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Oregon Department of Revenue

Presentation to the
House Committee on Revenue

Responses to questions from committee members

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OREGON
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Department of Revenue Response to questions

Could a U.S. corporation doing business in Oregon (e.g. company that manufactures and sells clothing) establish a manufacturing subsidiary in Guatemala and take advantage of a ten-year tax exemption under the tax laws in that jurisdiction?

As outlined below, it appears that the Guatemalan manufacturing subsidiary could take advantage of the income tax exemption under Guatemalan tax laws. The income generated by the subsidiary would not be subject to tax, provided that the company imports over half of its production inputs/components and exports its completed products.

The following information is from a publication of the Office of the United States Trade Representative:

> *"Guatemala provides tax exemptions to investors in free trade zones and maintains duty drawback programs aimed mainly at garment manufacturing and assembly operations or "maquiladoras" (firms that are permitted to operate outside a free trade zone and still receive tax and duty benefits). The 'Law for the Promotion and Development of Export Activities and Drawback' provides tax and duty benefits to companies that import over half of their production inputs/components and export their completed products. Investors are granted a 10-year exemption from both income taxes and the Solidarity Tax, which is Guatemala's temporary alternative minimum tax. Additionally, companies are granted an exemption from payment of tariffs and value-added taxes on imported machinery, and a one-year suspension (extendable to a second year) of the same tariffs and taxes on imports of production inputs and packing material. Taxes are waived when the goods are re-exported."*

Therefore, a U.S. corporation could establish a subsidiary corporation in Guatemala for the purpose of manufacturing products. The U.S. corporation could then purchase those products from its subsidiary for sale to U.S. customers, including customers in Oregon. The U.S. company can deduct the cost of purchasing products from its subsidiary, generating income in Guatemala.

The profits of the Guatemalan subsidiary are reflected in worldwide income of the corporation, but are not subject to tax in Guatemala or in the United States. In the absence of "tax haven" legislation, the income shifted to the Guatemalan subsidiary is also not subject to apportionment and taxation in Oregon.

If Guatemala is added as a listed jurisdiction in ORS 317.715(2), the income of the Guatemalan subsidiary would be shown as a modification to federal taxable income on the Oregon corporate tax return. That income would be apportioned to Oregon and subject to tax, based upon the percentage of Oregon sales as a percentage of sales everywhere. All intercompany transactions between the U.S. corporation and the Guatemalan subsidiary would be disregarded in these computations.

What efforts are being made at the federal level to address the problem of overseas profit shifting by U.S. corporations?

Multiple legislative proposals aimed at tax havens have been introduced to the U.S. Congress for consideration, and some have become law.

Senate Resolution 62 was passed in 2013 and allows the results of investigations into offshore profit shifting to be shared with regulatory agencies.

Section 627 of Public Law 113-235 prevents corporations currently incorporated in Bermuda or the Cayman Islands that were formerly incorporated in the U.S. from entering into contracts authorized by Public Law 113-235. Public Law 113-235 appropriates money for U.S. island territories, such as Guam.

Currently, the U.S. government is taking administrative actions to address corporate inversions, such as transferring ownership of a U.S. corporation to an overseas jurisdiction to take advantage of favorable tax treatment without any substantive change in the management or operations of the corporation. The U.S. Treasury Department has enacted regulations designed to curb inversions.

Other resources:

- The Congressional Research Service published a report on January 15, 2015, *Tax Havens: International Tax Avoidance and Evasion*, written by Jane G. Gravelle, a senior specialist in economic policy. Pages 38 to 43 contain a summary of federal legislation applicable to jurisdictions listed in ORS 317.715(2)(b). The report can be found at www.fas.org/sgp/crs/misc/R40623.pdf.
- **The Foreign Account Tax Compliance Act (FATCA)** requires U.S. individuals to report interests in foreign passive investment companies and foreign accounts. Overseas financial institutions are required to provide information about American account holders and comply with FATCA requirements. If the U.S. source income is bound for an overseas financial institution that is not FATCA compliant, 30 percent of U.S. source income is to be withheld. Sections 501-551 of Public Law 111-147 include FATCA requirements.
www.gpo.gov/fdsys/pkg/PLAW-111publ147/pdf/PLAW-111publ147.pdf
- **Section 1409 of Public Law 111-152** codifies the economic substance doctrine. www.gpo.gov/fdsys/pkg/PLAW-111publ152/pdf/PLAW-111publ152.pdf
- All but one of the **Title II, Subtitle B** provisions contain the tax credit provisions discussed by Gravelle.
www.gpo.gov/fdsys/pkg/PLAW-111publ226/pdf/PLAW-111publ226.pdf

Is there data available regarding the extent of profit shifting by U.S. corporations to listed jurisdictions as a percentage of gross domestic product (GDP) in those countries to compare to similar data compiled for non-listed jurisdictions, such as France?

Below are two tables, one showing profit shifting by U.S. corporations as a percentage of GDP in jurisdictions listed in or proposed to be listed in ORS 317.715(2), and the other showing similar data for jurisdictions not included in ORS 317.715(2). The profits and taxes-paid data comes from the Bureau of Economic Analysis (BEA). The BEA provides post-tax profits for all countries listed in the spreadsheet. Pre-tax profits and foreign income taxes paid are listed, if available. The GDP based on purchasing price parity (PPP) comes from the CIA World Factbook.

Some jurisdictions on the ORS 317.715(2)(b) list are not included on this spreadsheet if BEA or CIA data on that country is omitted.

Table 1

Jurisdiction	Pre-tax U.S. profits	Foreign income tax paid	Post-tax U.S. profits	PPP GDP	Pre-tax as a portion of PPP GDP	Post-tax as a portion of PPP GDP	Effective tax rate	Year of PPP GDP statistic
Andorra			1,000,000	3,163,000,000		0.03%		2012
Anguilla			1,000,000	175,400,000		0.57%		2009
Antigua and Barbuda			(2,000,000)	1,583,000,000		-0.13%		2012
Bahamas			2,080,000,000	11,190,000,000		18.59%		2012
Bahrain			13,000,000	33,480,000,000		0.04%		2012
Barbados	2,517,000,000	124,000,000	2,393,000,000	7,056,000,000	35.67%	33.91%	4.93%	2012
Belize			3,000,000	3,008,000,000		0.10%		2012
Bermuda	76,706,000,000	-336,000,000	80,042,000,000	5,600,000,000	1423.32%	1423.32%	0.00%	2011
Curacao			8,963,000,000	3,128,000,000		286.54%		2012
Cyprus			425,000,000	23,680,000,000		1.79%		2012
Dominica			9,000,000	1,004,000,000		0.90%		2012
Gibraltar			3,501,000,000	1,275,000,000		274.59%		2008
Grenada			2,000,000	1,447,000,000		0.14%		2012
Guatemala			144,000,000	78,910,000,000		0.18%		2012
Hong Kong	13,706,000,000	1,200,000,000	12,506,000,000	370,006,000,000	3.70%	3.38%	8.76%	2012
Liberia			(124,000,000)	2,681,000,000		-4.63%		2012
Luxembourg	96,079,000,000	1,043,000,000	95,036,000,000	42,440,000,000	226.39%	223.93%		2012
Malta			(213,000,000)	10,960,000,000		-1.94%		2012
Marshall Islands			(414,000,000)	475,400,000		-87.08%		2012
Maurtius			1,654,000,000	20,260,000,000		8.16%		2012
Monaco			(1,000,000)	6,213,000,000		0.02%		2012
Netherlands	172,250,000,000	3,971,000,000	168,279,000,000	705,300,000,000	24.42%	23.86%	2.31%	2012
St. Lucia			56,000,000	2,211,000,000		2.53%		2012

St. Vincent and the Grenadines			(1,000,000)	1,309,000,000		-0.08%		2012
Samoa			1,000,000	1,144,000,000		0.09%		2012
Switzerland	57,930,000,000	2,556,000,000	55,374,000,000	363,900,000,000	15.92%	15.22%	4.41%	2012
Trinidad and Tobago			970,000,000	26,710,000,000		3.63%		2012
UK islands, Caribbean*	40,881,000,000	,1242,000,000	39,639,000,000	3,425,780,000	1193.33%	1157.08%	3.04%	**
Vanuatu			6,000,000	1,230,000,000		0.49%		2012

**UK islands, Caribbean include: the British Virgin Islands, Cayman Islands, Montserrat, and the Turks and Caicos Islands.*
***CIA World Factbook statistics indicate the GDP (PPP) for each of the above islands as follows:*
British Virgin Islands - $500 million (2010), Cayman Islands - $2.25 billion (2008)
Montserrat - $43.78 million (2006), Turks and Caicos Islands - $632 million (2007)

Table 2

Jurisdiction	Pre-tax U.S. profits	Foreign income tax paid	Post-tax U.S. profits	PPP GDP	Pre-tax as a portion of PPP GDP	Post-tax as a portion of PPP GDP	Effective tax rate	Year of PPP GDP statistic
France	12,603,000,000	3,343,000,000	9,260,000,000	2,269,000,000,000	0.56%	0.41%	26.53%	2012
Canada	70,782,000,000	9,042,000,000	61,740,000,000	1,494,000,000,000	4.74%	4.13%	12.77%	2012
Mexico	21,555,000,000	5,191,000,000	16,364,000,000	1,823,000,000,000	1.18%	0.90%	24.08%	2012
United Kingdom	74,141,000,000	9,944,000,000	64,197,000,000	2,343,000,000,000	3.16%	2.74%	13.41%	2012
Denmark	5,554,000,000	2,809,000,000	2,745,000,000	211,100,000,000	2.63%	1.30%	50.58%	2012
Belgium	11,702,000,000	1,325,000,000	10,377,000,000	421,300,000,000	2.78%	2.46%	11.32%	2012
Germany	16,715,000,000	4,615,000,000	12,100,000,000	3,211,000,000,000	0.52%	0.38%	27.61%	2012
Austria	2,510,000,000	216,000,000	2,294,000,000	359,600,000,000	0.70%	0.64%	8.61%	2012
Taiwan	3,994,000,000	715,000,000	3,279,000,000	906,600,000,000	0.44%	0.36%	17.90%	2012
Japan	20,658,000,000	7,510,000,000	13,148,000,000	4,638,000,000,000	0.45%	0.28%	36.35%	2012
China	23,079,000,000	4,035,000,000	19,044,000,000	12,430,000,000,000	0.19%	0.15%	17.48%	2012
Egypt	4,737,000,000	2,020,000,000	2,717,000,000	541,500,000,000	0.87%	0.50%	42.64%	2012
Australia	25,365,000,000	4,967,000,000	20,398,000,000	974,200,000,000	2.60%	2.09%	19.58%	2012
New Zealand	1,125,000,000	139,000,000	986,000,000	132,700,000,000	0.85%	0.74%	12.36%	2012
Brazil	14,526,000,000	3,763,000,000	10,763,000,000	2,362,000,000,000	0.61%	0.46%	25.91%	2012
South Africa	1,512,000,000	383,000,000	1,129,000,000	584,000,000,000	0.26%	0.19%	25.33%	2012

Pre-tax U.S. profits: Profits reported before taxes in the jurisdiction by majority-owned affiliates of U.S. corporations in 2012.

Foreign income tax paid: Amount of foreign income taxes paid in the jurisdiction by majority-owned affiliates of U.S. corporations in 2012.
Post-tax U.S. profits: Profits reported after taxes in the jurisdiction by majority-owned affiliates of U.S. corporations in 2012.
PPP GDP: The GDP of the jurisdiction at purchasing price parity.
Pre-tax as portion of PPP GDP: The size of the jurisdiction's economy to the amount pre-tax profits reported in the jurisdiction by majority-owned affiliates of U.S. corporations in 2012. Pre-tax corporate profits are expressed as a percentage of the jurisdiction's GDP.
Post-tax as portion of PPP GDP: The size of the jurisdiction's economy to the amount pre-tax profits reported in the jurisdiction by majority-owned affiliates of U.S. corporations in 2012. Post-tax corporate profits are expressed as a percentage of the jurisdiction's GDP.
Effective tax rate: Pre-tax profits divided by foreign income tax paid in 2012.

How does this legislation actually work?

Here is an example of the impact of ORS 317.715(2) on apportionment.Corporation N runs a chain of grocery stores in the Netherlands and has revenues of $100 million with a $10 million profit. Corporation N incorporates Corporation O in Oregon to operate all of its Oregon stores. Corporation O has revenues of $100 million with a $10 million profit. Corporation N then incorporates Corporation B in the Bahamas. Corporation O pays $5 million in royalties each year to Corporation B for use of intellectual property. Corporation B then has $5 million in net income. Corporation O is in a unitary relationship with Corporation N and Corporation B.

Prior to the enactment of ORS 317.715(2), Corporation O deducted its royalty payments to Corporation B on its federal income tax return. Corporation O's Oregon taxable income is then reduced from $10 million to $5 million due to a 100 percent apportionment factor.

After the enactment of ORS 317.715(2), Corporation O adds the income of Corporation N and Corporation B to its Oregon taxable income, which increases from $5 million to $20 million. Corporation N is not taxed by Oregon because its sales are only included in the denominator of Corporation O's sales factor. However, the amounts paid to Corporation B now represent intercompany transfers and do not get sales factor representation. Thus, with a 50 percent apportionment factor, Corporation O's Oregon taxable income is $10 million.

If Corporation B were dissolved, Corporation O's taxable income would remain at $10 million because Corporation N's net income would still be included in Corporation O's Oregon taxable income, but the sales would only be present in the denominator of the sales factor. Accordingly, none of Corporation N's net income would be apportioned to Oregon because the apportionment factor is 50 percent.