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GREAT SEAL 1889 STATE OF NORTH DAKOTA

ROLL NUMBER

DESCRIPTION

3036

2007 HOUSE FINANCE AND TAXATION

HCR 3036

2007 HOUSE STANDING COMMITTEE MINUTES

Bill/Resolution No. HCR 3036 A

House Finance and Taxation Committee

☐ Check here for Conference Committee

Hearing Date: February 7, 2007

Recorder Job Number: 2988

Committee Clerk Signature Mickie Schmidt

Minutes:

Vice Chairman Drovdal opened the hearing on HCR 3036.

Representative Kelsh: I introduced HCR 3036 to put the ND Legislature in support of an effort on the federal level to stand up for those countries and corporations who pay their fair share of taxes. We need to recognize a problem that there are a few who don't pay their taxes. This just takes it to the federal level and asks and urges Congress to pass the legislation being controlled by Senators Dorgan and Levin. What it would do is the legislation would control foreign subsidiaries of this set up in tax haven countries. What happens is a company will form an off shore corporation up in the Islands and set up their corporate logo and then charges the US for the use of that logo. There's a list of countries that are considered tax havens and developed by their organization for economic corporation development.

Representative Weiler: Do you have any examples of any of these companies?

Representative Kelsh: There are several examples, there's a 5 story building located in the Cayman Islands that actually has 12,748 headquarters there.

Representative Weiler: 12,000 US companies located there?

Representative Kelsh: Yes.

Representative Weiler: Do we have any names of those companies do we?

 2-7-07 HCR 3036

Representative Kelsh: According to the General County Office report, it's a mobile corporation has 11 tax havens listed in the Bahamas'.

Representative Weiler: Where is Carl Levin from, which state and why are Conrad and Pomeroy not included in this?

Representative Kelsh: Don't know why?

Representative Weiler: So you say that Conrad and Pomeroy have already signed on?

Representative Kelsh: I'm not saying that, I don't know why, but Dorgan and Levin are meeting this effort.

Vice Chairman Drovdal: We'll close the hearing on HCR 3036.

2007 HOUSE STANDING COMMITTEE MINUTES

Bill/Resolution No. HCR 3036

House Finance and Taxation Committee

☐ Check here for Conference Committee

Hearing Date: February 7, 2007

Recorder Job Number: 2989

Committee Clerk Signature	Mickie Schmidt

Minutes:

Chairman Belter opened the hearing on HCR 3036 and asked what the committee's wishes were?

Representative Froelich: I move a Do Pass and put it on Consent Calendar.

Vice Chairman Drovdal: Second it

Chairman Belter: All those in favor signify by saying aye. The motion carries. Rep. Kelsh will carry HCR 3036.

Date: 2-7-07 Am
Roll Call Vote #: HCR 3036

2007 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO.

House Finance & Tax Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken Move A Do Pass + Put on Consent Calendar

Motion Made By Rep. Froelich Seconded By Rep. Drovdal

Representatives	Yes	No	Representatives	Yes	No
Chairman Belter			Rep. Froelich		
Vice Chairman Drovdal			Rep. Kelsh		
Rep. Brandenburg			Rep. Pinkerton		
Rep. Froseth			Rep. Schmidt		
Rep. Grande			Rep. Vig		
Rep. Headland					
Rep. Owens					
Rep. Weiler					
Rep. Wrangham					

Total (Yes) Voice Vote No

Absent

Floor Assignment Rep. Scot Kelsh

If the vote is on an amendment, briefly indicate intent:

* Voice Vote - all yeahs - Motion carries

REPORT OF STANDING COMMITTEE

HCR 3036: Finance and Taxation Committee (Rep. Belter, Chairman) recommends **DO PASS** and **BE PLACED ON THE CONSENT CALENDAR** (14 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). HCR 3036 was placed on the Tenth order on the calendar.

2007 SENATE FINANCE AND TAXATION

HCR 3036

2007 SENATE STANDING COMMITTEE MINUTES

Bill/Resolution No. **HCR 3036**

Senate Finance and Taxation Committee

☐ Check here for Conference Committee

Hearing Date: March 19, 2007

Recorder Job Number: # 5278

Committee Clerk Signature	Sharon Renfrew

Minutes:

Sen. Urlacher called the committee to order and opened the hearing on HCR 3036 which is a concurrent resolution urging Congress and the President of the United States to enact federal legislation to deny unintended tax benefits to foreign subsidiaries of United States companies which are set up in tax haven countries.

Sen. Anderson: appeared as co-sponsor stating I had no idea I was going to be testifying however I'm on this bill I think it's a good bill and I'd like to see it passed, any questions?

Sen. Triplett: Why would like to see it passed?

Sen. Anderson: I do not have an answer to that, I was asked to sign on the bill and that's why I did it and I thought someone should stand up here.

Sen. Cook: I certainly support the intent of this bill I don't think anybody likes off shore tax havens to avoid taxes because some of that is taxes that are due ND but I kinda question the second Whereas. An investigation by a former economist, who is he, was this some sort of a commission that was studied or was just an investigation that a particular individual did, I would like to know the answer to that question. Let's put a name to that form economist and did he do it on his own?

Sen. Anderson: I will stop to see Rep. Scott Kelsh and Rep. Gulleson to see if they can answer that.

Sen. Urlacher: I wonder if we can get a hold of the sponsors to come down here.

Sen. Horne: Rep. Kelsh is on the Finance & Tax Committee on the House side I would imagine that's where he's at now.

Donita Wald: Tax Dept. last session the taxation committee introduced state legislation which would fix the tax haven reporting problem for ND companies that was passed by the Senate and killed in the House, so we have taken some steps at least at the State level.

Sen. Cook: there's nothing we can do or the federal government can do to stop somebody from moving off shore, our only tools are to try to pass laws that we can enforce that will see that they are not able to shelter a lot of tax revenue taxes that are owed.

Donita: that's exactly right, what we tried to do is, that those are entities where they are shifting their income to and make them bring that income back into the United States. We have more of a problem with our waters edge reporting because of the fact that they just have to report basically those companies in the waters edge. That's where we tried to fix the problem last session.

Sen. Cook: what happened with that in the House, why was it killed?

Donita: I don't know what happened it got a DNP out of committee.

Rep. Gulleson: co-sponsor appeared stating this focuses on encouraging and in fact denying US companies to set up tax havens in off short in order to avoid paying US taxes. There are many unfortunately they are in the numbers of thousands of companies now and I think the latest one we just heard was Halliburton. This bill basically says that we are going to change our policy the things that we can manage which is federal tax policy to remove the language that encourage establishing these tax havens off shore and this resolution then very definitely just supports that. Unfortunately one of the companies that has done this and they've been there for a long time is Ingersoll Rand. Their corporate company moved their headquarters to either the Cayman Islands or Bermuda in order to avoid paying US taxes. So this bill basically says we appreciate what you do we embrace all these corporations but we want to discourage the practice and we're going to do it by changing the federal tax policy.

Sen. Cook: Halliburton I seen too where they just moved off shore are we sure that country they moved to is a tax haven?

Answer: the reports I got it is and it said that in the report.

Sen. Cook: would deny unattended tax benefits for companies who move off shore, what would we deny Ingersoll Rand?

Answer: this bill just supports the change of that federal policy and in that federal policy there is actually and I don't know how it got there but there is incentives for these companies to locate off shore. The way our policy is set up is if they receive a tax benefit by moving off shore, so we're going to change that policy so that benefit will no longer be there.

Sen. Cook: the second Whereas you make reference to an investigation by a former economist, who's the former economist, was it his own investigation that he did on his own, you make reference of hundreds of billions of dollars, I guess I would like to see that report whatever it was, is it commissioned by anybody, to what degree is their credibility to the number of hundreds of billions of dollars?

Answer: I will absolutely get you that information.

Sen. Urlacher: is this more suggestive or supportive?

Answer: supportive, we can't control this policy but we can support changing it at the federal level.

Sen. Urlacher: last session there was a similar bill that was killed in the House, can you relate to that?

Answer: not sure why, this time it was extremely well received by the House.

Sen. Urlacher: in relationship to oil activity around the world, how does this play into normal operation vs. some of the other companies that move off shore?

Answer: I don't know

Sen. Anderson: it says unintended tax benefits, what are the unintended?

Answer: I'm not sure.

Closed the hearing.

2007 SENATE STANDING COMMITTEE MINUTES

Bill/Resolution No. **HCR 3036**

Senate Finance and Taxation Committee

☐ Check here for Conference Committee

Hearing Date: March 21, 2007

Recorder Job Number: # 5359

Committee Clerk Signature	Sharon Renfrow

Minutes:

Sen. Urlacher called the committee to order for action on HCR 3036.

Sen. Cook: the intent is to send a message to Congress on safe havens. I had a question on the second Whereas and Rep. Gulleson brought us this handout entitled Tax Notes. I think we should clean it up and remove the benefit of tax havens, could make it better.

Sen. Urlacher: are you suggesting a rewrite?

Sen. Cook: there's a lot of money being lost

Sen. Oehlke: we could delete the 2nd Whereas.

Sen. Cook: I guess what I'm saying is in order for me to vote for it; it's going to need some re-write if that's really the intent.

Sen. Horne: I think Sen. Oehlke has a good suggestion if that's the main hang up lets just delete that 2nd Whereas and its still a strong resolution and still conveys the message that we have a serious concern about what's happening and its costing us billions and I would support with that deletion.

Sen. Tollefson: the resolution is great and all it really is doing is encouraging Congress and our representatives down there to get into the tray and attempt to correct the situation. We can be as specific as we want to be but I think the generalities even of the resolution as it is written the message is there. I don't know I suppose the more specific we can get the more effective it would be, it's really just an encouragement anyway.

Sen. Triplett: I **move a DO PASS as is**, second by Sen. Tollefson.

Roll call vote: 6-1-0 Bill passes, Sen. Horne to carry the bill.

Date: 3-21-07

Roll Call Vote #: 1

2007 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. HCR 3036

Senate Finance & Tax Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken Do Pass

Motion Made By Triplett Seconded By Tollefson

Senators	Yes	No	Senators	Yes	No
Sen. Urlacher	✓		Sen. Anderson	✓	
Sen. Tollefson	✓		Sen. Horne	✓	
Sen. Cook		✓	Sen. Triplett	✓	
Sen. Oehlke	✓				

Total (Yes) 6 No 1

Absent 0

Floor Assignment Horne

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HCR 3036: Finance and Taxation Committee (Sen. Urlacher, Chairman) recommends **DO PASS** (6 YEAS, 1 NAY, 0 ABSENT AND NOT VOTING). HCR 3036 was placed on the Fourteenth order on the calendar.

2007 TESTIMONY

HCR 3036

tax notes

Volume 104, Number 14 ■ September 27, 2004

DEPARTMENTS

Ren Gulleson

ECONOMIC ANALYSIS

Shifting of Profits Offshore Costs U.S. Treasury $10 Billion or More

By Martin A. Sullivan — martysullivan@comcast.net

WE WANT TO KNOW WHAT YOU THINK

This article is the third in a series by Dr. Sullivan presenting provocative data.

We not only welcome but also invite opposing views because one of *Tax Notes'* missions is to provide a forum for debate presenting all views.

Please send comments to taxnotes@tax.org. We will publish your responses as letters to the editor unless you tell us otherwise. Longer submissions can be published as viewpoints.

U.S. multinational corporations are increasingly shifting their profits out of the United States, costing the federal Treasury an estimated $10 billion or more of lost revenue each year.

The domestic-to-foreign shifting of profits, which totals about $75 billion a year, does not appear to reflect a corresponding shifting of economic activity by those U.S. multinationals to those same low-tax havens, which include Bermuda and Ireland. Rather, the profit shifting appears to reflect an aggressive use — or abuse — of the nation's tax laws.

The figures on profit shifting and federal revenue loss raise important questions about the tax code, Treasury regulations, and federal enforcement of each. Indeed, the figures provide just one more indication that the U.S. system of taxing international income is nearing a breakdown.

This is the third in a series of articles about profit shifting by U.S. multinationals around the world. The first article addressed the increasing amount of profits reported in tax havens (see *Tax Notes*, Sept. 13, 2004, p. 1190); the second examined the large increase in foreign profits relative to domestic profits for one business sector — the pharmaceutical industry (see *Tax Notes*, Sept. 20, 2004, p. 1336).

Using Commerce Department data, this article demonstrates that the outward flow of profits that pharmaceutical companies reported in their annual reports is only part of a larger trend.

A Clean Break

Figure 1A on p. 1478 shows a rapid rise in the foreign profits of U.S. corporations. Over the last 12 years, foreign profits have more than tripled — from $89 billion in 1993 to $298 billion in the first half of 2004 (reported at annualized levels). Moreover, during the last few years of the period, it appears the rate of increase has accelerated. From 2002 to 2004, foreign profits jumped by more than $92 billion.

To provide a perspective on the rise, Figure 1B on p. 1479 takes domestic profits (the mirror image of the foreign profit data shown in Figure 1A) and divides that figure by profits as they are reported by the Commerce Department. This measure of profits includes both domestic and foreign profits of U.S. corporations. Figure 1B shows that the domestic share of profits has declined significantly — from 83.6 percent in 1993 to 74.4 percent in June of this year.

Not only is there a decline, but the data also show a clear-cut shift between the periods before and after 1999. For 1994 through 1998, the domestic share of profits remained remarkably close to the average for that period of 82 percent. For the 2000-2004 period, the domestic share hovered close to the 75.6 percent average for those years.

> ***The domestic share of profits has declined from 83.6 percent in 1993 to 74.4 percent this year.***

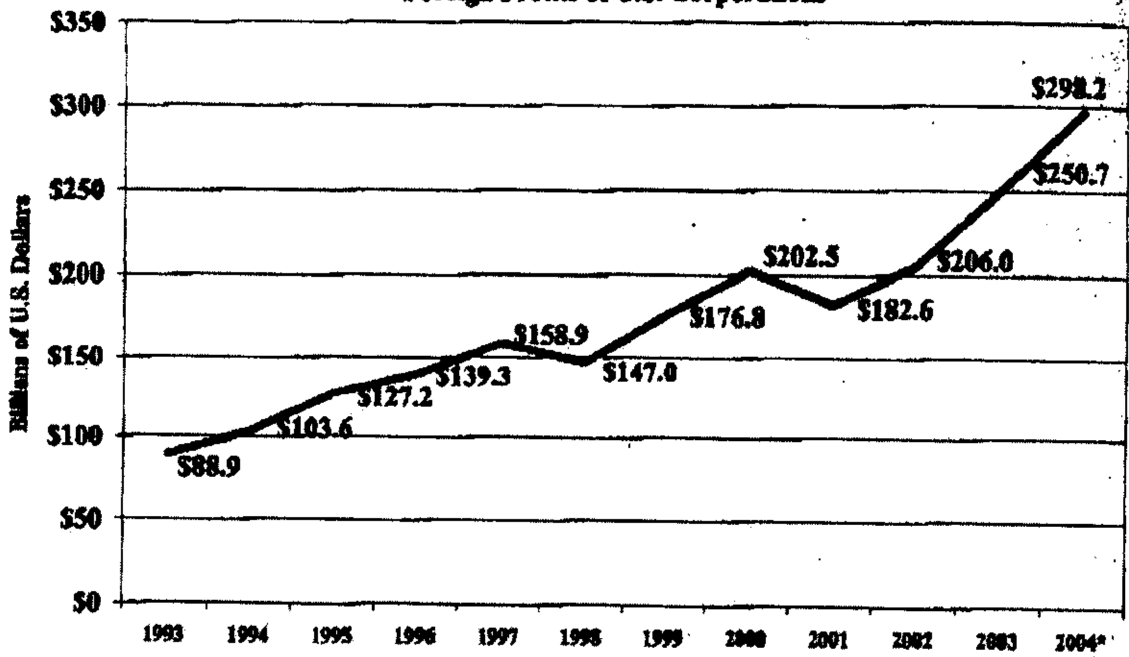
Is the 6.6 percent difference between the two averages significant? The answer is yes. So far in 2004, U.S. corporations are generating worldwide profits at an annualized level of $1.166 trillion. If the domestic share of those profits had remained at 82 percent instead of dropping to 75.6 percent, domestic profits would have been $956 billion instead of $881 billion — a difference of $75 billion.

What Has Treasury Lost?

Because of the variety of possible circumstances, the wide range of foreign tax rates, and the complexity of U.S. rules for taxing foreign income, there is no easy way to determine what the effect of a $75 billion profit shift from domestic to foreign locations has on U.S. tax revenue. Here are three illustrations of some possibilities:

(1) *Profit Shift to Moderate-Tax Countries.* The U.S. tax rate is 35 percent. The foreign rate is 30 percent. A $75 billion shift reduces U.S. tax revenue by $26.25 billion. If and when foreign profits are repatriated, they're subject to effective U.S. tax of 5 percent (because of the relief provided by the foreign tax credit) and yield $3.75 billion in tax revenue. The net loss to the United States (ignoring the time value of money) is $22.5 billion annually.

Figure 1A
Foreign Profits of U.S. Corporations



Source: Tables 6.16c and 6.16d of the National Income and Product Accounts, produced by the Bureau of Economic Analysis, U.S. Department of Commerce (http://www.bea.gov).
* Data for 2004 are for the first six months reported at annualized rates.

(2) *Profit Shift to Tax Havens With No Deferral.* The $75 billion shifted to tax havens does not escape U.S. tax because the antideferral rules of subpart F of the Internal Revenue Code subject the foreign profits to current U.S. tax. There is no revenue loss.

(3) *Profit Shift to Tax Havens With Permanent Deferral.* If the corporation can sidestep the antideferral rules, it may never pay tax U.S. tax on foreign profits. The U.S. loss of revenue is the total $26.25 billion.

It is important to note that even without deferral, profit shifting to tax havens can generate revenue losses for the United States. That occurs through what is known as "cross-crediting."

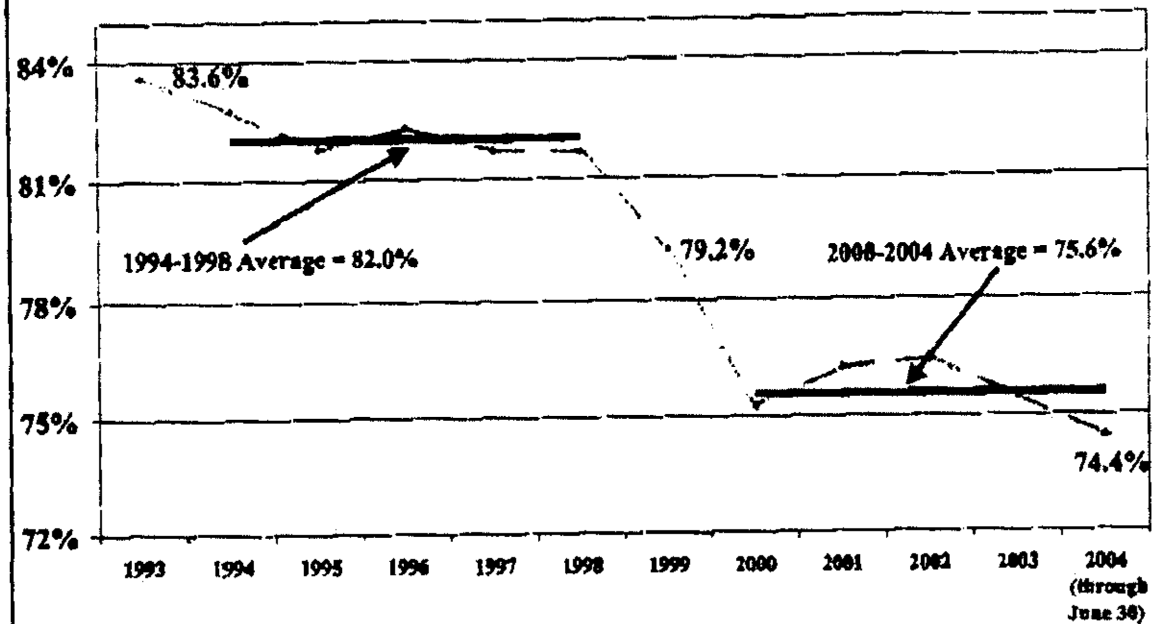
For example, suppose a subsidiary of a U.S. multinational conducts operations in a country with a tax rate higher than the U.S. rate, and suppose it wants to repatriate $1 billion of profits to the U.S. parent in the form of dividends. If the foreign tax rate is 45 percent, the parent will have $100 million of unused foreign tax credit (because under U.S. law, the foreign tax credit on $1 billion of foreign profits would be limited to $350 million). If the parent corporation could shift $300 million of U.S. profits into a zero-tax country, it would increase its foreign tax credit limit and therefore its foreign tax credit by (roughly) $100 million. The net result is a $100 million reduction in U.S. tax (with no increase in foreign taxes).

Without the need to cross-credit or without the availability of deferral, there is little reason for most companies to invest in no-tax countries.

Obviously there is an enormous range between the estimated revenue loss of zero (in illustration (2)) and more than $20 billion (in illustrations (1) and (3)). The temptation to simply take the average between zero and, say, $20 billion should be avoided because the situation in illustration (2), though theoretically possible, is highly undesirable and therefore highly unlikely. Without the need to cross-credit or without the availability of deferral, there is little reason for most companies to invest in no-tax countries.

As another illustration, consider the following example based on the latest available tax return

Figure 1B
Domestic Share of Profits of U.S. Corporations



Source: Author's calculations using Tables 6.16c and 6.16d of the National Income and Product Accounts produced by the Bureau of Economic Analysis, U.S. Department of Commerce (http://www.bea.gov). Ratio (expressed as percentage) is one minus the ratio of profits from the "rest of the world" divided by corporate profits (with capital consumption adjustment and inventory valuation adjustment).

data from the IRS. Using 1998 IRS data, Stephen Shay, former Treasury international tax counsel (now with Ropes & Gray in Boston), estimates an average effective U.S. corporate tax rate of 27.6 percent and an average foreign corporate tax rate of 19.8 percent ("Exploring Alternatives to Subpart F," *Taxes*, March 2004, pp. 31-40). If there were no variation and the average tax rates applied to all corporate taxpayers, a shift of $75 billion in profits out of the United States would result in a revenue loss of $20.7 billion (0.276 x 75) if the profits are never returned to the United States — either through a voluntary dividend payment or through the reach of subpart F antideferral rules. If the profits do come back to the United States, the U.S. Treasury would receive only $5.85 billion because of the $14.85 billion (0.198 x 75) foreign tax credit.

Here is yet another rough way of estimating revenue losses. If domestic profits were roughly 8 percent larger — as suggested by what we suppose domestic profits levels would be without the recent shift (that is, $956 billion instead of $881 billion), then we might expect domestic corporate tax receipts also to be about 8 percent larger. The Office of Management and Budget estimates corporate tax receipts will be $181.5 billion in 2004. If they were 8 percent larger, they would be $196 billion, $14.5 billion more.

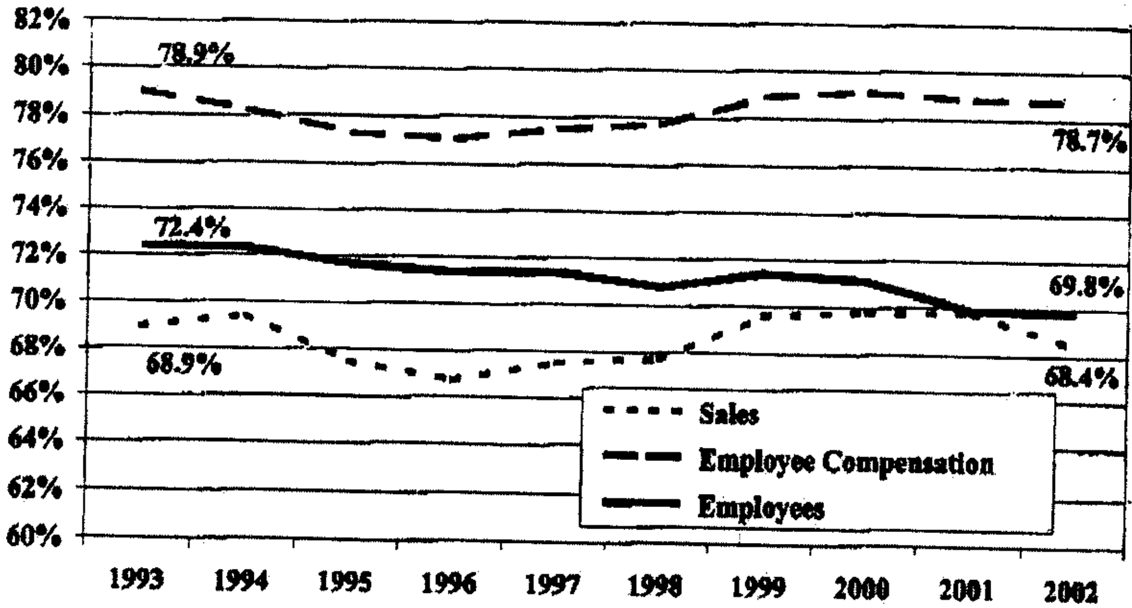
Although it's difficult to estimate revenue losses from income shifting and although there is a wide range of possibilities — that is, from zero to $26 billion — there appears to be little reason to shy away from estimates at the upper end of the range. As do all revenue estimators, we can exercise some judgment here and conservatively estimate revenue losses as being at least $10 billion and perhaps as much as $20 billion annually.

From the government's perspective, $10 billion or $20 billion is bad enough, but those revenue losses are only above what was "normal" for the 1994-1998 period. If there was inappropriate income-shifting during that period (and there is considerable evidence that was so (see, for example, *Tax Notes*, Nov. 18, 2002, p. 880)), then the total revenue losses from inappropriate income shifting by U.S. multinationals are correspondingly larger.

Capitalism or Tax Dodge?

If U.S. corporations are responding to investment incentives that low tax rates provide, if they are moving their capital and their research and their

Figure 2
Domestic Share of U.S. Multinationals Worldwide Economic Activity: No Significant Trends



Source: Author's calculations using data from the Bureau of Economic Analysis, U.S. Department of Commerce (http://www.bea.gov). Ratio (expressed as percentage) is one minus the ratio of data for foreign affiliates minus the sum of data for foreign affiliates and U.S. parents. Pre-2000 data are from *U.S. Direct Investment Abroad: 1999 Benchmark Survey*, Table 1; 2000-2002 data are from data tables at the BEA Web site. The 2002 data, the latest currently available, are preliminary.

jobs (what we mean by real "economic activity") to low-tax locations, that is no tax dodge. It is sound business. If shifting profits are the result of income following income-generating real investment, then policymakers should seriously reconsider our overall tax policy and its effects on competitiveness in world markets, and not worry about the antideferral rules or the transfer pricing rules.

> ***If profits are being shifted without a corresponding shift of real economic activity, that is an indication that income-shifting abuses are occurring.***

But if profits are being shifted without a corresponding shift of real economic activity, that is an indication that income-shifting abuses are occurring. And that is what the data seem to show, as illustrated in Figure 2 above. From 1993 to 2002 (the latest available data), there was little or no decline in the domestic share of U.S. multinationals' operations (as measured by sales, number of employees, and employee compensation) coinciding with the declining share of domestic profits shown in Figure 1A.

Although those measures of economic activity are used to determine transfer prices and as factors in determining profit allocations for purposes of widely used profit-split methods, they are not conclusive proof of inappropriate income shifting. There is, however, important additional corroborating evidence.

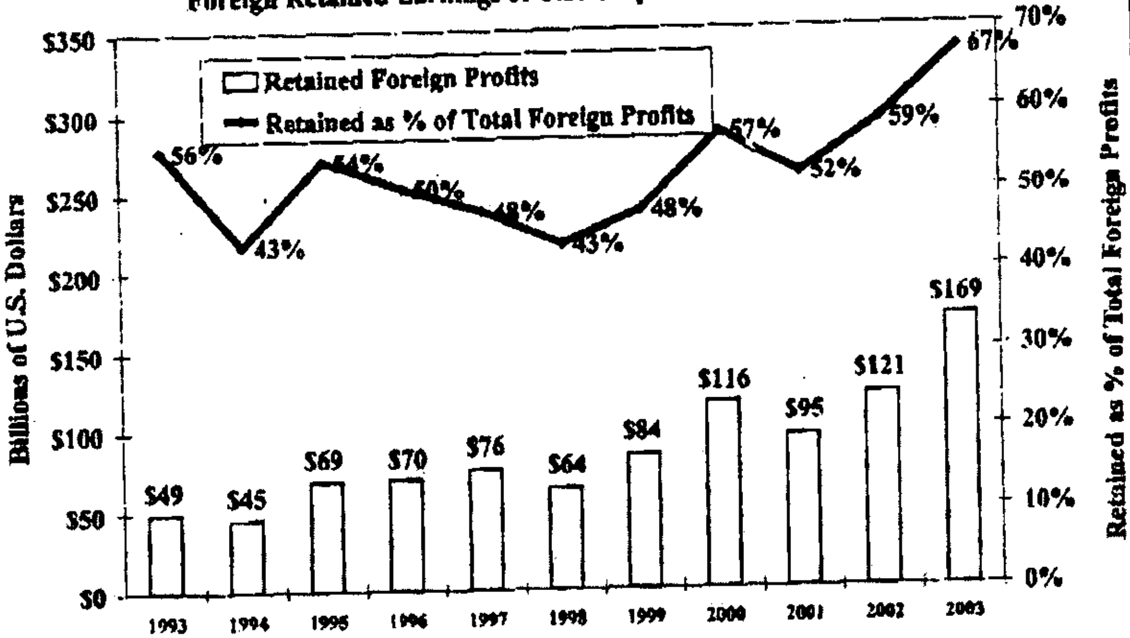
For example, there recently has been a marked increase in the percentage of foreign profits retained offshore. Figure 3 on p. 1481 shows that retained foreign profits in 2003 totaled $169 billion, $120 billion more than in 1993. With generally low foreign tax rates, the benefits of income shifting are generated primarily through deferral.

No Surprise to Some

Many commentators have noted that, particularly since the late 1990s, the opportunities for tax-advantaged profit shifting have increased. Most notable among those commentators is the Treasury Department itself, which has expressed concern about two major developments in international taxation.

First, there is the increased ease in setting up hybrid entities — made possible by changes in the

Figure 3
Foreign Retained Earnings of U.S. Corporations Rising Rapidly



Source: Author's calculations using Tables 6.20c, 6.20d, and 6.21d of the National Income and Product Accounts produced by the Bureau of Economic Analysis, U.S. Department of Commerce (http://www.bea.gov).

income tax regulations. Skillful use of hybrids allows U.S. multinational corporations to shift profits *and* avoid antideferral rules. In Notice 98-11, 1998-1 C.B. 433, the IRS explained:

> The recent entity classification regulations . . . (the "check-the-box" regulations) have facilitated the creation of the hybrid branches used in these arrangements. . . . Treasury and the Service have concluded that the use of certain hybrid branch arrangements, such as the ones illustrated below, is contrary to the policies and rules of subpart F. This notice announces that Treasury and the Service will issue regulations to address such arrangements.

But a concerted outcry from lobbyists and Congress blocked the issuance of any regulations to prevent the widely recognized abuse.

A second growing gap in U.S. tax rules involves the use of cost-sharing arrangements. An absence of the full force of the commensurate-with-income standard combined with the inherent difficulties of valuing intangible assets (often in pre-market stages of development) allows high-value intangibles to be transferred to tax havens with inadequate payment of taxes to the United States (which should tax the full value of the transfer).

The data presented in this article verify and make clear what tax insiders have known for years. Because maintenance has not kept up with necessary repairs, the U.S. system of taxing international income is breaking down. Because a strong international enforcement mechanism is necessary to prevent domestic tax evasion, the long-term practicability of the entire corporate tax system is in question. ■