ORGANIZATION *for* INTERNATIONAL INVESTMENT
Global Investment Grows America's Economy

March 15, 2017

Chair Barnhart and distinguished members of the House Revenue Committee:

On behalf of the Organization for International Investment (OFII), I urge the committee to oppose adoption of H.B. 2067. This bill would further continue a flawed tax policy that remains a barrier to attracting foreign direct investment (FDI). Rather, we would urge the committee to reject the blacklist altogether or consider the legislative approach outlined in H.B. 2672 because it would add a tool to the state's arsenal in preventing corporate tax evasion while ensuring that legitimate transactions are not inadvertently targeted. This letter addresses the following topics:

- **The tax haven blacklist approach creates unwanted policy consequences;**
- **The tax haven criteria approach would help state prevent tax evasion;**
- **The tax treaty exemption helps mitigate trade disputes and keeps states competitive for FDI;**
- **The arm's length exemption ensures legitimate transactions are not inadvertently targeted;**
- **The 80/20 exemption would create a clear test to demonstrate taxable presence; and,**
- **The effectively connected income (ECI) standard is a common federal and state norm to tax non-U.S. companies.**

OFII is a business association representing the U.S. subsidiaries of global companies ("U.S. subsidiaries"), including more than 40 large employers in Oregon. Our membership list is enclosed. OFII advocates for non-discriminatory treatment for U.S. subsidiaries and promotes policies that will encourage them to invest and create jobs in the United States. U.S. subsidiaries provide 6.4 million U.S. jobs, pay salaries that are more than 30 percent higher than the private sector average, produce 26 percent of U.S. exports, and employ 20 percent of the U.S. manufacturing workforce. In Oregon, U.S. subsidiaries employ more than 50,000 state residents, offering wages and benefits that are 43 percent higher than the statewide average.

The tax haven blacklist approach creates unwanted policy consequences

The blacklist fails as sensible tax policy because it leads to many adverse consequences for the state. The blacklist:

1. **Undermines economic development efforts**: The blacklist imposes punitive taxation on both legitimate businesses operating in deemed tax havens and firms using those nations as a tax shelter. This threatens Oregon's global business reputation and undermines the state's competitiveness for attracting FDI and job creation from any business that has operations in a listed tax haven jurisdiction. The moment these companies invest in Oregon, they would be subject to additional, punitive taxation.

2. **Establishes rigid, convoluted tax policy:** Since the blacklist can only be updated by the legislature every two years, Oregon could find itself as a true outlier in tax policy. For

example, a foreign jurisdiction could change its tax approach to align with international tax norms, but Oregon's tax haven blacklist would fail to adjust in a timely manner.

3. **Fails to address legitimate tax evasion efforts:** The blacklist approach handicaps the state's ability to target abusive tax activity that may occur in countries not currently blacklisted.

4. **Creates disputes with trading partners:** The blacklist approach leads to inevitable disputes with sovereign nations, many of who are U.S. trading partners and allies, or could be in the future.

5. **Positions the state as an outlier**: For these reasons, the blacklist approach has been rejected by the Multistate Tax Commission (MTC)[1], the Organization for Economic Co-operation and Development (OECD)[2], and every other state except Montana[3] because of its harmful consequences.

H.B. 2672 would address all of these concerns.

The tax haven criteria approach would help state prevent tax evasion

Rather than adopt H.B. 2067, we would urge the committee to examine the policy solution outlined in H.B. 2672. This bill would adopt the tax haven criteria approach, which would add a tool to prevent corporate tax evasion. Importantly, the criteria approach can apply to any corporate fact pattern that demonstrates tax abuse, not just to those businesses incorporated in blacklisted jurisdictions. In addition, the factors used to identify tax haven activity in H.B. 2672 are already used by Oregon's Department of Revenue in selecting tax haven jurisdictions. Therefore, H.B. 2672 would alleviate all the above-mentioned policy consequences but would still allow the state to pursue tax evasion.

The tax treaty exemption helps mitigate trade disputes and keeps states competitive for FDI

We would urge the committee to adopt a treaty exemption, which is meant to align the state's tax approach with bilateral tax treaties, which are negotiated by the highest levels of governments to: 1) provide a reliable tax environment for companies operating across borders; 2) prevent double taxation on certain income streams; 3) ensure taxpayer transparency; and 4) ensure appropriate taxes are paid.[4] The majority of bilateral tax treaty partners are historical U.S. allies and major trading partners that would never meet the tax haven criteria.

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[1] In 2011, the MTC moved away from the blacklist approach, keeping only the criteria approach. It has since refrained from adopting a blacklist.

[2] In 2002, the OECD released a tax haven list of 35 jurisdictions (which Montana copied), to achieve more transparency and effective information exchange from each listed country. By 2009, each listed country met the OECD's goals of transparency and information exchange and the list was never added to or looked at again (see page 4).

[3] In recent years, Connecticut and Rhode Island adopted the criteria approach, and the District of Columbia abandoned the blacklist approach in favor of the criteria approach. West Virginia and Alaska also utilize the criteria approach. Only Montana has the tax haven blacklist approach.

[4] The full list of U.S. tax treaties is available here: https://www.irs.gov/businesses/international-businesses/united-states-income-tax-treaties-a-to-z

At a minimum, U.S. tax treaty partners should not face the threat of being labeled a tax haven because such concerns have already been addressed at the highest levels of government. Undermining bilateral tax treaties would impose tax on the very income streams that tax treaties protect from double taxation.

For these reasons, Rhode Island[5] and Connecticut,[6] the last two states to adopt tax haven policy, built in a tax treaty exemption to provide taxpayer certainty and ensure that their tax policies align with international and federal tax norms. H.B. 2672's tax treaty exemption is modeled on the Connecticut approach. Other states like Massachusetts,[7] New Jersey[8], Pennsylvania[9] West Virginia,[10] as well as the District of Columbia,[11] have built treaty exemptions into their tax methodologies.

The arm's length exemption ensures legitimate transactions are not inadvertently targeted

If the intent of the state is to pursue tax abuse, then a firm's arm's length transactions, undertaken without the principal purpose to avoid the payment of taxes should be exempt. These transactions are recognized to be non-tax motivated transactions by the Internal Revenue Service (IRS), states, and governments around the world.

For instance, companies annually complete Section 6662 Transfer Pricing Studies for all intercompany transactions to document their compliance with arm's length transfer pricing. Some companies also enter into Advanced Pricing Agreements with the IRS, which are contracts specifying the company's pricing method utilized for its related party transactions.

The IRS also scrutinizes related party transactions to ensure proper arms-length transfer pricing. When the IRS makes transfer pricing adjustments following audits, Oregon receives the apportioned tax benefits of any adjustments without having to expend additional resources.

The 80/20 exemption would create a clear test to demonstrate taxable presence for non-U.S. companies

H.B. 2672 also would adopt an 80/20 test, which is a common state standard in administering extraterritorial tax policy. The Multistate Tax Commission has adopted the test as a threshold that non-U.S. companies must meet in order to demonstrate a viable, taxable state presence

[5] Rhode Island Title 44, § 44-11-4.1(d), available at http://webserver.rilin.state.ri.us/Statutes/TITLE44/44-11/44-11-4.1.HTM
[6] Connecticut SB 1601, Section 37, available at https://www.cga.ct.gov/2015/TOB/s/2015SB-01601-R00-SB.htm
[7] Massachusetts, § 63-32B(c)(3)(iv) , available at https://malegislature.gov/Laws/GeneralLaws/PartI/TitleIX/Chapter63/Section32B
[8] New Jersey Technical Advisory Memorandum, published 2-24-16
[9] Pennsylvania Rev-802 form:
[10] West Virginia § 11-24-13f(a)(6), available at http://www.legis.state.wv.us/wvcode/ChapterEntire.cfm?chap=11&art=24&section=13F
[11] District of Columbia § 47-1810.07(a)(2)(E), available at http://dccode.org/simple/sections/47-1810.07.html

within its water's edge rules.[12] Therefore, only non-U.S. companies with at least 20 percent of their "property, payroll, or sales" factors in the United States have a large enough U.S. presence to be subject to state taxes.

Additionally, if a non-U.S. company does not have this level of property, payroll, or sales activities in the United States, then it is unlikely that there is a reduction of U.S. taxable income due to abusive transactions. This test is consistent with the tax approaches seen in Illinois,[13] among other states.

The effectively connected income (ECI) standard is a common federal and state norm to tax non-U.S. companies

H.B. 2672 would also adopt an ECI standard, which is the how many states and the IRS tax non-U.S. companies. For example, Governor Cuomo's enacted FY 2014-2015 Budget adopted ECI as a starting point for taxation of foreign companies.[14] Additionally the District of Columbia[15] and West Virginia[16], to name a few, use ECI in their approaches.

In addition, all non-U.S. companies that have ECI are required to file 1120-F forms with the Internal Revenue Service (IRS). An Oregon tax return would simply need to ask U.S. taxpayers whether their foreign affiliates file 1120-Fs to screen for companies with ECI. In addition, the IRS audits noncompliant firms to ensure that those with ECI pay rightfully-owed federal taxes.

The right path forward is to move away from the tax haven blacklist

The blacklist approach brings many unwanted policy consequences, so we urge this committee to oppose consideration of H.B. 2067 because this bill would exacerbate an already flawed tax policy. Rather, we urge the committee to strike the blacklist approach altogether or consider H.B. 2672. Either approach would better align Oregon with other state, federal, and international norms and keep the state globally competitive for attracting FDI.

Thank you for your consideration. Please contact Evan Hoffman, OFII's director of state government affairs at ehoffman@ofii.org or (202) 659-1903, with any questions or comments.

Sincerely,

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[12] The MTC has adopted the 80/20 rule in its model combined reporting water's edge rules, available at http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/Combined%20Reporting%20-%20FINAL%20version.pdf

[13] Illinois 35 ILCS 5/1501(a)(27), available at http://ilga.gov/legislation/ilcs/documents/003500050K1501.htm

[14] Beginning 2015, a foreign corporation's NY income starting point is now effectively connected income per its 1120-F. S.B. 6359, A.8559, (Chapter 59), enacted 3/31/2014, available at http://assembly.state.ny.us/leg/?default_fld=&bn=S06359&term=2013&Summary=Y&Actions=Y&Memo=Y&Text=Y

[15] District of Columbia § 47-1810.07(a)(2)(D), available at http://dccode.org/simple/sections/47-1810.07.html

[16] West Virginia § 11-24-13f(a)(4), available at http://www.legis.state.wv.us/wvcode/ChapterEntire.cfm?chap=11&art=24&section=13F

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