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Subcommittee Hearing to Examine Billions of Dollars in U.S. Tax Avoidance by Multinational Corporations

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WASHINGTON –U.S.-based multinationals have dodged billions of dollars in taxes by shifting profits to low-tax jurisdictions overseas, and have used loopholes in the law to avoid taxes on repatriated income that should be subject to taxation, information uncovered by the U.S. Senate Permanent Subcommittee on Investigations shows.

“Major U.S. corporations are increasingly earning their profits here but shipping them overseas to avoid paying the taxes they owe,” said Sen. Carl Levin, D-Mich., the subcommittee chairman. “At a time when we face such difficult budget choices, and when American families are facing a tax increase and cuts in critical programs from education to health care to food inspections to national defense, these offshore schemes are unacceptable.”

Case studies of offshore tax avoidance schemes by Microsoft and Hewlett-Packard will be featured today at a subcommittee hearing. Thursday’s hearing is the latest in a decade of Subcommittee investigations into how wealthy individuals and multinational corporations use offshore tax schemes to dodge paying the taxes they owe. The hearing will show how corporations use weaknesses in tax law concerning “transfer pricing” – the shifting of property from a U.S. parent company to overseas subsidiaries – and other loopholes in tax law and accounting rules to earn substantial U.S. profits without paying substantial U.S. taxes.

Tax avoidance has helped push corporate income tax revenue, as a share of all federal revenue, to historically low levels, meaning corporations bear a much smaller share of the tax burden, leaving more for American families to carry. According to the Congressional Research Service, the share of corporate income taxes has fallen from a high of 32.1 percent of federal tax revenue in 1952 to just 8.9 percent in 2009. Meanwhile, payroll taxes – which almost every income earner, rich, middle-income and poor, must pay – have skyrocketed from 9.7 percent of federal revenue to 40 percent.

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The hearing will outline two case studies of how U.S. multinational corporations exploit loopholes.

One case study will show how Microsoft has developed software products in the United States using U.S. research and development tax credits, sold intellectual property rights in those products to offshore subsidiaries in low-tax jurisdictions, and then used transactions to shift the bulk of the profits from product sales around the world to the tax havens, avoiding U.S. taxes. The case study will also show how Microsoft's U.S. parent corporation transferred the U.S. rights to intellectual property offshore, and then bought back a portion of those rights to make U.S. sales, a gimmick it used to avoid U.S. taxes on 47 percent of the revenue from Microsoft products developed and sold in the United States.

The second case study will show how Hewlett-Packard has used a tax loophole to avoid paying U.S. taxes on billions of dollars in offshore income that it has returned to the United States to run its U.S. operations. Hewlett-Packard obtained the offshore cash by directing two of its offshore subsidiaries to provide serial, alternating loans to its U.S. operations. With the apparent support of its auditor, Ernst & Young, Hewlett-Packard characterized the ongoing lending as occasional short-term loans which are exempt from U.S. taxation under the tax code.

The hearing witnesses include executives from Microsoft, Hewlett-Packard, and Ernst & Young; officials from the IRS and the Financial Standards Accounting Board; and academic experts.

The specific findings of the investigation are as follows.

Tax Incentives to Shift Profits Offshore. Current weaknesses in the tax code's transfer pricing regulations, Subpart F, and Section 956, and in the Financial Accounting Standards Board's (FASB) accounting standard, APB 23 relating to deferred tax liabilities on permanently or indefinitely invested foreign earnings, encourage and facilitate the shifting of intellectual property and profits offshore by multinational corporations headquartered in the United States.

Ambiguity in Accounting Standard APB 23. Ambiguities in accounting standard APB 23 create the potential for companies to manage their earnings by avoiding reporting U.S. tax liabilities for foreign profits, thereby improving the appearance of their financial statements to shareholders and investors. The financial reporting benefits of APB 23 encourage MNCs to move and keep their businesses and earnings offshore.

Aggressive Transfer Pricing. Microsoft Corporation has used aggressive transfer pricing transactions to shift its intellectual property, a mobile asset, to subsidiaries in Puerto Rico, Ireland, and Singapore, which are low or no tax jurisdictions, in part to avoid or reduce its U.S. taxes on the profits generated by assets sold by its offshore entities.

Offshoring Profits. From 2009 to 2011, by transferring certain rights to its intellectual property to a Puerto Rican subsidiary, Microsoft was able to shift offshore nearly \$21 billion, or almost half of its U.S. retail sales net revenue, saving up to \$4.5 billion in taxes on goods sold in the United States, or just over \$4 million in U.S. taxes each day.

Check-the-Box and the CFC Look-Through Rule Undermine Subpart F. In FY2011, Microsoft Corporation excluded an additional \$2 billion in U.S. taxes on passive income at its offshore subsidiaries, relying on the "check-the-box" regulations and the controlled foreign corporation (CFC) "look-through" rule, which have undermined the intent of the tax code's Subpart F to prevent the shifting of passive CFC profits to tax havens to avoid U.S. tax.

Short Term Offshore Loans. Since at least 2008, Hewlett Packard Co. has used billions of dollars of intercompany offshore loans to effectively repatriate untaxed foreign profits back to the United States to run their U.S. operations, contrary to the intent of U.S. tax policy.

Auditor Reliance. H-P's auditor, Ernst & Young, knew that the company had set up a structured loan program to obtain billions of dollars in continual, alternating loans each year from two offshore entities and used those offshore funds to run its U.S. operations, but continued to support H-P's view that those offshore funds had not been repatriated to the United States and were not subject to taxation.

- [PSI Memo on Offshore Profit Shifting and the U.S. Tax Code \[PDF\]](#)
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