

Putting Profits Over Patriotism

In a recent article in the *New York Times*, David Cay Johnston details how some sleazy American companies are reincorporating in Bermuda and other countries to avoid taxes. Insurance companies led the way a few years ago, and when Congress failed to take action, other patriotically challenged corporations followed suit.

The ploy entails little more than some creative paperwork. In late 2000, for example, Silicon Valley computer-hard-drive maker Seagate Technology turned itself into a Cayman Islands “shell company” called “New SAC,” whose operations, Seagate notes in its 2000 annual report, “are substantially identical to the operations of Seagate Technology before the transactions.”

In fact, these freshly minted offshore companies don’t do anything at all in their new “home” countries. The chief financial officer for New Jersey-based Ingersoll-Rand, which expects to cut its U.S. taxes by \$40 million a year by pretending to move to Bermuda, cheerfully admitted to the *Times* that Ingersoll won’t even set up an office in Bermuda. “We just pay a service operation” to accept mail, he said.

Stanley Works, the well-known Connecticut toolmaker, expects to cut its taxes from \$110 million a year to \$80 million by reincorporating in Bermuda. New Hampshire-based Tyco International says it saved more than \$400 million last year by doing the same. Others with existing or planned mail drops in Bermuda include: the infamous Global Crossing; New Jersey manufacturer Foster Wheeler; the Texas oil-well-services giant Nabors Industries; and Cooper Industries of Texas, which anticipates cutting its taxes by 40 percent. The big accounting firms—motto: “we have no scruples”—are aggressively promoting the new scheme. In a message to its clients, an Ernst & Young partner conceded that it might look unpatriotic, but concluded that “the improvement on earnings is powerful enough that maybe the patriotism issue needs to take a back seat.”

Why would setting up a mail drop on a sunny island allow an American company to avoid taxes?

United States corporate income tax laws do have restrictions against companies using tax havens like Bermuda. But our anti-tax-haven rules generally apply only to companies incorporated in America. As newly-borne “foreign corporations,” companies claim to be suddenly exempt from the anti-tax-haven rules; they argue they must pay taxes only on whatever profits they deign to characterize as American. Not surprisingly, that’s a lot less than what they really earn here.

The tax-shelter promoters would like everyone to believe

this is all so VERY, VERY COMPLICATED that nothing can be done about it. But that’s just blowing smoke. We don’t have to let a mail drop in Bermuda turn an American corporation into a foreign corporation. Instead, Congress should simply follow the lead of countries such as Germany, Japan and the United Kingdom, and treat any ostensibly “foreign” corporation whose shares are mostly owned by Americans as, well, American.

Beyond that, we ought to scrap an antiquated rule that lets American companies indefinitely “defer” reporting their foreign profits on their U.S. tax returns. It’s not that we want to tax actual foreign earnings—we give companies a full tax credit for the taxes they pay to foreign governments if they ever report the foreign income. But deferral opens up the door to other scams companies use to shift their American profits on paper to tax-haven countries, and our current anti-abuse rules are far too weak.

Eliminating deferral would stem these abuses and hugely simplify the corporate tax laws to boot. That’s exactly what the Kennedy administration unsuccessfully proposed back in the early sixties, and what both the House and Senate passed in the mid-seventies—unfortunately not at the same time.

Is there any chance of really taking on multinational corporate tax sheltering, given our current political leadership? On the negative side, Bill Thomas, the California Republican who chairs the House Ways and Means Committee, has been an outspoken advocate of *expanding* multinational loopholes, and the Bush administration seems to have similar views. On the other hand, the outrageous Enron tax-haven situation and the blatantly unpatriotic cynicism of the accounting firms in promoting the new wave of phony offshore schemes ought to create considerable public pressure on lawmakers.

Senator Chuck Grassley of Iowa, ranking Republican on the Senate Finance Committee, has rarely been known as a corporate tax reformer, but in this case he believes something needs to be done. “There is no business reason for doing this, other than to escape U.S. taxation,” he told the *Times*. I believe the Finance Committee needs to investigate this activity.” Likewise, Rep. Charles Rangel of New York, the ranking Democrat on the House Ways and Means Committee, says that companies shouldn’t be allowed to “choose profits over patriotism.”

So maybe this will be the year that the tax-avoiding companies and their sneering tax advisors get their comeuppance. We can always hope.