Senator Levin

SUMMARY OF CUT UNJUSTIFIED TAX (CUT) LOOPHOLES ACT FOR THE 113TH CONGRESS

February 4, 2013

NEED TO CLOSE CORPORATE TAX LOOPHOLES

- While corporate profits are at all-time high of over $1.75 trillion in the third quarter of 2011, corporate revenues are near all-time lows as a percentage of federal revenues, down from about 40% to 10%.
- While the top nominal corporate tax rate is 35%, the reality is that U.S. corporations pay an average effective tax rate of less than 15%. One major reason is the proliferation of corporate tax loopholes.
- U.S. multinational corporations can use a myriad of tax loopholes to keep their taxes far lower than their domestic competitors. One study found, for example, that 30 of the largest U.S. multinationals, with combined profits of $160 billion, paid no U.S. corporate income tax at all over the period 2008-2010.

CUT LOOPHOLES ACT

1. Title I: Ending Offshore Tax Abuses

a. The tax code provides incentives for corporations to shift jobs and profits offshore, where that income is exempt from taxation until it is repatriated.

b. Some abuses involve corporations sending valuable assets offshore to their foreign subsidiaries to avoid paying U.S. taxes. For example, the Senate Permanent Subcommittee on Investigations (PSI) found that three profitable companies – Apple, Google, and Microsoft – used offshore tax loopholes to avoid paying taxes on $80 billion in profits over a three year period.

c. Normally, once foreign earnings are repatriated, they are taxed. However, in another example of offshore tax abuse, the PSI found that Hewlett-Packard used a gimmick to make it appear it was not repatriating its foreign earnings but was instead making short term loans averaging over $6 billion from its foreign subsidiaries to its U.S. parent. For almost two straight years, it used the "loans" to run its U.S. operations, all without paying taxes on those funds.

d. This title proposes more than a dozen provisions to expose offshore tax abuses and close offshore tax loopholes, including measures to:

   i. penalize offshore financial institutions and jurisdictions that impede U.S. tax enforcement;

   ii. defer tax deductions for U.S. corporations moving jobs and operations offshore until the corporation repatriates the offshore profits from those operations and pays taxes on them;

   iii. end transfer pricing abuses by taxing immediately excess income to foreign affiliates receiving U.S. intellectual property, limiting income shifting through U.S. property transfers offshore, and tightening the rules related to the valuation of "goodwill" and other intangibles;

   iv. prevent corporations that renounce their U.S. residency despite their U.S. origins and operations from "earnings stripping" to avoid U.S. taxes;

   v. require foreign tax credits to be calculated on a pooled basis to stop the manipulation of those tax credits to dodge U.S. taxes;

   vi. shift the burden of proof on establishing who controls an offshore entity;

   vii. stop corporations managed and controlled in the United States from claiming foreign status;

   viii. treat offshore funds deposited in U.S. bank accounts as repatriated funds subject to taxes;

ix. treat derivative payments made from the United States to offshore recipients as U.S. income;
x. end vanishing companies by stopping "check-the-box" for foreign entities and "CFC look-through;"
xi. end loophole that allows corporations to avoid paying taxes on repatriated income by treating it as a loan; and
xii. require multinationals to disclose their employees, revenues, and tax payments on a country-by-country basis.

2. Title II: Strengthening Tax Enforcement

a. This title would strengthen tax enforcement by tightening rules related to tax shelter promotors, stiffening penalties on aiders and abettors of tax evasion, strengthening the tax levy process, and modernizing federal tax lien registration.

3. Title III: Ending Excessive Corporate Tax Deductions for Stock Options

a. Stock options are currently the only type of compensation where the federal tax code allows corporations to claim a bigger deduction on their tax returns than the corresponding expense on their corporate books. That approach enables profitable corporations to report higher earnings to shareholders, while using the stock option deduction to reduce or eliminate those earnings on their tax returns and pay little or no taxes.
b. For example, Facebook booked stock options given to its founder at 6 cents per share, but was able to later claim a tax deduction at about $40 per share. Because the tax code allows stock option tax deductions in excess of stock option expenses on the books of the corporation, Facebook got an estimated $16 billion tax deduction when it went public. Further, because the tax deduction could be carried back, Facebook could claim a half-billion dollar refund of taxes it had already paid. And because of net loss carry-forward rules, this profitable company will be able to use its $16 billion deduction to reduce or eliminate its taxes for years to come.
c. Corporations are also generally precluded from deducting compensation above $1 million paid to any employee. However, stock option compensation is exempt from that limit.
d. This title would ensure that:
    i. corporations take stock option tax deductions at the time, and in an amount not greater than, the stock option expenses shown on their books; and
    ii. stock options compensation is subject to the same tax deductibility cap as other forms of compensation (at $1 million per executive).

4. Title IV: Closing the Derivatives Blended Rate Loophole

a. Since 1981, profits from certain derivatives—including commodity futures— have benefited from a more favorable "blended tax rate." Specifically, a short term capital gain from these derivatives is taxed, not at the short term capital gains rate, but at a rate which is 60% long term capital gains and 40% short term capital gains, even if the derivatives are held for seconds. Normally, investments have to be held for at least 1 year to get preferential long term capital gains tax treatment.

b. This blended rate loophole lowers the taxes on these derivatives by about 10%, which encourages commodity speculation (and high frequency trading) compared to investments in stocks, bonds, and other financial instruments subject to normal capital gains rules.
c. This has been supported by the President and is in-line with a recent House Republican Ways and Means Committee draft.
d. This title would end the blended rate for derivatives.

5. Title V: Ending the Tar Sands Oil Spill Loophole

a. An IRS interpretation citing guidance from 1980 excludes oil produced from "tar sands" from having to contribute to the Oil Spill Liability Trust Fund. Congress needs to update the law to reflect the commercial use of tar sands and other unconventional oils and ensure they help pay for oil spills.
b. In 1980, tar sands accounted for less than 1% of Canadian crude oil. By 2011, more than 30% of Canadian oil production came from tar sands. Last year, of the 2 million barrels of oil a day shipped to the U.S. from Canada, approximately 1.1 million was tar sands oil.
c. Tar sands oil spills are already putting our communities at risk. For example, in July 2010, a large tar sands oil spill contaminated the Kalamazoo River in Michigan. This was one of the largest onshore oil spills in U.S. history, and cleanup costs exceeding $800 million. Over $44 million from the Oil Spill Liability Trust Fund was obligated for the cleanup.
d. This title would ensure that tar sands oil contributes to the Oil Spill Liability Trust Fund.

6. Title VI: Ending the Carried Interest Loophole

a. This title would ensure that investment managers, such as hedge fund managers, would pay ordinary income rates on all of their income from providing management services.