclosures can be used to hide actual tax payments, exaggerate U.S. or other country-specific tax rates, and overstate tax assets. It also impedes accurate assessments of the value of public companies.

As a practical matter, tax practices, liabilities, and risks can be assessed only on a country-by-country basis, because taxes are assessed by individual jurisdictions. Yet current U.S. tax-related disclosures appear primarily in the footnotes to a corporation's financial statement, and provide only limited disclosures—provisions made for U.S. federal taxes, U.S. state taxes, and "foreign" taxes. The current structure provides tax data on the United States versus the rest of the world combined. The data on foreign taxes is particularly unhelpful given that different corporations operate in different countries which vary widely in their tax rates, credits, and deductions, not to mention their tax enforcement. A combined foreign tax rate is of little practical value. In addition, it obscures rather than illuminates a corporation's tax risks in individual countries. For example, if a corporation maintains significant operations in one country, then a raid by that country's tax officials would matter more to investors than if the raid took place elsewhere.

In addition, some countries base taxes on where a corporation or its subsidiaries are incorporated, while others do so according to where corporate management and control take place. Some countries are considering proposals to apportion corporate profits. Thus, it should be no surprise that corporations themselves recognize this importance, and determine their effective tax rates and other information based on a jurisdiction-by-jurisdiction basis.[60] Investors need country-by-country data to evaluate each corporation's existing and potential tax liabilities and risks.

Importantly, the United States is not the only country faced with this problem. Abroad, foreign governments recognize the need to improve their companies' disclosures. The European Union, for example, is requiring member countries to begin disclosing cross-border tax deals with multinationals, and is considering proposals to require country-by-country reporting among the 28 member nations and designated tax havens.

To better inform investors, the SEC should revise its international tax disclosure framework to specifically require multinational corporations to disclose, on an annual, country-by-country basis:

- profit or loss before taxes;
- income tax accrued for the current year;
- revenues from unrelated parties, related parties, and in total;
- income tax paid (on a cash basis);
- effective tax rate;
- stated capital;
- accumulated earnings;
- number of employees; and
- tangible assets other than cash or cash equivalents.

Much of this information is likely already collected by corporations internally for business, payroll, and tax purposes, and so would not require much additional effort to report publicly. Some of it may already be included in a corporation's existing Regulation S-K-mandated disclosures.

Each of the listed factors would provide basic data about a corporation's operations. None involves proprietary data. As proof, some financial institutions and corporations in the extractive industries already provide most of the information in their European Union public filings with no ill economic effects. The E.U. further appears to be moving towards expanding those same public disclosures to all of its corporations.

Large U.S. multinational corporations will soon be required to provide similar information in non-public, country-by-country filings with the IRS. Rather than create a patchwork of SEC and IRS disclosure requirements for various industries and corporations, the SEC should require the same information for all publicly traded corporations.

It is only with a full appreciation of basic facts about a corporation's operations at a country-by-country level that an investor can meaningfully assess that corporation's international tax practices, liabilities, and risks. As a practical matter, the relevant information could be easily introduced as a slightly-revised version of various Items of Regulation S-K (most easily, Items 101 and 102).

## *B. Investors and the Public Deserve Additional Explanations of Tax Disclosures*

In addition to country-by-country reporting, investors and the public would have much greater ability to understand international taxes if the SEC further specified in modest rules changes or, if appropriate, guidance that U.S. corporate issuers should:

- provide their U.S. and foreign effective tax rates and explain any effective tax rate that is significantly lower than the statutory rate in the countries in which they do business;
- use the company's weighted average statutory rate based on geographic revenue mix instead of home country statutory rate in the tax rate reconciliation schedule (which would help explain the likely effective tax rate, especially as worldwide rules change);
- explain any large or increasing Unrecognized Tax Benefit balance;
- disclose for all non-de minimis intracompany debt transactions, the countries where the debt is held, the amount of the debt, and the average interest rate "paid" by the relevant subsidiary on that debt;
- disclose and explain any material tax incentives or benefits provided by a foreign jurisdiction, including the estimated tax savings, any conditions attached to the incentive or benefit, and the likelihood that the incentive or benefit may be lost; and
- disclose of any legal proceedings by foreign governments related to taxes paid to any such government, regardless of whether such matter is material to the financial position of the corporation.[61]

Each of these disclosures would enable investors to identify significant offshore tax-related risks. Depending upon the substance of the disclosures, each could provide information to investors that would "significantly

alter" the "total mix" of information about the company. For example, we note that the first four items would likely have had a dramatic impact on resolving the valuation discrepancies at issue in the Dell case described above.

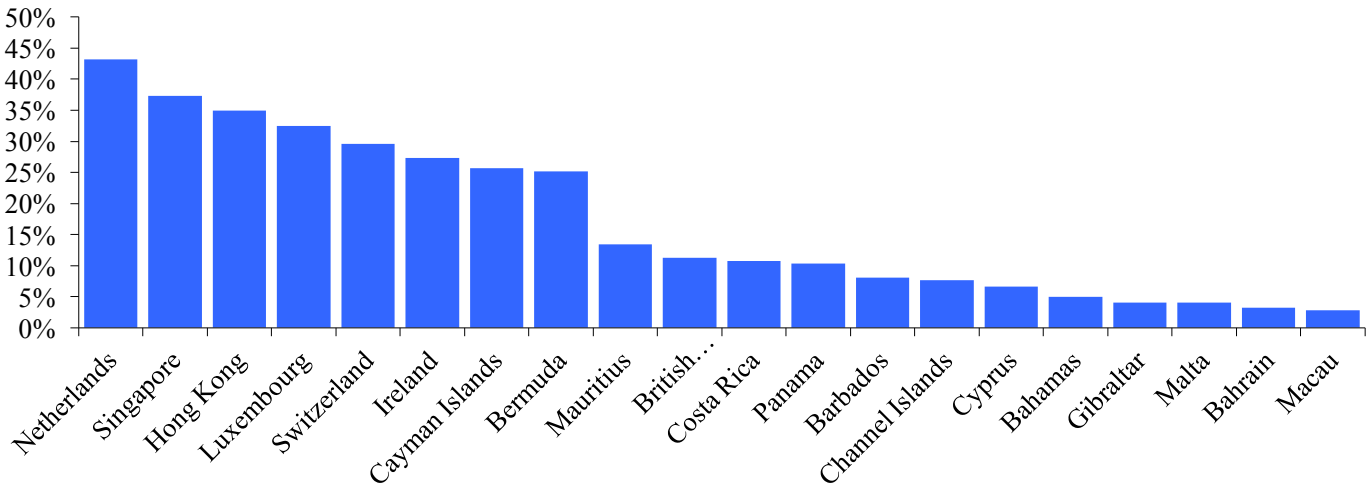
Collectively, the SEC should revise Items 101, 102, 103, and 303 of Regulation S-K, as well as the instructions to them, to more effectively capture this critical information for investors.

## *C. Disclosure of International Subsidiaries*

A second issue of concern involves corporate subsidiaries. Regulation S-K currently requires companies to disclose a list of subsidiaries of the registrant.[62] However, that list currently only needs to include subsidiaries that are "significant," as defined by Regulation S-X. As the SEC's own Investor Advisory Committee noted, "[d]isclosure documents may not, therefore, provide a complete understanding of a company's structure and leaves open the possibility of undisclosed pockets of meaningful firm-specific and systemic risk."[63]

The use of corporate subsidiaries has sky-rocketed in recent years. At the same time, the use of offshore subsidiaries in complex international tax strategies is also very high. For example, the vast majority of Fortune 500 companies have at least one subsidiary in a country identified as a tax haven (See Figure 3).[64]

*Figure 3: Percent of Fortune 500 Companies with 2014 Subsidiaries in 20 Top Tax Havens*[65]




*Source:* Offshore Shell Games: The Use of Offshore Tax Havens by Fortune 500 Companies, U.S. Public Interest Research Group and Citizens for Tax Justice, 1, Oct. 2015.

Today, some issuers fail to disclose (or fully identify) subsidiaries that control billions of dollars. For example, a study by Americans for Tax Fairness found that U.S. issuer, Walmart, had 78 previously unknown subsidiaries in tax havens.[66] According to the study, Walmart owns at least $76 billion in assets through subsidiaries domiciled in the tax havens of Luxembourg ($64.2 billion) and the Netherlands ($12.4 billion), accounting for a stunning 90 percent of the assets in Walmart's International division ($85 billion) or 37 percent of its total assets ($205 billion).[67]

Because the SEC doesn't require full disclosure of all subsidiaries, investors have no way of really knowing how many subsidiaries there are, or the risks associated with them. Interestingly, unlike the SEC, entities that are

regulated by the Federal Reserve Board of Governors do have to make more meaningful disclosures about their respective subsidiaries. One recent study by Citizens for Tax Justice found that, for 27 firms regulated by both the SEC and Federal Reserve Board of Governors, the entities reported 7 times more subsidiaries to the Federal Reserve than in their SEC filings.[68] If their primary regulator thinks these disclosures are important, it should not be unreasonable for an investor to think so too. Unfortunately, for firms that are not regulated by the Federal Reserve, investors have almost no ability to collect any of this information.

*Table 4: Comparison of Subsidiary Data Presented to the Federal Reserve and the SEC for 27 Financial Institutions*[69]

| Company | Unique Institutions Reported to Federal Reserve | Subsidiaries Reported to SEC | Tax Haven Subsidiaries Reported to Federal Reserve | Tax Haven Subsidiaries Reported to SEC |
|---|---|---|---|---|
| Ally Financial | 74 | 10 | 4 | 0 |
| American Express | 369 | 136 | 32 | 24 |
| Bank of America | 1,487 | 98 | 109 | 21 |
| Bank of New York Mellon | 828 | 49 | 188 | 6 |
| BB&T | 172 | 113 | 2 | 3 |
| Capital One Financial | 190 | 2 | 0 | 0 |
| Charles Schwab | 48 | 4 | 5 | 0 |
| CIT Group | 207 | 205 | 53 | 55 |
| Citigroup | 1,117 | 116 | 140 | 21 |
| Citizens Financial Group | 41 | 36 | 0 | 0 |
| Discover Financial Services | 36 | 25 | 2 | 2 |
| Fifth Third Bancorp | 937 | 50 | 2 | 4 |
| First American | 104 | 22 | 4 | 0 |
| Goldman Sachs Group | 3,057 | 76 | 987 | 17 |
| J.P. Morgan Chase & Co. | 2,051 | 43 | 385 | 4 |
| KeyCorp | 97 | 1 | 2 | 0 |
| Macy's | 56 | 24 | 3 | 2 |
| Morgan Stanley | 2,763 | 788 | 669 | 188 |
| Nordstrom | 29 | 3 | 1 | 0 |
| Northern Trust | 63 | 73 | 29 | 32 |
| PNC Financial Services Group | 807 | 15 | 92 | 0 |
| Raymond James Financial | 117 | 121 | 4 | 3 |
| Regions Financial | 29 | 48 | 0 | 0 |
| State Street | 209 | 36 | 64 | 10 |
| SunTrust Banks | 73 | 16 | 1 | 0 |
| U.S. Bancorp | 95 | 28 | 6 | 4 |
| Wells Fargo | 1,333 | 72 | 52 | 5 |
| **TOTALS** | **16,389** | **2,210** | **2,836** | **401** |

*Source:* Citizens for Tax Justice, Lax SEC Reporting Requirements Allow Companies to Omit Over 85 Percent of Their Tax Haven Subsidiaries, June 30, 2016.

Perversely, as the importance of information about offshore activities and taxes has increased, the amount of disclosures has decreased. Today, investors are actually receiving less information than they used to receive.

One academic study looking at the subsidiaries disclosed by Google and Oracle found that 98 and 99 percent of these companies' subsidiaries disappeared from exhibit 21 between 2009 and 2010, even though most of those subsidiaries appeared to be active a year later.[70] Similarly, after Citizens for Tax Justice highlighted Nike's numerous subsidiaries in Bermuda in a 2013 report, the following year, half of those subsidiaries disappeared from its SEC filing.[71]

These large U.S. corporate issuers thought these subsidiaries were important enough to disclose one year, but as scrutiny on tax havens and liabilities increased, these leading U.S. corporations decided that the disclosures were no longer important. This is a clear failure for investors and public policy.

Public companies should disclose all of their subsidiaries, rather than just "significant" ones, providing the name, location, Legal Entity Identifier number,[72] and relation to the parent entity. This information is critical for investors to understand how companies are structured and operate, including whether they are operating in high-risk jurisdictions, may have actual or potential tax liabilities, or may be engaged in other types of unknown or ill-understood corporate activities.

The SEC require basic disclosures of all foreign affiliates of U.S. corporations. Stopping this abuse would require a simple change to Item 601 of Regulation S- K.

# V. Conclusion

For markets to function properly, it is critically important for investors and the public to be armed with sufficient information to meaningfully assess the business operations, management, and risks of U.S. public companies.

As multinational corporations have increasingly relied upon complex, international tax strategies to affect their bottom lines, the SEC's disclosure framework has not kept pace. It's time for the SEC's disclosure rules to catch up. The agency should more actively engage investors on these issues and update the specific disclosure requirements without delay.

# References


[1] Citizens for Tax Justice, Fortune 500 Companies Hold a Record $2.4 Trillion Offshore, Mar. 3, 2016, available at http://ctj.org/pdf/pre0316.pdf.

[2] In re Appraisal of Dell Inc., C.A. No. 9322, 99-100 (Del. Ch. May 11, 2016), available at http://www.potteranderson.com/media/experience/706_Appraisal%20of%20Dell%205%2011%2016.pdf.

[3] Linda K. Krull, Permanently Reinvested Foreign Earnings, Taxes, and Earnings Management, The Accounting Review, Vol. 79, 745-767, July 2004, available at https://www.jstor.org/stable/3203277?seq=1#page_scan_tab_contents.

[4] Adam Kanzer, before the Independent Commission for the Reform of International Corporate Taxation, Mar. 18, 2015, available at http://www.icrict.org/wp-content/uploads/2015/04/Adam-KANZER-statement.pdf (Kanzer Statement).

[5] We note that item 103 directs companies to disclose "any material legal proceedings." Importantly, the SEC has recognized that materiality in this context may is broader than just what may be "material" to the financials of the company. For example, the SEC directs companies to disclose government actions involving environmental laws that the company "reasonably" believes may result in penalties of $100,000 or more. C.F.R. 229.103, Instructions to Item 103, para. 5.

[6] Securities Act of 1933, P.L. 114-94, December 4, 2015, *available at* http://legcounsel.house.gov/Comps/Securities%20Act%20Of%201933.pdf and Securities Exchange Act of 1934, P.L. 112- 158, August 10, 2012 ("Exchange Act"), *available at* https://www.sec.gov/about/laws/sea34.pdf.

[7] In general, the Securities Act of 1933 sets for the information that must be disclosed in the public offering of securities, while the Exchange Act of 1934 sets forth ongoing reporting requirements for publicly held companies.

[8] Concept Release, 81 Fed. Reg. 23921 (Apr. 22, 2016). The SEC's mission has been established as the obligation to "protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation." Securities and Exchange Commission, "The Role of the SEC", *available at* https://investor.gov/introduction-markets/role-sec.

[9] See *Basic Inc.* v. *Levinson*, 485 U. S. 224 (1988).

[10] This standard was recently reinforced by the Supreme Court. See *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27 (2011).

[11] Citizens for Tax Justice, Fortune 500 Companies Hold a Record $2.4 Trillion Offshore, Mar. 3, 2016, available at http://ctj.org/pdf/pre0316.pdf.

[12] Matt Gardner, GE Just Lost a Tax Break – and Congress Will Probably Fix That, Tax Justice Blog, Jan. 7, 2014, available at http://www.taxjusticeblog.org/archive/2014/01/ge_just_lost_a_tax_break_-_and.php#.V2wvbzkrKu4.

[13] Citizens for Tax Justice. "The U.S. Has a Low Corporate Tax." http://www.ctj.org/pdf/businessroundtable.pdf.

[14] Offshore Profit Shifting and the U.S. Tax Code: Part 2 (Apple, Inc.), before the Permanent Subcommittee on Investigations, May 21, 2013, available at http://www.hsgac.senate.gov/subcommittees/investigations/hearings/offshore-profit-shifting-and-the-us-tax-code_- part-2.

[15] Zion, David, Ravi Gormatam, and Ron Graziano. "Parking A-Lot Overseas." Credit Suisse. April 4, 2016. https://doc.research-and-analytics.csfb.com/docView?language=ENG&format=PDF&source_id=em&document_id=1045617491&serialid=jHde13PmaivwZHRANjglDIKxoEiA4WVARdLQREk1A7g%3D.

[16] Press Release, All interested countries and jurisdictions to be invited to join global efforts led by the OECD and G20 to close international tax loopholes, OECD, Feb. 23, 2016, available at http://www.oecd.org/tax/all-interested-countries-

and-jurisdictions-to-be-invited-to-join-global-efforts-led-by-the-oecd-and-g20-to-close-international-tax-loopholes.htm.

[17] Kimberly, Clausing, "The Effect of Profit Shifting on the Corporate Tax Base in the United States and Beyond," Jan. 11, 2016, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2685442.

[18] Ibid.

[19] See Heath Aston, Chevron hits out at 'tax dodger' claims at fiery Senate inquiry, The Sydney Morning Hearald, Nov. 18, 2015, available at http://www.smh.com.au/business/the-economy/chevron-hits-out-at-tax-dodger-claims-at-fiery-senate-inquiry-20151118-gl21v8.html#ixzz4B1ifEtpD.

[20] Vanessa Barford and Gerry Holt, Google, Starbucks, Amazon: The Rise of 'Tax Shaming', BBC News, May 21, 2013, available at http://www.bbc.com/news/magazine-20560359.

[21] Chris Arnold, Google's Paris Offices Raided In Tax Investigation, NPR, May 24, 2016, available at http://www.npr.org/sections/thetwo-way/2016/05/24/479297435/googles-paris-offices-searched-in-tax-investigation.

[22] Caterpillar Inc., 10-K, Exhibit 13, at A-30 (Feb. 17, 2015) (fiscal year ending Dec. 31, 2014), available at https://www.sec.gov/Archives/edgar/data/18230/000001823015000061/cat_exx13x12312014.htm.

[23] Ibid.

[24] Caterpillar's Offshore Tax Strategy, hearing before U.S. Senate Permanent Subcommittee on Investigations, S. Hrg. 113-408, Apr. 1, 2014, available at https://www.gpo.gov/fdsys/pkg/CHRG-113shrg89523/pdf/CHRG-113shrg89523.pdf ; see also Shruti Date Singh and Richard Rubin, Caterpillar Faces IRS Penalties, More Taxes on Swiss Parts Unit, Bloomberg, Feb. 18, 2015, available at http://www.bloomberg.com/news/articles/2015-02-18/caterpillar-faces-irs-penalties-more-taxes- on-swiss-parts-unit

[25] "Offshore Profit Shifting and the U.S. Tax Code – Part 1 (Microsoft and Hewlett-Packard)," hearing before U.S. Senate Permanent Subcommittee on Investigations S. Hrg. 112-781, Sept. 20, 2012, available at https://www.gpo.gov/fdsys/pkg/CHRG-112shrg76071/pdf/CHRG-112shrg76071.pdf (reflecting billions of dollars in income that the company claimed was "permanently reinvested" abroad was, in fact, lent back to U.S. affiliates for use in the U.S.).

[26] See, e.g., Lynnley Browning, HP loses $190 million tax case against IRS, Reuters, May 15, 2012, available at http://www.reuters.com/article/us-hp-tax-idUSBRE84E0L820120515.

[27] Press Release, Closing tax gaps - OECD launches Action Plan on Base Erosion and Profit Shifting, OECD, July 19, 2013, available at http://www.oecd.org/tax/closing-tax-gaps-oecd-launches-action-plan-on-base-erosion-and-profit-shifting.htm.

[28] See, e.g., Renae Merle, Why McDonalds and Google are in trouble in Europe, Washington Post, May 31, 2016, available at https://www.washingtonpost.com/business/economy/why-mcdonalds-and-google-are-in-trouble-in-europe/2016/05/31/78d091c0-2417-11e6-aa84-42391ba52c91_story.html.

[29] See David Crow and Andrew Ward, Pfizer chief's long quest for tax inversion ends in failure, Financial Times, Apr. 6, 2016, available at https://next.ft.com/content/bc90afe6-fc10-11e5-a31a-7930bacb3f5f.

[30] Allergan's stock declined sharply following the issuance of the new rules. Rachel Graf, Allergan (AGN) Stock Tanks on Tax Inversion Rules, Jim Cramer: 'Screaming Buy' Below $220, The Street, Apr. 5, 2016, available at https://www.thestreet.com/story/13518623/1/allergan-agn-stock-tanks-as-tax-inversion-rules-threaten-pfizer-merger.html.

[31] Cortez, Michelle. "Allergan Falls After Treasury Rules Announced; Pfizer Gains." *Bloomberg*, April 4, 2016. http://www.bloomberg.com/news/articles/2016-04-04/allergan-plunges-after-treasury-rules-announced-pfizer-gains.

[32] Some companies appear to have vague discussions of the potential risks associated with changes in U.S. or foreign tax laws, but these disclosures provide insufficient information to assess the impacts on the issuers of these changes.

[33] See Exchange Act, Sec. 2.

[34] In re Appraisal of Dell Inc., C.A. No. 9322, 105 (Del. Ch. May 11, 2016), available at http://www.potteranderson.com/media/experience/706_Appraisal%20of%20Dell%205%2011%2016.pdf.

[35] Dell Inc., 99-100.

[36] Dell Inc., 105.

[37] Dell Inc., 110. Under existing law, corporations are able to avoid U.S. taxation on foreign income if the income is categorized as indefinitely invested abroad. So this is what many U.S. corporations do. This hyper-technical accounting determination does not necessarily always line up with the actual practices of the firms, however.

[38] Dell Inc., 110.

[39] Dell Inc., 105. The Court ultimately sided with the expert who projected the lower rate. Id.

[40] Donohoe, M., McGill, G., and Outslay, E. Through the looking glass darkly: what can we learn about a U.S. multinational corporation's international operations from its financial statement disclosures? National Tax Journal 65 (4), 2012, available at http://www.ntanet.org/NTJ/65/4/ntj-v65n04p961-84-through-glass-darkly-what.pdf.

[41] Linda K. Krull, Permanently Reinvested Foreign Earnings, Taxes, and Earnings Management, The Accounting Review, Vol. 79, 745-767, July 2004, available at https://www.jstor.org/stable/3203277?seq=1#page_scan_tab_contents.

[42] Linda Krull (2004).

[43] Dave Michaels and Alan Katz, Foreign Tax Surprise Like Disney's Have SEC Seeking Sunlight, Bloomberg, Mar. 5, 2015, available at http://www.bloomberg.com/news/articles/2015-03-05/foreign-tax-surprises-like-disney-s-have-sec-seeking- sunlight.).

[44] Statement of Nili Shah, Deputy Chief Accountant, Division of Corporation Finance (reported by Dave Michaels and Alan Katz, Foreign Tax Surprise Like Disney's Have SEC Seeking Sunlight, Bloomberg, Mar. 5, 2015, available at http://www.bloomberg.com/news/articles/2015-03-05/foreign-tax-surprises-like-disney-s-have-sec-seeking-sunlight.).

[45] David Zion, Ravi Gomatam, and Ron Graziano, Credit Suisse, Parking A-Lot Overseas, Mar. 17, 2015, available at https://doc.research-and-analytics.csfb.com/docView?language=ENG&format=PDF&source_id=em&document_id=1045617491&serialid=jHde13P maivwZHRANjglDIKxoEiA4WVARdLQREk1A7g%3D.

[46] David Zion, Ravi Gomatam, and Ron Graziano.

[47] Statement of Tim Nollen, an analyst at Macquarie Capital USA (reported in Dave Michaels and Alan Katz, Foreign Tax Surprise Like Disney's Have SEC Seeking Sunlight, Bloomberg, Mar. 5, 2015, available at http://www.bloomberg.com/news/articles/2015-03-05/foreign-tax-surprises-like-disney-s-have-sec-seeking-sunlight.).

[48] Adam Kanzer, before the Independent Commission for the Reform of International Corporate Taxation, Mar. 18, 2015, available at http://www.icrict.org/wp-content/uploads/2015/04/Adam-KANZER-statement.pdf (Kanzer Statement).

[49] Kanzer Statement (citing Kate Linebaugh, Firms Keep Stockpiles of 'Foreign' Cash in U.S., Wall St. Journal, Jan. 22, 2013, available at http://www.wsj.com/articles/SB10001424127887323301104578255663224471212).

[50] Offshore Funds Located Onshore, Addendum to Repatriating Offshore Funds, Majority Staff Report by the U.S. Senate Permanent Subcommittee on Investigations, Comm. on Homeland Sec. and Gov't Affairs, 112 Cong., Dec. 14, 2011, available at https://www.hsgac.senate.gov/subcommittees/investigations/issues/tax-havens-and-abusive-tax-schemes.

[51] Ibid.

[52] Statement of Pat McGurn, ISS (reported in in Madison Marriage, Investor Complacency over Tax Avoidance Wanes, Financial Times, Nov. 16, 2014, available at https://next.ft.com/content/fe8e7fcc-6b2f-11e4-be68-00144feabdc0).

[53] Engagement Guidance on Corporate Tax Responsibility, UN Principles for Responsible Investment, at 5, 2015.

[54] Statement by Fiona Reynolds (reported in Madison Marriage, Investor Complacency over Tax Avoidance Wanes, Financial Times, Nov. 16, 2014, available at https://next.ft.com/content/fe8e7fcc-6b2f-11e4-be68-00144feabdc0).

[55] The Church of England's Investment Advisory Group has argued that "companies should eschew aggressive tax planning, aggressive tax avoidance and abusive tax arrangements for both ethical and business risk reasons." See Madison Marriage, Investor Complacency over Tax Avoidance Wanes, Financial Times, Nov. 16, 2014, available at https://next.ft.com/content/fe8e7fcc-6b2f-11e4-be68-00144feabdc0).

[56] For example, the United Nations Principles on Responsible Investment, with more than 1,300 signatories managing $45 trillion, has created an initiative to provide guidance for investors on how to engage with investee companies on corporate tax issues. See, e.g., Engagement Guidance on Corporate Tax Responsibility, UN- Principles for Responsible Investment, 2015, summary available at http://i.emlfiles1.com/cmpdoc/2/0/5/9/7/files/334837_pri_tax-guidance- 2015_summary_final.pdf.

[57] In March 2014, investors with assets totaling more than $10 trillion called upon stock exchanges to propose listing standards for ESG issues. Recommendations for Stock Exchange Requirements on Corporate Sustainability Reporting, Ceres/Investor Network on Climate Risk, Mar. 2014, available at http://www.ceres.org/resources/reports/investor- listing- standards-proposal-recommendations-for-stock-exchange-requirements-on-corporate-sustainability-reporting.

[58] The UN Principles for Responsible Investment has assembled a catalogue of tax-related disclosure efforts for investors' reference, which includes materials prepared by accounting firms, investor groups, public advocates, and international bodies. This resource center, which we strongly encourage the SEC to review and evaluate, is available at https://www.unpri.org/page/pri_website_base.tax-resources.

[59] For example, in 2011, the SEC issued a no-action letter to Lazard Ltd., effectively permitting the company to exclude a proposal to "annually assess the risks created by the actions Lazard takes to avoid or minimize U.S. federal, state, and local income taxes, and that it provide a report to shareholders on the assessment." In granting Lazard's request, the SEC noted that the proposal relates to "decisions concerning the company's tax expenses and sources of financing." Lazard Ltd. No- Action Letter, Feb. 16, 2011, available at http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2011/afscme021611- 14a8.pdf.

[60] See, e.g., Hewlett-Packard Company, Form 10-K, Dec. 17, 2014, 50, available at http://h30261.www3.hp.com/~/media/Files/H/HP-IR/documents/reports/2015/hp-10-k-as-filed.PDF, (fiscal year 2014) (explaining that HP considers "future market growth, forecasted earnings, future taxable income, the mix of earnings in the jurisdictions in which we operate and prudent and feasible tax planning strategies" when assessing its valuation).

[61] We note that item 103 directs companies to disclose "any material legal proceedings." Importantly, the SEC has recognized that materiality in this context may is broader than just what may be "material" to the financials of the company.

For example, the SEC directs companies to disclose government actions involving environmental laws that the company "reasonably" believes may result in penalties of $100,000 or more. C.F.R. 229.103, Instructions to Item 103, para. 5.

[62] Reg S-K, Item 601(b)(21).

[63] Letter from the SEC Investor Advisory Committee to Division of Corporation Finance, SEC, 4, June 15, 2015, available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-approved-letter-reg-sk-comment-letter-062016.pdf.

[64] Offshore Shell Games: The Use of Offshore Tax Havens by Fortune 500 Companies, U.S. Public Interest Research Group and Citizens for Tax Justice, 1, Oct. 2015, available at http://ctj.org/pdf/offshoreshell2015.pdf.

[65] Ibid.

[66] Americans for Tax Fairness, The Walmart Web: How the World's Biggest Corporation Secretly Uses Tax Havens to Dodge Taxes, June 2015, available at http://www.americansfortaxfairness.org/files/TheWalmartWeb-June-2015-FINAL1.pdf.

[67] Ibid.

[68] Citizens for Tax Justice, Lax SEC Reporting Requirements Allow Companies to Omit Over 85 Percent of Their Tax Haven Subsidiaries, June 30, 2016, available at http://ctj.org/ctjreports/2016/06/lax_sec_reporting_requirements_allow_companies_to_omit_over_85_percent_of_th eir_tax_haven_subsidiari.php#.V3V7PTkrLjA. This report further found that eight leading US financial firms reported a whopping 2594 subsidiaries in tax havens to the Federal Reserve, but only 272 to the SEC. Id.

[69] Ibid.

[70] Jeffrey Gramlich and Janie Whiteacre-Poe, Disappearing Subsidiaries: The Cases of Google and Oracle, Mar. 6, 2013, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2229576.

[71] Matt Gardner, Nike's Disappearing Tax Haven Subsidiaries: Lost at the Beach?, Citizens for Tax Justice Blog, July 28, 2014, available at http://www.taxjusticeblog.org/archive/2014/07/nikes_disappearing_tax-haven_s.php#.V3A42VJiO8U.

[72] The Legal Entity Identifier (LEI) is a unique number assigned to distinct legal entities. Efforts have been underway for years to promulgate a global LEI system, and the SEC has helped move those efforts along. Now is a time to further push those efforts forward.

# About the FACT Coalition

## *Who We Are*

The Financial Accountability and Corporate Transparency (FACT) Coalition is a non-partisan alliance of more than 100 state, national, and international organizations working toward a fair tax system that addresses the challenges of a global economy and promotes policies to combat the harmful impacts of corrupt financial practices.

## *Our Goals*

- End the use of anonymous shell companies as vehicles for illicit activity;
- Strengthen, standardize, and enforce anti-money laundering laws;
- Require greater transparency from multinational corporations to promote informed tax policy;
- Ensure that the U.S. constructively engages in global financial transparency initiatives; and
- Eliminate loopholes that allow corporations and individuals to offshore income and avoid paying their fair share of taxes.

## *Why It Matters*

There is untold wealth hidden in secrecy jurisdictions around the globe. The wealth stripping from corrupt practices and regimes, illegal activity, and legal-but-ethically-bankrupt tax avoidance schemes is larger than most can possibly imagine. Because of the secret nature of the financial flows, it is impossible to know precisely the amount of money, but economist Gabriel Zucman estimates at least $7.6 trillion is in tax havens and secrecy jurisdictions. The Boston Consulting Group estimates $11 trillion. And the Tax Justice Network estimates between $21 and $32 trillion dollars. More than $2 trillion is from U.S. corporate entities, and the annual cost to U.S. taxpayers is between $111 billion and $150 billion in lost tax revenue each and every year.

We seek a larger conversation about how specifically certain interests are manipulating the tax system and undermining our ability to act collectively to solve problems. The secrecy, in particular, allows certain entities to play by a different set of rules than the rest of us. Internationally, the secrecy facilitates corruption and impoverishes developing countries. In the U.S., we are complicit in the draining of wealth of other nations and fueling the austerity movement in our own.

## *Learn More*

Interested in learning more about the FACT Coalition or becoming a member? Visit our website at www.thefactcoalition.org or contact Jacob Wills at jwills@thefactcoalition.org or +1 (202) 683-4816.

FACTCOALITION

Financial Accountability & Corporate Transparency



2040 S St. NW, Lower Level | Washington, DC | 20009 | USA
Tel. +1 (202) 683-4816 | Fax. +1 (202) 683-4849 | www.thefactcoalition.org