US Senate PSI holds hearing on impact of Tax Code on the Market for Corporate Control and Jobs

The US Senate Homeland Security and Governmental Affairs Permanent Subcommittee on Investigations (PSI) hearing on 30 July 2015 on the “Impact of the US Tax Code on the Market for Corporate Control and Jobs” generated a consensus among Senators and witnesses that corporate tax rates must be lowered and the international tax system reformed to reduce US companies’ incentive to relocate headquarters overseas and their vulnerability as acquisition targets.

Chairman Rob Portman said in an opening statement that the “current tax system increasingly drives US businesses into the hands of those best able to reduce their tax liabilities, not necessarily those best equipped to create jobs and increase wages here at home.” As part of a Finance Committee working group he led with Senator Chuck Schumer, Senator Portman endorsed a framework for international tax reform that includes a move toward a territorial system through a dividend exemption regime with anti-base erosion rules, and a form of “patent box.”

In her opening statement, Ranking Member Claire McCaskill expressed concern for the “increasing numbers of US companies heading for the exits, whether through an inversion or by otherwise relocating overseas,” as well as the “huge upswing in cross-border mergers and acquisitions activity.” She described an innovation box proposal to tax business income derived from intellectual property development at a preferential rate – which was the subject of a House proposal released on 29 July – as a “very promising approach,” but said there are challenges in determining the intellectual property (IP) rights that should be protected and the types of research and development (R&D) activity that should be incentivized.
Portman, McCaskill, and other Senators sought to put the focus on the tax system, rather than specific companies. “If there is a villain in this story, it is the US tax code,” Portman said. “And, frankly, it’s Washington, not doing what Washington should be doing to reform it.”

“We should resist the urge to demonize foreign companies operating inside the United States,” Senator McCaskill said, adding that “blaming companies for doing the math that our tax code represents is a waste of time.” Instead, Congress needs to “hold the mirror up to ourselves” and figure out why they are unable to compromise on tax reform. Similar comments were made by other senators in attendance, including full Committee Chairman Ron Johnson and Senator Kelly Ayotte.

Panel I
Witnesses:
- Jim Koch, Founder and Chairman, Boston Beer Company
- David Pyott, Chairman of the Board and Chief Executive Officer (1998-2015), Allergan, Inc.
- Walter Galvin, Vice Chairman (October 2009-February 2013) Chief Financial Officer (1993-2010), Emerson

The first panel consisted of current and former executives who testified that the tax system is costing jobs, wages, and economic growth in the United States. “Because of our broken corporate tax system, I can honestly say that I will likely be the last American owner of the Boston Beer Company,” said Koch, brewer of Samuel Adams Boston Lager.

Pyott said he is convinced that Allergan “would have remained an independent, American company had it not been for the disadvantages caused by our uncompetitive US corporate tax system,” citing in particular the worldwide system that taxes repatriated foreign earnings and creates a competitive disadvantage relative to companies in other industrialized nations. “These tax advantages are worth literally billions – billions that a foreign acquirer has access to – essentially for free – but American companies do not,” Pyott said. “Unsurprisingly they use those billions to buy up American companies that cannot compete with the tax savings offered by the vast majority of other Organisation for Economic Co-operation and Development (OECD) nations.” He described a takeover attempt by Valeant, a Canadian firm represented in the second panel, before Allergan – whose products include Botox – was acquired by Actavis.

Galvin testified that being domiciled in the United States means Emerson pays more in taxes on worldwide earnings, is prone to being outbid by foreign competitors for acquisition targets, and is encouraged to invest abroad, rather than bringing cash home. “Congress must modernize our tax code by moving to a territorial system and lowering the corporate rate like other countries have done, and continue to do,” he said, adding that the Portman-Schumer international framework is a thoughtful effort.

Under questioning from Chairman Portman, Koch said a regular feature of his life is talking to investment bankers, who – alluding to McCaskill’s opening statement – “can do the math,” regarding the potential for acquisition. Being an attractive American company puts a business on the radar screen for foreign investors, he said.

Portman said Pyott was consistently named one of the top CEOs and Allergan was not a company that was floundering, for which an acquisition might have made sense to change the management or improve business performance. “This was tax driven,” he said of the company being targeted for acquisition.

McCaskill said a move to a territorial tax system, which everyone understands is “inevitable,” must include measures to prevent abuse and limit base erosion, and asked witnesses about measures that could prevent gaming of the system. Galvin described something similar to former House Ways and Means Committee Chairman Dave Camp’s Tax Reform Act of 2014 proposal to tax the foreign income of US multinational companies to the extent the effective foreign tax rate on such income is less than 15%.

Pyott said, simply, if the United States can lower the corporate rate so that it is competitive with other
countries, “then we have solved a lot of problems.” Portman later echoed that sentiment, saying probably the best anti-base erosion policy is lowering the corporate tax rate.

McCaskill further asked whether a patent box should be structured such that R&D must be performed within the country in order to receive a preferential rate, along the lines of the OECD nexus approach. Pyott said that would be a very sound policy for the United States given the nation’s strength in R&D.

Senator James Lankford asked about debt financing. Galvin said the United States has fairly liberal and weak thin capitalization rules on acquisitions, and so acquiring companies tend to use a great deal of debt financing. With its high corporate rate, companies tend to load their debt into the United States, he said; lowering the rate would lower the incentive to do so.

Panel II
Witnesses:

› Howard Schiller, Chief Financial Officer (December 2011-June 2015), Board of Directors (September 2012-Present), Valeant Pharmaceuticals International, Inc.

› Joshua Kobza, Chief Financial Officer, Restaurant Brands International

Schiller spoke about the benefits of the Canadian tax system, including a low corporate rate and territorial system of taxing foreign earnings. Kobza described Burger King’s “search for a brand that would complement our business and create additional opportunities for growth,” and structuring the merger transaction with Tim Hortons “in a way that honored the history and roots of both companies.” Much of the questioning of the second panel was spent on the motivations for combining the two companies and domiciling the company in Canada, including those related to tax, and why the United States was not a candidate for the merged company’s headquarters.

Senator McCaskill questioned Schiller about Valeant’s single-digit effective tax rate. She said she understood the math and the fact that their practices are legal, but still asserted that such a low tax rate infuriates average Americans. Admitting that the subject was beyond the scope of the hearing, Senator McCaskill also questioned Schiller about the pricing of a particular pharmaceutical drug, asserted that many of those taking it are likely on Medicare, and said Congress should investigate how drug pricing is potentially straining health entitlement programs.

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