

To: Editorial Board Members and Columnists

Fr: Frank Clemente, Executive Director, Americans for Tax Fairness

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**Obama’s Treasury Department Can Stop Pfizer’s $35 Billion Tax Dodge**

Pfizer, one of the world’s [largest pharmaceutical companies](http://www.pmlive.com/top_pharma_list/global_revenues) and [most profitable companies](http://fortune.com/fortune500/), is attempting to dodge up to $35 billion in U.S. taxes it currently owes through a merger with Allergan, a drug firm based in the tax haven of Ireland.

In effect, Pfizer will renounce its American identity, 166 years after being founded in New York City. The shift to Ireland will be largely a change of address to dodge U.S. taxes, as the combined company will still be majority owned by Pfizer’s current shareholders and will continue to be directed and managed from Manhattan. This structure is known as an inversion.

For the last two years, Congress has shown it is incapable of passing legislation to prohibit inversions. **Fortunately, President Obama’s Treasury Department has the authority to eliminate one of the big tax loopholes that Pfizer hopes to exploit with its merger.**

Americans for Tax Fairness issued a report in February that estimated this loophole [could save Pfizer as much as $35 billion in U.S. taxes owed](http://www.americansfortaxfairness.org/files/Pfizer-report-FINAL-for-WEB.pdf) on about $150 billion in offshore profits that the company held in 2014. The ATF report was widely covered in more than 100 news stories including by the [Associated Press](http://bigstory.ap.org/article/86d89df7484141c281e773cdc20dbadf/tax-group-blasts-pfizer-urges-stop-its-tax-cutting-deal), [The Washington Post](https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEwjc7-iC1dPLAhUBRz4KHV38DYYQFggcMAA&url=https%3A%2F%2Fwww.washingtonpost.com%2Fnews%2Fbusiness%2Fwp%2F2016%2F02%2F25%2Fgiving-up-its-u-s-citizenship-could-save-pfizer-35-billion-in-taxes%2F&usg=AFQjCNEpNdLRsSUFy3Uinld59OG5QRgRtg&sig2=WVRpY6c6CoeXT_tWzohFvg\) and [USA Today](http://www.usatoday.com/story/money/2016/02/25/pfizer-tax-dodging-report/80937220/).

**Within the next few weeks, the Treasury Department is expected to finalize regulations that will limit the tax benefits that Pfizer and other corporations can take advantage of when they merge or invert with a foreign firm**, typically based in a tax haven. This recent [Wall Street Journal story](http://www.wsj.com/articles/sanders-urges-treasury-to-set-tax-restrictions-on-inversion-deals-1458316802?mod=ST1) and [column by the New York Times](http://www.nytimes.com/2016/03/13/your-money/pfizers-eager-to-go-but-the-market-has-doubts.html?rref=collection%2Fcolumn%2Fbusiness-strategies&_r=0) business page editor provide background on the situation and what is at stake. **We urge you to promptly editorialize on this matter.**

There is a lot of corporate pressure on the Obama Administration and the Treasury Department to not close the loophole that Pfizer and other companies are using. **Editorials and columns from influential newspapers would draw public and lawmaker attention to this critical issue and explain the need for Treasury to act in behalf of the public’s interest.**

The rest of this memo provides background on the executive authority President Obama and his Treasury Department can exercise to close this loophole, and it provides more explanation about Pfizer’s tax dodge and its prescription drug price gouging.

**The Tax Loophole Pfizer is Exploiting**

To save up to $35 billion in taxes through the merger, Pfizer will use a so-called “hopscotch loan.” It works like this: Pfizer has at least $150 billion in offshore profits in its foreign subsidiaries, according to ATF and confirmed by the company to [The New York Times](http://www.nytimes.com/2015/11/15/your-money/a-tax-cutting-move-that-pfizer-can-hardly-resist.html?_r=4&mtrref=undefined&gwh=4C60BD93B8F0B53F17F3BD9539DC3FFF&gwt=pay). Federal law allows Pfizer to defer paying any U.S. taxes on those subsidiary profits until they are repatriated to the U.S. parent. Pfizer gets a tax credit for any foreign taxes already paid.

Once Pfizer completes its foreign merger, its foreign subsidiaries will be able to loan these offshore profits *tax free* to the new foreign parent, Allergan. Thus, the loan “hopscotches” over the inverting U.S. parent corporation – Pfizer – avoiding its existing U.S. tax obligations. The profits can then be distributed to Allergan’s U.S. shareholders without paying any U.S. taxes.

[The Treasury Department issued guidance in 2014](https://www.treasury.gov/press-center/press-releases/Pages/jl2647.aspx), known officially as a Notice, which sought to **prohibit the use of hopscotch loans to avoid taxes on existing offshore profits at the time of an inversion**. Unfortunately, the way Treasury drafted its Notice, it only applies when the shareholders of the inverting U.S. company **own 60% or more of the new foreign company**.

Cleverly, Pfizer structured its merger with Allergan so that [Pfizer’s shareholders own 56% of Allergan](https://www.washingtonpost.com/news/wonk/wp/2015/11/23/pfizer-and-allergan-to-merge-in-160-billion-inversion/) – just below the 60% requirement. Thus, the Treasury rule that *prohibits* tax breaks from hopscotch loans will *not* apply. So Pfizer will be free and clear to loan its offshore profits to Allergan, its new foreign parent, and dodge up to $35 billion in U.S. taxes.

Pfizer’s tax dodge is already being copycatted. Johnson Controls, a Milwaukee firm, announced in January that it plans to merge with Tyco International, a former U.S. company also based in Ireland. Johnson Controls structured the deal so its shareholders will own [56% of the new foreign parent](http://www.wsj.com/articles/johnson-controls-tyco-to-merge-in-inversion-deal-1453724828). On March 20, IHS, a large data company based in Colorado, announced it will merge with a smaller rival Markit and reincorporate in London. [IHS shareholders will own 57%](https://www.washingtonpost.com/news/business/wp/2016/03/21/data-company-ihs-becomes-latest-to-give-up-u-s-citizenship-for-lower-taxes/) of the merged company.

**Treasury’s Authority to Close the “Pfizer Loophole”**

Likely within the next few weeks, the Treasury Department will finalize a regulation that implements [notices it issued in 2014](https://www.treasury.gov/press-center/press-releases/Pages/jl2647.aspx) and [2015](https://www.treasury.gov/press-center/press-releases/Pages/jl0282.aspx), which were intended to reduce the tax benefits of corporate inversions and addressed certain instances of post-inversion tax avoidance, such as hopscotch loans.

In the final regulation, Treasury can make a simple fix that would prevent Pfizer, Johnson Controls, IHS and most likely other companies that invert from using hopscotch loans to permanently dodge the U.S. taxes they currently owe on existing offshore profits.

Treasury appropriately used its authority under [Section 956](https://www.law.cornell.edu/uscode/text/26/956) of the Tax Code to prohibit such post-inversion tax avoidance in its 2014 Notice but only applied it to inversions under [Section 7874](https://www.law.cornell.edu/uscode/text/26/7874) of the Tax Code. Section 7874 only applies when the new foreign parent company is at least 60% owned by the original shareholders of the former U.S. parent. Treasury’s final rule should be decoupled from Section 7874 so that inversions where less than 60% of the shareholders of the new foreign parent are the original U.S. shareholders will apply. This would prohibit the tax breaks sought by Pfizer, Johnson Controls, and IHS and others most likely coming down the pike if these tax-dodging inversions succeed.

**Treasury now has ample evidence that companies are trying to get around its initial Notice and it has broad authority to prevent such tax avoidance.**

As reported in [The Wall Street Journal](http://www.wsj.com/articles/sanders-urges-treasury-to-set-tax-restrictions-on-inversion-deals-1458316802?mod=ST1%5d\), Harvard Law School senior lecturer Stephen Shay, who previously served as Deputy Assistant Secretary for International Tax Affairs in the Treasury Department, argued in a recent [Tax Notes article](https://dash.harvard.edu/bitstream/handle/1/25499324/Shay_Fleming_Peroni%20Treasury_s%20Unfinished%20Work%20on%20Corporate%20Expatriations%20150tn0933%5B1%5D.pdf?sequence=1) that Treasury can use its existing regulatory authority to prevent the use of hopscotch loans to dodge taxes. Nine members of the U.S. House of Representatives made a similar case to Treasury in a [recent letter](http://doggett.house.gov/images/DoggettMembersLettertoLew.pdf). Fifty-five national organizations also made the case to Treasury in a [recent letter](http://www.americansfortaxfairness.org/atf-sign-on-letter-to-jack-lew-on-pfizer-merger/), which explained Treasury’s legal authority (see pp. 4-5).

**Pfizer’s Other Tax Dodging and Drug Price Gouging**

Should you decide to draft an opinion piece about the Pfizer tax dodge, you may find helpful this other information from the [ATF Pfizer report](http://www.americansfortaxfairness.org/files/Pfizer-report-FINAL-for-WEB.pdf):

* Pfizer’s 2014 worldwide corporate tax rate—which the company advertised as 25.5% and held up as a rationale for its tax-avoiding inversion—was really only 7.5%. [This figure was confirmed by *The Wall Street Journal*](http://www.wsj.com/articles/pfizer-piles-profits-abroad-1447031546?alg=y)*.* ATF estimated Pfizer’s worldwide tax rate to be only an average of 6.4% between 2010 and 2014, as opposed to the company’s claim of 24%.
* Pfizer’s tax dodge has a human cost. The estimated $35 billion in taxes Pfizer will dodge could fund the National Cancer Institute for almost seven years, provide high-quality preschool for all low- and moderate-income four-year olds for nearly five years, or provide free tuition for two years of community college for up to 9 million students over five years.
* **Pfizer has routinely hiked the prices of dozens of prescription drugs at 10 times or more the rate of inflation each year since 2012.** Seven of Pfizer’s top selling drugs had their prices hiked an average of 39% over two years—from 2013 to 2015—under the Medicare Part D prescription drug program, 23 times the inflation rate. Lipitor, Pfizer’s widely-prescribed cholesterol treatment, jumped 35% during that period. Pfizer’s nerve medication Lyrica spiked 77% between 2010 and 2014, under the same program. About 38.1 million Americans are enrolled in Medicare’s Part D prescription drug program.
* **If Pfizer wants to be an Irish company to cut its taxes but still be based in America, then it should charge American patients the same much lower drug prices it charges Irish consumers.** Pfizer charges 12 times as much on this side of the Atlantic under the Medicare program for the same seven top-selling drugs as it charges in Ireland.
* **While Americans suffer from lost tax revenue and high drug prices, Pfizer thrives**. Over the last five years, Pfizer has had sales averaging more than $50 billion a year, with earnings averaging $9.4 billion for a robust profit margin of nearly 18%. Pfizer’s 2015 earnings margin of 18.8% is up nearly 50% since 2011.
* **Pfizer got $5 billion in federal contracts over a recent five-year span.** Even as the company avoids paying its rightful share of taxes to America, the U.S. is paying the company about a billion dollars a year for prescription drugs. Federal government contracts represent about 5% of the company’s total U.S. sales.
* **Taxpayers provided Pfizer with $591 million in tax breaks over the last five years through federal research and experimentation tax credits and domestic manufacturing tax deductions.** This is a costly taxpayer subsidy to a company that is charging customers exorbitant prices.

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