January 25, 2013

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Congressional Research Service Finds Evidence of Massive Tax Avoidance by U.S. Corporations Using Tax Havens

A new report from the non-partisan Congressional Research Service (CRS) finds that U.S. corporations report a huge share of their profits as officially earned in small, low-tax countries where they have very little investment and workforce while reporting a much smaller percentage of their profits in larger, industrial countries where they actually have massive investments and workforces.[1] The report confirms that U.S. corporations are artificially inflating the proportion of their global profits that are generated in small, low-tax countries — in other words, shifting their profits to tax havens.

CRS looked at the location of foreign profits, as reported by U.S.-based multinationals in surveys conducted by the Commerce Department's Bureau of Economic Analysis. CRS's report focused on five small countries generally considered to be tax havens (the Netherlands, Luxembourg, Ireland, Bermuda and Switzerland) and compared them to five of the top "traditional" foreign countries where American companies actually do business (Canada, Germany, the United Kingdom, Australia and Mexico). The results are striking.

Comparing reported profits to workforce and investments, CRS finds:

■ In 2008, American multinational companies reported earning 43 percent of their $940 billion in overseas profits in the five little tax-haven countries, even though only four percent of their foreign workforce and seven percent of their foreign investments were in these countries.

■ In contrast, the five "traditional economies," where American companies had 40 percent of their foreign workers and 34 percent of their foreign investments, accounted for only 14 percent of American multinationals' reported overseas' profits.

When comparing reported profits to countries' total economic output (gross domestic product), what CRS finds is even more alarming:

■ U.S. multinational profits in the five traditional economies averaged one to two percent of those countries' total economic output. But the multinationals' reported profits in the five tax-haven countries averaged 33 percent of those tax havens countries' economies.

■ More specifically, U.S. multinational foreign profits reported in Bermuda equaled a ridiculous 1000 percent of that tiny island's total economic output. That was up by a factor of five since 1999.

■ In even tinier Luxembourg, American business profits jumped from 19 percent of that country's economy in 1999 to 208 percent the economy by 2008.

These preposterous disparities between "the profits reported by American firms in the two groups of countries . . . compared with measures of real economic activity in those locations," CRS concludes, are further "evidence that American companies are shifting profits in an attempt to reduce their tax liabilities and that U.S. tax revenues suffer as a result."

If asked whether American multinational corporations engage in tax avoidance by shifting their profits into tax havens, any knowledgeable person would honestly answer, "Of course." But corporate lobbyists and CEOs deny this, or say, in the standard corporate gobbledegook: "Our company pays all applicable taxes in every jurisdiction where we operate."[2]

What's most alarming is that the tax avoidance by these corporations *is* mostly legal. Our tax rules allow U.S. corporations to "defer" (delay) paying U.S. taxes on their offshore profits until those profits are brought to the U.S. (until those profits are "repatriated"). Often those profits are never repatriated. The benefit of deferral creates an incentive for corporations to take profits that are really generated from business activity in the U.S. and claim that they are "foreign" profits generated in countries with no corporate tax or a very low corporate tax (offshore tax havens).

The tax rules make it easy for U.S. corporations to claim that more of their profits are generated abroad than is really the case. For example, multinational corporations are allowed to move intangible assets like patents between subsidiaries in different countries and turn U.S. profits into royalties paid by U.S. corporations to their subsidiaries in tax havens. The U.S. corporations are, officially, left with no profits to report to the IRS, and are able to defer U.S. taxes on the profits that are officially earned by the subsidiaries in tax havens.

A number of legislative reforms could reduce this type of corporate tax avoidance, and many have been proposed by the President. But, as we have explained elsewhere, ending this type of tax avoidance by corporations ultimately will require ending deferral.[3]

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[1] Mark P. Keightley, "An Analysis of Where American Companies Report Profits: Indications of Profit Shifting," Congressional Research Service, January 18, 2013.

[2] Jesse Drucker, "Yahoo, Dell Swell Netherlands' $13 Trillion Tax Haven," Bloomberg, January 23, 2013. http://www.bloomberg.com/news/2013-01-23/yahoo-dell-swell-netherlands-13-trillion-tax-haven.html

[3] Citizens for Tax Justice, "Congress Should End 'Deferral' Rather than Adopt a 'Territorial' Tax System," March 23, 2011. http://www.ctj.org/pdf/internationalcorptax2011.pdf