HB 2099 Testimony, 4/2/15

I'm Dr. Daniel Morris, the Research Director for Our Oregon. Our Oregon represents organizations and individuals who care about many issues, from preserving funding for our schools and critical services to protecting the environment. I'm here today to testify in support of cracking down on offshore tax havens, which cost Oregon millions of dollars in revenue each year. This is revenue that could be invested in education, infrastructure and services. Our Oregon supports HB 2099, and would recommend that the committee consider amendments that would make this bill even stronger.

As Oregon's economy has grown, more and more personal income taxes have been collected, but corporate income taxes have stayed flat (Exhibit A). One reason corporate taxes are low today is that many large U.S.-based multinational corporations use accounting tricks to make profits made in America appear to be generated in offshore tax havens – countries with minimal or no taxes. This has a special impact on Oregon because our corporate taxes are based on reported profits – if money is off-shored, it's not counted towards taxable income, and the state collects less revenue.

Bloomberg News reported that Fortune 500 companies have offshored a total of $2 trillion in profits in offshore subsidiaries—that's an astronomical number. Hiding these profits from taxation costs states billions of dollars in revenue each year. Exhibit B is a list of the 30 U.S. corporations that have offshored the most profits, according to U.S. PIRG and Citizens for Tax Justice. Though these profits, on paper, are located in foreign countries, in reality much of this money is already deposited with U.S. banks and circulating in the U.S. economy.[1]

In 2013 the legislature passed a law to crack down on offshore tax haven abuse by requiring corporations to count the sales and income of subsidiaries in certain countries when calculating Oregon taxes. This law was written to catch offshored profits attributed to

[1] Wall Street Journal, http://www.wsj.com/articles/SB10001424127887323301104578255663224471212

paper shell companies, but does not punish corporations with legitimate operations in foreign countries.

There are a number of countries with tax systems that are set up in such a way that corporations can use subsidiaries there to reduce their overall taxes. These tax schemes can very complex. Exhibit C shows a scheme that Pepsi used to reduce its taxes when it bought a controlling interest in a Russian juice company. This scheme was approved by the Grand Duchy of Luxembourg and only came to light when documents were leaked to journalists. This deal involves subsidiaries in eight different countries, and presumably there are features in each country's tax code that allow a deal like this to happen. So it makes sense to cast a wide net when identifying additions to Oregon's list of countries that facilitate tax haven abuse.

Representatives of several countries have contacted the Oregon Legislature to object to their inclusion on the list. I want to respond to several of these arguments.

Nominal vs. Effective Tax Rates

The Revenue Committee heard testimony that the Netherlands should not be included on Oregon's list because their nominal (stated) corporate tax rates are high. This is not a compelling argument, because the nominal tax rate is a meaningless number if corporations aren't paying it. Therefore, instead of basing policy decisions on nominal tax rates, we should look at effective tax rates.

The Department of Revenue considers countries with effective tax rates lower than 5% good candidates for inclusion on Oregon's list, because 5% is substantially below the U.S. corporate tax rate. The Department of Revenue's analysis of effective tax rates on subsidiaries of U.S. corporations is based on data from the U.S. Bureau of Economic Analysis on the reported profits and taxes of foreign affiliates of U.S.-based multinational companies. These data show that in 2012 the effective tax rate on profits booked to the Netherlands was only 2.3%. That is clearly a low tax rate that qualifies the Netherlands for inclusion on Oregon's list.

Barbados, with an effective tax rate of 5% for foreign affiliates of U.S. corporations, is already on Oregon's list, but five other countries with even lower effective tax rates are not: Ireland (2.4%), the Netherlands (2.3%), Singapore (4.2%), Sweden (1.4%) and Switzerland (4.4%). (Exhibit E) For consistency, I recommend all these countries with effective tax rates lower than 5% be added to Oregon's list.

Countries facilitate tax haven abuse even if profits don't end up there

One claim the Committee heard is that the Netherlands should not be treated like a tax haven because they're not just some Caribbean island, but a major economic power. In response I would say that having a large economy and having a tax system that promotes tax avoidance are not mutually exclusive.

It is true that the public perception of a tax haven is that of a small country with weak tax laws where income gets hidden. But in the modern system of global finance, corporate profits get stashed in countries like Bermuda only after being routed through subsidiaries in other countries to strip out tax liability. That means even if the offshored profits don't end up in the Netherlands, key features of their tax system facilitate the offshoring and therefore it is appropriate for foreign subsidiaries there to be counted when figuring Oregon taxes.

According to the European Commission, "A main feature of the Dutch corporate income tax is the participation exemption: dividends and realized capital gains from subsidiaries are not taxed at the parent company. Furthermore, under certain conditions a parent company may be taxed as a group together with one or more of its subsidiaries. For corporate income tax purposes this means that the parent company and subsidiary are deemed to be one fiscal entity. **The main advantages of group taxation are that the losses of one company can be offset against profits from another company within the group, and that fixed assets can in principle be transferred tax free from one company to another.**"[2] (emphasis added)

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[2] http://ec.europa.eu/taxation_customs/taxation/gen_info/economic_analysis/tax_structures/index_en.htm

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Major U.S. corporations like Google and Apple exploit this feature of the Netherlands' tax code to save billions of dollars in taxes. The practice is so common it even has a nickname: the Dutch Sandwich. Exhibit D is an illustration from the New York Times showing how this works. Exhibit E includes several recent news articles highlighting how U.S. corporations use Netherlands' tax laws to dodge taxes. I recommend that the Revenue Committee ask representatives of the Netherlands what steps they have taken to stop this tax dodging.

Transparency is good but won't fix the problem

The Revenue Committee heard testimony that the Netherlands shouldn't be treated as a tax haven since they participate in many tax treaties and disclose certain information to other governments. This is not a compelling argument. As Chair Barnhart noted, tax schemes involving the Netherlands are currently legal, so simply sharing more information about them isn't likely to make any immediate difference.

Discouraging business?

This Committee has heard arguments that this legislation will drive business away from Oregon, but that's very unlikely. The reality is, tax data show that for all the big corporations doing business in Oregon, their Oregon sales make up only a very small part of their total business, which means Oregon is only going to tax a very small portion of their income (Exhibit F). What's more, though income booked to these countries will get counted towards Oregon taxes, so will the sales. Since Oregon uses a single sales factor apportionment formula, the share of corporate income taxed by Oregon will be smaller when subsidiaries in foreign countries are included. So while counting income reported in tax havens can make a big difference for state revenue, for these corporations these are very tiny numbers relative to the amount of profits that they are racking up, and it's hard to imagine that these changes around the margins really drive any big corporate decisions.

In conclusion, cracking down on offshore tax haven abuse will ensure corporations pay their fair share in taxes so that we can better fund the things that matter to Oregonians. Our Oregon recommends this committee amend HB 2099 to include Ireland, Singapore, Sweden and Switzerland, in addition to the Netherlands. Thank you for your attention to this important issue.