A Brief History in Time of Tax Planning: The Rise and Fall and Rise (Again?) of Corporate Tax Aggressiveness

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Presented at the ABA Conference
on Tax Policy and Simplification

May 9, 014

Corporate Tax Policy Issues

- 1960s-1970s
  - ♦ Corporate tax revenues constituted 17-25% of federal revenues.
- 1981
  - ♦ Congress enacted the "Economic Recovery Tax Act" (ERTA) to stimulate capital investment through:
    - ♣ Accelerated depreciation
    - ♣ Investment credits
    - ♣ Safe harbor leasing

Corporate Tax Policy Issues

- Particularly troublesome was the “safe harbor leasing” provision, which enabled corporations with high taxable income (e.g., General Electric) to purchase tax depreciation deductions and investment credits from loss corporations (e.g., Chrysler Corporation).
- GE “paid” $349M for approximately $632.8M of tax benefits.
  - During 1981-1984, GE reported $9,577M of book profits and received a net refund of $98M in taxes!
  - Commentators likened the magnitude of the tax breaks to a Molotov cocktail.

Corporate Tax Policy Issues

- GE's defenders made the following argument:

  GE may find itself in an uncomfortable public-relations situation because it received a $103.8M net refund of tax payments in 1981 and will realize substantial future tax benefits from tax-transfer leases. Still, in doing so it paid $349 million or so to various companies to help them benefit from the tax subsidies arising from investment in capital assets. If Congress wished these subsidies to be widely available, then ***GE deserves some thanks for helping make them so****.* [emphasis ours]

Corporate Tax Policy Issues

- 1982-1985
  - ♦ Fearful that it may have effectively eliminated the corporate income tax as a source of revenue, Congress repealed safe harbor leasing within months of its enactment.
  - ♦ The corporate income tax share of the federal revenue pie dropped to 6% in 1984.
  - ♦ Several studies were published showing that many highly "profitable" corporations were paying no federal income taxes.
    - ♣ Citizens for Tax Justice – Top 50 corporate "***freeloaders***"
    - ♣ Wheeler/Outslay study on General Dynamics Corporation

Corporate Tax Policy Issues

1984 was a banner year for corporate profits. They were up 26% over 1983, reaching an all-time high of $286 billion…Despite this spectacular rebound in profitability, 1984 was yet another banner year in corporate tax avoidance.

Citizens for Tax Justice. *Corporate Taxpayers & Corporate Freeloaders: Four Years of Continuing, Legalized Tax Avoidance by America's Largest Corporations 1981-1984*. (August 1985)

Corporate Tax Policy Issues

- Public outcry from the “average man” ensues!

You report…that the General Dynamics Corporation has paid no taxes since 1972, despite profits in the billions, and the dividends paid to its stockholders were also exempt under present law. What kind of tax laws do we have that allow this to happen?… Congress permits such tax loopholes to exist…while it wrings its hands over the Federal deficit. Is it any wonder that many citizens feel a sense of outrage at tax time? Tax avoidance has become a major industry, and special interests dominate tax legislation. ***Who speaks for the average man?***

Joseph H. Aaron
Letter to the New York Times
February 1, 1985

Corporate Tax Policy Issues

- 1986 – Congress enacts a “landmark” Tax Reform Act
    - ♦ The stated goals were to ***shift*** $120 billion of the tax burden from individuals to corporations and to simplify the tax laws.
    - ♦ The cornerstones of the Act were:
        - ♣ Base broadening (eliminate exclusions and deductions)
        - ♣ Tax rate reduction
    - ♦ The Internal Revenue Code is renamed.

Corporate Tax Policy Issues

- As part of TRA86, Congress enacted the corporate "***alternative minimum tax***" (AMT) and gave the following reason:

  *Congress also believed that **fairness** in the tax system requires that corporate taxpayers pay amounts of tax appropriate for their level of earnings. **Congress found it unjustifiable that under prior law some corporations reported large earnings and paid significant dividends to their shareholders, yet paid little or no taxes on that income to the government**.*

- One of the "adjustments" to compute the AMT base was to add back 50% of the excess of book income over taxable income.

Corporate Tax Policy Issues

- In 2002 Citizens for Tax Justice issued another study showing that the average tax rate paid by the top 250 U.S. corporations was 20.1%.

From 1996 through 2000, just ten large profitable companies enjoyed a total of $50 billion in corporate tax breaks. That brought their combined tax bills down to only 8.9 percent of their $191 billion in U.S. profits over the five years.

Citizens for Tax Justice

Surge in Corporate Tax Welfare Drives Corporate Tax Payments Down to Near Record Low. Mimeo, April 17, 2002.

Corporate Tax Policy Issues

- The study concluded that:

  With significant help from Congress, corporations appear to be finding ways around tax reforms adopted in 1986. We hope our findings will encourage lawmakers to reexamine this important area of taxation.

- The phrase "*corporate welfare*" once again reared its ugly head.

- It was déjà vu all over again!

Corporate Tax Policy Issues

- More studies were published showing the disparity between book and taxable income was widening at an accelerated pace.

  Pre-tax book income of active corporations…grew from $752.7 billion for 1996 to $819.6 billion for 1997, and fell slightly for 1998 to $816.7 billion. Similarly, tax net income grew from $660.2 billion for 1996 to $693.6 billion for 1997, and also fell for 1998 to $657.7…The net effect of these differential growth patterns was to increase the difference between pre-tax book income and tax net income from $92.5 billion for 1996 to more than $159.0 billion for 1998, an increase of 71.9 percent.

  Plesko, G. 2002. "Reconciling Corporation Book and Tax Net Income, Tax Years 1996-1998." Internal Revenue Service *Statistics of Income Bulletin* (Spring 2002): 116.

Corporate Tax Policy Issues

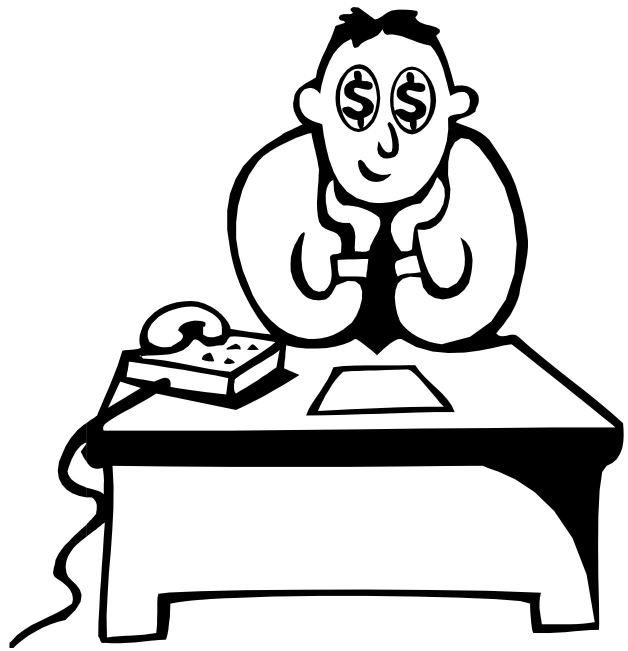
- CPA and law firms participated in the tax shelter frenzy
  - ♦ One firm summed up its tax group strategy as follows:

    All of us in the firm need to focus on money.

    Think green.

    Green is good!

  - ♦ *Show us the money!*
    - ♣ *Financial alchemy*



Corporate Tax Policy Issues

- In February 2013, the Joint Committee on Taxation issued its 2,700 page report on Enron Corporation, which showed that Enron reported $2.3 billion of net (book) income from 1996-1999, while at the same time reporting $3 billion of tax losses – sound familiar?
- On February 13, 2003, the Senate Finance Committee held a public hearing to discuss the report.

You are about to witness a shocking event in the history of American corporate tax policy and financial accounting. We are going to have the veil torn off the world of tax shelters and manipulation of accounting.

Opening statement of Sen. Chuck Grassley
Chairman, Committee on Finance
Hearing, "Enron: The Joint Tax Committee's Investigative Report"

Corporate Tax Policy Issues

- Biting commentary follows!

But it's increasingly clear that lying to shareholders and lying to the IRS are just opposite sides of the same coin. Accounting is no longer a way to provide an accurate and unified view of a company's finances. Instead, it has become a means to an end. For the public books, the goal is to achieve smooth and steady earnings growth that will lift the value of the company's stock…For the IRS, the goal is the exact opposite – keeping income, and thus taxes, to a minimum. ***The fact that accountants have become so good at serving both ends is the clearest evidence of the corruption of their profession***.

Alan Murray. "Inflated profits in corporate books is half the story." *The Wall Street Journal* (July 2, 2002).

Corporate Tax Policy Issues

- More letters from the “average man”

*"Tax Moves by Enron Said to Mystify the I.R.S."…describes a foreseeable consequence of the complexity of our tax laws. The responsibility lies with Congress, which has over time created an incomprehensible tax edifice. Loopholes are simply clever and entirely legal interpretations of this complexity. The only solution that makes sense is to radically reform the system, to make it simple … **This might go so far as to make tax reporting and book reporting identical**. Corporations would no longer be able to report high earnings for book purposes unless they reported the same earnings for tax purposes, while tax avoidance based on lower earnings would require lower reported earnings for all purposes, including reports to public markets.*

Larry Israel. *Letter to the New York Times*.
February 13, 2003

Corporate Tax Policy Issues

- A 2004 GAO study revealed that more than 70% of foreign-owned U.S. companies paid no FIT between 1999-2000 (61% of U.S.-owned U.S. companies also paid no tax).
  - ♦ Senator Dorgan: *Stark evidence that "gaping loopholes" exist in the tax Code and its administration and enforcement*.
  - ♦ Senator Levin: *Too many corporations are finagling ways to dodge paying Uncle Sam, despite the benefits they receive from this country*.
  - ♦ Headline in the L. A. Times: "Corporate Tax Dodges: Ugly and Antisocial" (April 11, 2004)

Corporate Tax Policy Issues

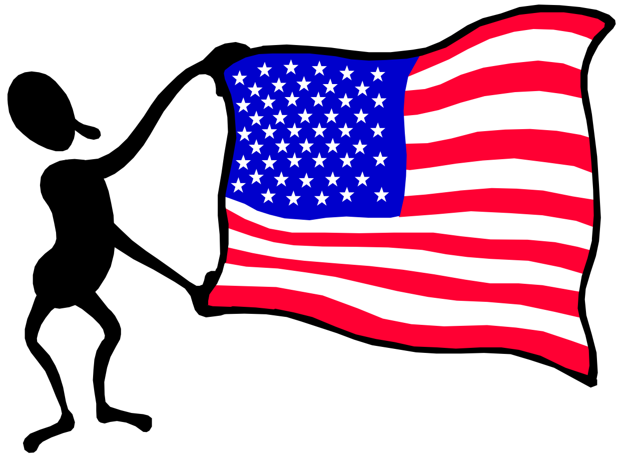
- A 2008 GAO study revealed that more than 65.2% of foreign-owned U.S. companies and 66.7% of U.S.-owned U.S. companies paid no FIT between 1998-2005.
  - Senator Dorgan: *A shocking indictment of the current tax system. It's shameful that so many corporations make big profits and pay nothing to support our country. The tax system that allows this wholesale tax avoidance is an embarrassment and unfair to hardworking Americans who pay their fair share of taxes. …* ***It's time for big corporations to pay their fair share***.
  - Senator Levin: *Too many corporations are using* ***trickery*** *to send their profits overseas and avoid paying their fair share to the United States*.

Corporate Tax Policy Issues

- What might explain this phenomenon?
  - ***Tax planning reason***: Most small corporations operate as flow-through entities
  - ***Tax aggressive reason***: Large corporations manipulate cross-border transfer prices to shift income to low-tax jurisdictions
- Predictable editorial responses:
  - ***New York Times***: "The Corporate Free Ride"
  - ***Tax Foundation***: "AP Makes Serious Error in Story on Corporate Income Tax"

Corporate Tax Policy Issues

- The aftermath
  - ♦ Corporate America has become more sensitive about how much tax it pays.
  - ♦ Wal-Mart and Berkshire Hathaway, Inc. – ***We pay taxes!***



Corporate Tax Policy Issues

- Where are We Today

The Sorry State of Corporate Taxes

"Corporate lobbyists incessantly claim that our corporate tax rate is too high, and that it's not 'competitive' with the rest of the world," said Robert McIntyre, Director of Citizens for Tax Justice and the report's lead author. "Our new report shows that both of these claims are false. Most of the biggest companies aren't paying anywhere near 35 percent of their profits in taxes and ***far too many aren't paying U.S. taxes at all****. Most multinationals are paying lower tax rates here in the United States than they pay on their foreign operations."*

Citizens for Tax Justice

February 2014

Corporate Tax Policy Issues

111 of the companies enjoyed at least one year in which their federal income tax was zero or less.

26 companies enjoyed negative income tax rates over the entire five-year period, despite combined pre-tax profits of $170 billion.

Of the 125 multinational companies in this sample, two-thirds paid a lower U.S. tax rate than the rate they paid to foreign governments on their foreign profits. On average, their foreign effective tax rate was 12 percent larger than their U.S. effective rate.

111 of the companies enjoyed at least one year in which their federal income tax was zero or less.

The total amount of federal income tax subsidies enjoyed by the 288 profitable corporations over the five years was $362 billion.

Tax Policy on the Horizon

- President Obama’s international tax agenda

  The proposals the President is describing today are designed to build on this progress. They include six proposals that Congress should act on immediately to encourage job growth in the United States and that are fully paid for by ***closing tax loopholes that encourage the shifting of jobs and shielding of profits overseas****. The President is also calling for Congress to extend current temporary tax incentives this year to bring more certainty to the near-term economy and for fundamental tax reform that would encourage more investment in America with a new international minimum tax, a lower rate for American manufacturing, and a simpler, broader tax code.*

Tax Policy on the Horizon

- The President's FY 2015 proposals to "reform" the U.S. international tax system were estimated to raise $276 billion over 2015-2024, the most controversial of which are:
  - ♦ Defer deducting interest related to foreign source income until such income was recognized as income in the United States (for example, as a repatriated dividend).
  - ♦ Determine the foreign tax credit on a pooling basis.
  - ♦ Tax currently "excess returns" associated with transfers of intangibles offshore.

Tax Policy on the Horizon

- Rep. Camp's proposal
  - ♦ Rep. Dave Camp proposes to exempt 95% of dividends received from 10/50 and CFCs by U.S. corporations (the 5% that is taxable is designed to substitute for a disallowance of deductions related to the exempt foreign income under §265).
  - ♦ Foreign withholding taxes imposed on dividends qualifying for the 95% DRD and deemed paid credits otherwise available under §902 will not be creditable.
  - ♦ Deemed repatriation of foreign earnings in year prior to transition
    - ♣ 90% DRD for noncash portion
    - ♣ 75% DPD for cash portion

Tax Policy on the Horizon

- Corporate America's coalitions:
  - ♦ Alliance for Competitive Taxation (ACT): 25% rate, territorial tax
  - ♦ Coalition for Fair Effective Tax Rates: Equalize ETRs across industry
  - ♦ Campaign for Home Court Advantage: Revenue-neutral, territorial
  - ♦ Let's Invest for Tomorrow (LIFT): Revenue-neutral, territorial
  - ♦ Promote America's Competitive Edge (PACE): Lower rate, territorial
  - ♦ Reforming America's Taxes Equitably (RATE): Reduce tax rate
  - ♦ Tax Innovation Equally (TIE): Protect intangible income, territorial
  - ♦ WIN America Campaign: Repatriation holiday

The Changing Role of the Tax Department

- Increasing expectations of the tax function

Cost	Value	Risk
•Cost efficiency •Cost minimization	•Driving shareholder value (EPS) •Higher ROI •Reduced taxes	•Corporate governance •Accuracy of compliance •Accuracy of financial reporting •Failure to meet disclosure requirements •Reputation

Pre-1990s

1990s

Post-SarbOX

The Changing Role of the Tax Department

- The "present" for tax departments

Economic Survival → Post-Crisis

Economic Survival

- Preserve cash/focus on liquidity
- Challenge cost
- Deliver immediate value through tax planning
- In-house vs. outsourcing/co-sourcing
- Tax implications of mergers/divestitures
- Distressed business tax considerations

Post-Crisis

- Re-evaluate the tax function operating model
- Improve reporting and compliance efficiency
- Navigate increased global risk and transparency

Regulators Internal audit Capital markets COO CEO Board of directors
Directors Tax department Business partners CFO Audit committee

The Changing Role of the Tax Department

- Pre-SarbOX, corporations began "***reengineering***" their tax departments from cost centers to profit centers.
  - The goal was to add value to the "bottom line."

    In the mid-1990's, Enron's management began to view the role of its tax department as more than managing its Federal income tax liabilities. ***Rather, Enron's tax department became a source for financial statement earnings, thereby making it a profit center for the company****.*

Joint Committee on Taxation

Written Testimony of the Staff of the Joint Committee on Taxation on the Report of Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issue, and Policy Recommendations (JCX-10-03), February 13, 2003

The Changing Role of the Tax Department

At WorldCom, the process was different – the reported EIT rate was simply dictated by Sullivan or Myers. In both 2002 and 2001, WorldCom's Tax group undertook the exercise of estimating an EIT rate; we were told that in both years, Meyers or Sullivan informed the Tax group that the Company used a lower EIT rate to book income tax expense than the rate calculated by the Tax group. Members of the Tax Group who participated in this exercise thought the process of arriving at a reported EIT rate was problematic. In some quarters, ***the Tax group learned of WorldCom's EIT rate by listening to Sullivan's conference calls with analysts***; in other quarters, the rate would be communicated to the Tax group directly by Myers or Yates. The Tax group acquiesced in this process, as reflected by a January 2001 e-mail from Walter Nagel, WorldCom's General Tax Counsel to Yates, in which Nagel stated, "[w]e also need to consider whether we book tax at 42% or 41%. I will call my spiritual adviser: Mr. Myers."

Report of Investigation by the Special Investigative Committee of the Board of Directors of WorldCom, Inc. 2003.

The Changing Role of the Tax Department

- The focus within the corporate tax department today has shifted to external constituencies.

"It's not just the SEC. The FASB obviously is coming to the party as well…As we work through this year, I think we'll see new sunlight on the way corporations prepare their tax positions and establish reserves. Another external group is the audit committee of the board. Again, they are becoming more and more involved in taxes…As we explore the various risks the company faces, tax is clearly on that list. An expense of over a billion dollars must be on that list."

The Changing Role of the Tax Department

"I also put … our outside auditors into the external bucket…We have evolved from a relationship that included both the audit and tax planning to one that is focused almost exclusively on the audit. But once again, the challenge there is to preserve the collaborative parts of that relationship that we remember from three or four years ago as we move to what is sometimes more of an arm's-length relationship…I will also put the IRS into the new external category…Finally, for the external audience, I turn to our stock analysts…For the second year in a row, one of the analysts asked a tax question. ***It is interesting to see the extent to which the analysts are now concerned about the tax provision – less so with the historical tax provision, but obviously more interested in the forward-looking view as to what the tax rate might be****."*

Matthew McKenna
Senior VP of Finance, PepsiCo, Inc.
February 9, 2006

The Changing Role of the Tax Department

- The new world facing VPs of Tax / Tax Directors
  - ASC 740 is at the "top of minds" of CFOs and Boards of Directors.
  - The SarbOX environment requires tax directors to have direct involvement with the C-Suite and Audit Committee.
  - ASC 740 has moved from back-of-the-room stuff to being central to key executives – no one wants a restatement!
  - An E&Y survey of tax directors found that ***tax risk management*** is a key element in corporate performance and their personal performance measure.
  - The profile of an effective tax director is changing!

The Changing Role of the Tax Department

- The VP of Taxes / Tax Director's constituency
  - SEC – oversight of FASB, review of registrant filings, rule-making, comment letters and investigations – ***increasing comment letters***
  - PCAOB (and similar non-US bodies) – oversight of public company auditing profession, review of audit engagements, standard-setting and rule-making
  - FASB (and similar non-US bodies) – setting standards for financial reporting, including international convergence, BEPS
  - IRS (and other taxing authorities) – oversight of tax practitioners, review of filings, rule-making
  - Shareholders and creditors – enhance shareholder value

The Changing Role of the Tax Department

*Right now companies are balancing risk mitigation with tax planning…" With the former winning out and given a zero tolerance for tax shelters … **companies will find it increasingly difficult to lower their effective tax rate**. And … "won't that put the CFO between a rock and hard place?*

Kris Frieswick, CFO Magazine

November 1, 2005

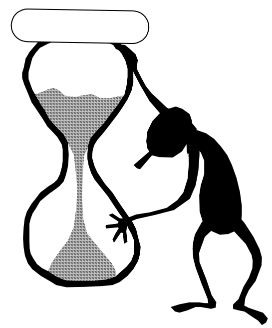
The Changing Role of the Tax Department

- The "***resource allocation paradox***"

… the hours needed for compliance and compliance-related work are greater than for tax planning, but the value of that work for the corporation – when value is measured by the corporation's bottom line. Both tax compliance and tax planning are necessary and important. But what the paradox does is raise the issue of resource allocation. Who should work on compliance and who on planning? Should we outsource one, or other? How can I use technology to improve the efficiency of the tax compliance process?

Deloitte LLP

What I have to do vs. what I want to do!

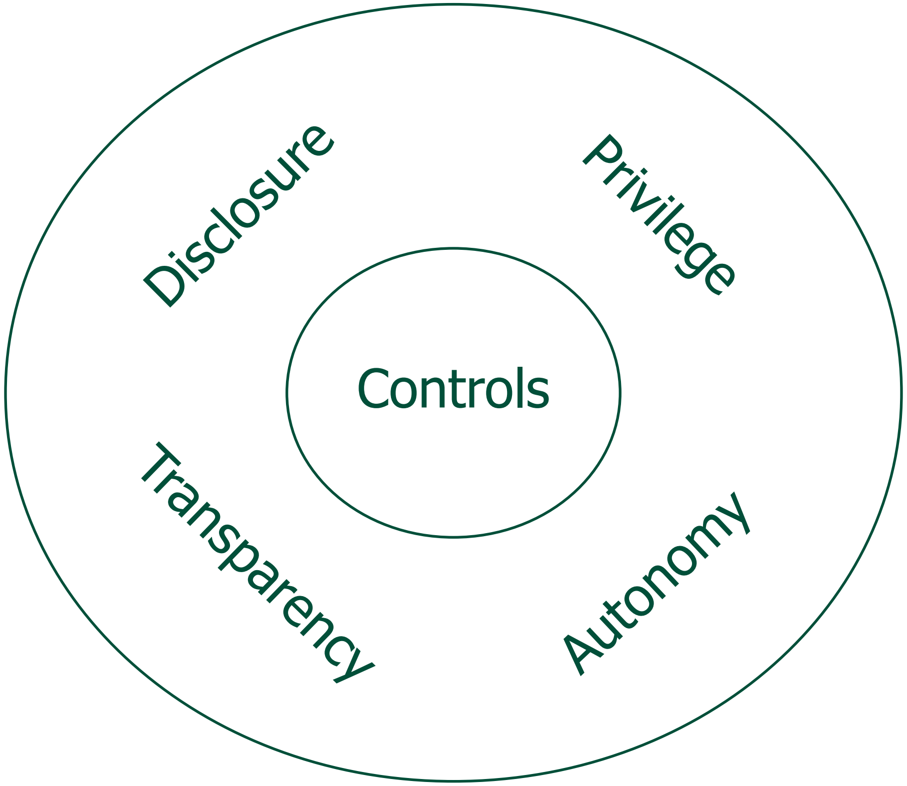


The Changing Role of the Tax Department

- Factors related to tax risk management (TRM)
  - ♦ Transparency
    - ♣ Tax reserves – too high or too low
  - ♦ Disclosure
  - ♦ Accountability
    - ♣ Ethics hotline
    - ♣ Delineation of responsibilities
  - ♦ Reputation – stay off the front page of the *Wall Street Journal*

The Changing Role of the Tax Department

- Tax Risk Management tradeoffs



The Changing Role of the Tax Department

Vodafone Group Plc Tax Code Of Conduct

This Code of Conduct applies to all tax professionals working in companies owned by Vodafone Group Plc. It endeavours to guide the role of tax professionals within the Group, their key responsibilities, their professional conduct and their approach to working relationships with external parties.

Vodafone believes its obligation is to pay the amount of tax legally due in any territory, in accordance with rules set by governments. In so doing it is not able to determine the "fair" amount of tax to pay.

It is not appropriate for the details of the Group's tax affairs to appear in the public domain. Vodafone will however only enter into transactions which would be fully justifiable should they become public.

The Changing Role of the Tax Department

- SEC rules concerning tax services
  - ♦ The SEC allows an audit firm to provide "tax services" to its audit clients provided such services do not impair the auditor's independence with respect to such clients.
  - ♦ Services specifically allowed include:
    - ♣ Tax compliance (return preparation)
    - ♣ Tax planning (explanation or "black-and-white" advice)
    - ♣ Tax advice
  - ♦ These tax services must be pre-approved by the audit committee.

The Changing Role of the Tax Department

- Questions that must be asked under SarbOX 302 and 404 that require auditors to provide more details on the "control environment" in the client's tax department.
  - ♦ Who sets the mission statement for the tax department?
  - ♦ Are compensation and performance measurements aligned with the mission statement and corporate values?
  - ♦ Who sets policy for approving tax-advantaged transactions?
  - ♦ Who approves the use of special-purpose entities or tax havens?
  - ♦ Who establishes the scope of information and documentation to be provided to independent auditors?

The Changing Role of the Tax Department

- Who is responsible for identifying and monitoring key tax rules?
- Who approves the financial reporting of tax benefits from tax-advantaged transactions?
- Who approves the hiring of tax service providers?
- Who approves decisions to litigate tax matters?
- Who sets policy for tax lobbying activities?
- Who approves assertions of business purpose when needed to support tax reporting positions?
- Who approves APB 23 assertions?

The Changing Role of the Tax Department

- Increasing regulation

Planning Era

- Tax Planning
- Tax Compliance
- Tax Audit Management
- Tax Provision

Pre 2004

Transparency Era

- Schedule UTP
- E-filing
- Schedule M-3
- Reportable transactions
- FAS 123R, FAS 141R
- SOX 404
- FIN 48
- Tax Planning
- Tax Compliance
- Tax Audit Management
- Tax Provision

2004-2013

Regulatory Era

- BEPS
- U.S., State, Foreign Jurisdiction Audits
- Transfer Pricing
- OECD – joint audits
- International tax reform
- Schedule UTP
- E-filing
- Schedule M-3
- Reportable transactions
- FAS 123R, FAS 141R
- SOX 404
- FIN 48
- Tax Planning
- Tax Compliance
- Tax Audit Management
- Tax Provision

Today

A Tax Lawyer's Quandary

March 22, 2013

A Tax Lawyer's Quandary

By Chuck Klosterman

I am a tax lawyer. ***Is advising wealthy companies of ways to reduce their tax bills through sophisticated legal structures ethically permissible?*** *The structures take advantage of* ***legal loopholes*** *in the tax legislation.*

NAME WITHHELD, NEW YORK

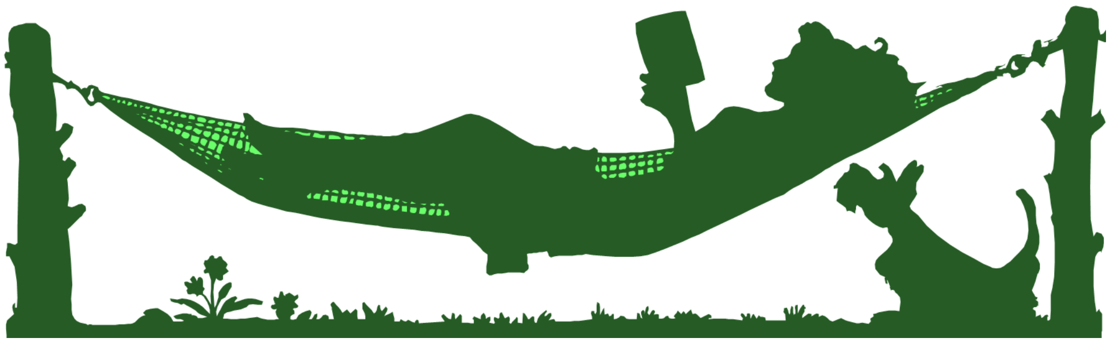
A Tax Lawyer's Quandary

The Ethicist's Answer

The ethics of specific professions create unique realms of responsibility. In the same way that a defense attorney is ethically obligated to give his client the best possible defense – even if he's convinced of the individual's guilt – your principal responsibilities lie with the company hiring you. ***You need to do your job to the best of your abilities, within the existing rules. You should, however, voice your moral apprehension about the use of such loopholes to the company you represent****.*

A Tax Lawyer's Quandary

The International Tax Lawyer / Accountant Answer

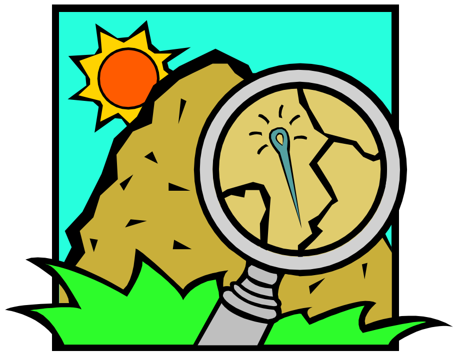


Government Responses to Transparency

- Schedule M-3 (Treasury press release)
  - Increase the transparency of corporate tax return filings
  - Help agents determine whether the return should be audited and identify the differences that matter most in the audit of the return ("***LIFE audits***").
  - Lead to a reduction in unnecessary audits ("***chasing shadows***") and a swifter focus on those differences that are more likely to arise when taxpayers take aggressive positions or engage in aggressive transactions.
    - The emphasis is on risk management
  - Identify emerging issues and evolving business trends

Government Responses to Transparency

- Why parse book-tax differences between permanent and temporary differences?
  - A growing emphasis on ETR planning to meet earnings goals at publicly-traded corporations.
  - Why not parse temporary differences between taxable temporary differences and deductible temporary differences?
    - Which should the IRS focus on?



Government Responses to Transparency

- The thinking behind disclosures of uncertain tax positions

*My second point is that income tax contingencies also fall within the scope of Statement [FAS] 5. In other words, the accounting and disclosure requirements of Statement 5 apply to items of tax cushion. Statement 109 provides additional disclosure requirements for income tax items that arise as a result of temporary differences. Some of you no doubt are thinking, 'If we follow that guidance, and comply with the disclosure requirements in Statements 109 and 5 – **we'd be providing a virtual roadmap for the IRS.**' This issue has been with us for some time.*

Government Responses to Transparency

A company's concern about maintaining confidentiality in this area is understandable, but it has to be balanced with the need for the company's investors, analysts, and regulators to gain a clear understanding of liquidity and the financial position and results of operations. Moreover, compliance with GAAP and SEC disclosure requirements is a responsibility a company voluntarily takes on when it decides to access the public markets. ***Confidentiality concerns do not excuse violations of GAAP or the SEC's disclosure rules****.*

Scott A. Taub
Acting Chief Accountant of the SEC
May 2004

Government Responses to Transparency

…The financial statements and related footnote disclosures perhaps are the most detailed way management communicates externally. Management's Discussion and Analysis is a critical supplement to the financial statements. MD&A should provide readers information 'necessary to gain an understanding of [a company's] financial condition, changes in financial condition and results of operations.

Donald Nicolaisen
Former Chief Accountant – SEC
February 11, 2004

Government Responses to Transparency

…The [corporate finance] division now has more accountants than attorneys for the first time in its history, which means we're looking at lots and lots of financial statements.

The concern in the UTP area is over whether there is enough transparency in that area and how much is enough without stepping over the line of confidentiality and where you're in a position where you're harming the company rather than helping investors understand, and it's a very fine line and we agree with that.

Carol Stacy
Chief Accountant – SEC Division of Corporate Finance
February 9, 2006

Government Responses to Transparency

- SEC comment letters – now public

…Tell us supplementally, and disclose in future filings, the nature of the IRS examination reserves, the basis for recognition and the amounts reserved. As part of your response, describe the issues or matters underlying the recorded reserves, as well as the factors considered in determining the amount and timing of all amounts reserved. Explain the basis for your determination that is probable that a loss has been incurred at the financial statement dates.

Government Responses to Transparency

You state that because you are subject to taxes in the United States and numerous foreign jurisdictions, you could be subject to changes in tax rates, the adoption of new United States or international tax legislation, or exposure to additional tax liabilities. These appear to be risks that could apply to any registrant with international operations. ***Please tell us what consideration you have given to including a more tailored discussion of any specific risks associated with your current tax structure, including any agreements or arrangements that provide material tax benefits****. See Item 503(c) of Regulation S-K.*

Government Responses to Transparency

- The Advent of Schedule UTP

It has been clear since my first day on the job that I thought transparency and increased information flow were the key to the future of sound, fair and efficient tax administration.

If we receive information with tax returns and from third parties, we can identify potential non-compliance more efficiently and target our resources more effectively. I also believe the concept of more transparency is consistent with our nation's historic framework of a voluntary compliance system. Our tax system is set up in such a way that taxpayers fill out their own returns. This self-assessment system reflects the fact that it is the taxpayer, and not the IRS, who possesses all of the information relevant to tax liability. We then use information reported by the taxpayer to make judgments about issues to pursue, and returns to audit.

Government Responses to Transparency

Inherent in this system is the basic assumption that a taxpayer will be forthcoming in dealing with the IRS with respect to the items it has reported on its tax return, including the underlying positions related to those items. But this is much more than an assumption – it is the foundation on which our tax system is built.

Guided by the fundamental principle that transparency is essential to achieving an effective and efficient self-assessment tax system, the IRS took a major step towards transparency with Announcement 2010-9. It described our proposal to require business taxpayers to report basic information regarding their uncertain tax positions when they filed their tax returns.

Government Responses to Transparency

- *I believe that it helps achieve what most taxpayers and the IRS strive for and basically want:*
  - *We want certainty regarding a taxpayer's tax obligations sooner rather than later;*
  - *We want consistent treatment across taxpayers; and*
  - *We want an efficient use of government and taxpayer resources by focusing on issues and taxpayers that pose the greatest risk of tax noncompliance.*

Prepared Remarks of IRS Commissioner Doug Shulman to the American Bar Association, IR-2010-98, Sept. 24, 2010

Taxpayer Responses to Transparency

- Managing tax controversy – *you don't want to be in the tax reserve business*

Uncertain Tax Positions

As of June 30, 2013, we had $8.6 billion of unrecognized tax benefits of which $6.5 billion, if recognized, would affect our effective tax rate. As of June 30, 2012, we had $7.2 billion of unrecognized tax benefits of which $6.2 billion, if recognized, would have affected our effective tax rate.

Taxpayer Responses to Transparency

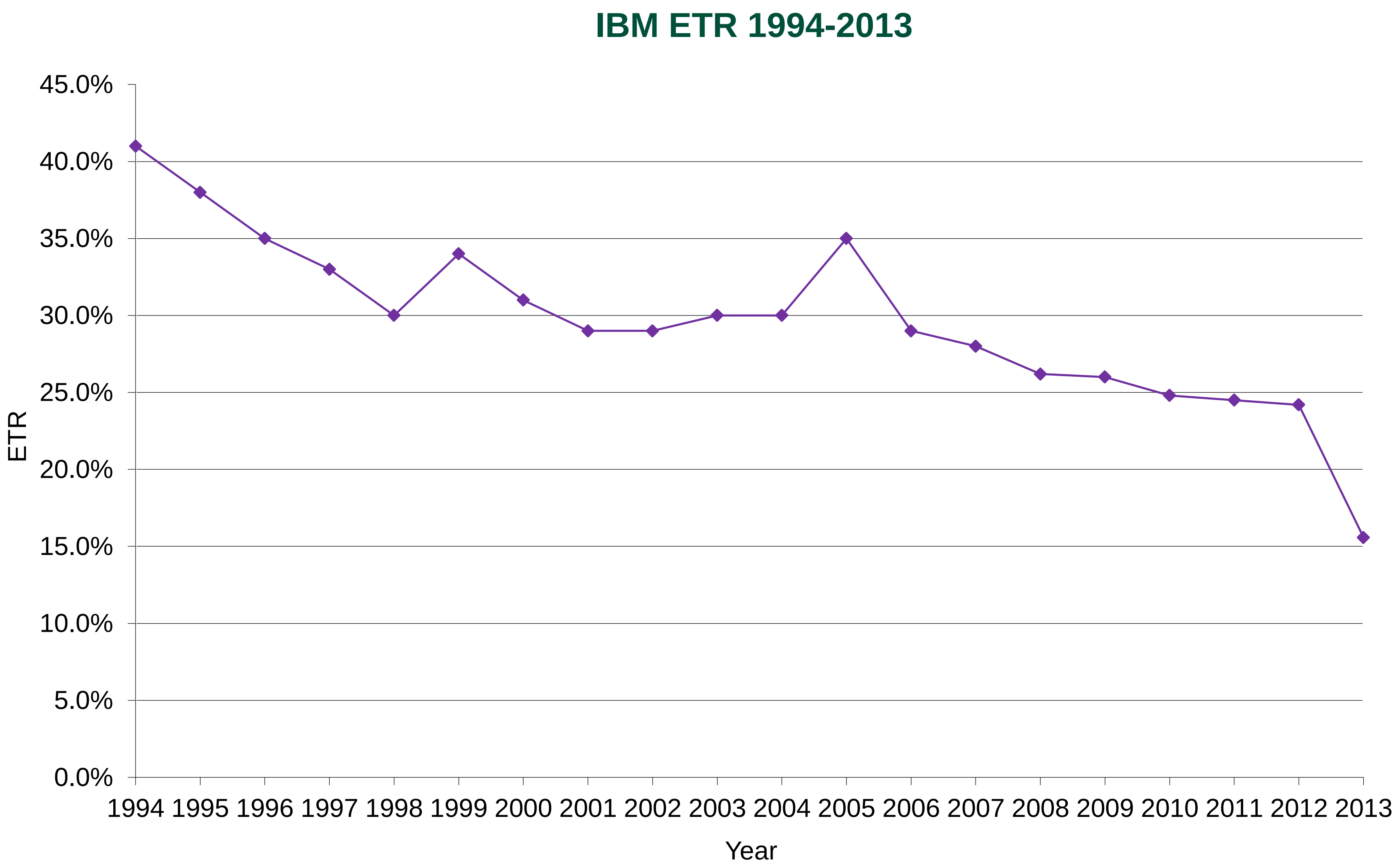
During the third quarter of fiscal year 2011, we reached a settlement of a portion of an I.R.S. audit of tax years 2004 to 2006, which ***reduced our income tax expense by $461 million****. While we settled a portion of the I.R.S. audit, we remain under audit for these years. In February 2012, the I.R.S. withdrew its 2011 Revenue Agents Report and reopened the audit phase of the examination. As of June 30, 2013, the* ***primary unresolved issue relates to transfer pricing****, which could have a significant impact on our financial statements if not resolved favorably. We believe our allowances for tax contingencies are appropriate. We do not believe it is reasonably possible that the total amount of unrecognized tax benefits will significantly increase or decrease within the next 12 months, because we do not believe the remaining open issues will be resolved within the next 12 months. We also continue to be subject to examination by the I.R.S. for tax years 2007 to 2012.*

Taxpayer Responses to Transparency

	2013	2012	2011
Balance, beginning of year	7,202	6,935	6,542
Decreases related to settlements	(30)	(16)	(632)
Increases for tax positions related to the current year	612	481	739
Increases for tax positions related to prior years	931	118	405
Decreases for tax positions related to prior years	(65)	(292)	(119)
Decreases due to lapsed statutes of limitations	(2)	(24)	-
Balance, end of year	8,648	7,202	6,935

Income Taxes Payable	632	
Cash		171
Income Tax Expense		461

Taxpayer Responses to Transparency



Taxpayer Responses to Transparency

- Has Schedule UTP / FIN 48 changed taxpayer aggressiveness – Preliminary data 2007 - 2013

Corporate Tax Policy Issues

- The Joint Committee on Taxation observed that one consequence of proposals designed to conform book and taxable income would be the:

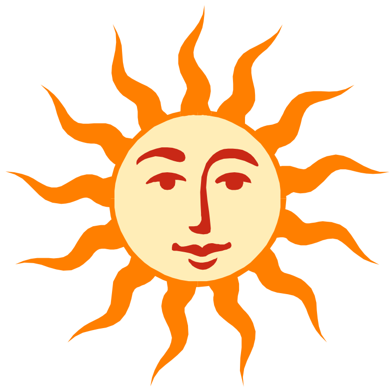
  *…creation of a "**healthy tension**" between a company's desire to have high book income and its desire to have low taxable income. Assuming this tension exists under any given proposal, management will be constrained in taking aggressive positions for either book or tax purposes, because such positions by definition will either cost the company additional tax dollars (in the case of aggressive book positions) or result in diminished book income (in the case of aggressive tax positions).*

Corporate Tax Policy Issues

- A former Commissioner of the IRS endorsed public disclosure of corporate tax return information, stating that:

  There's no doubt in my view that compliance would be helped by ***increased transparency*** *if the [tax] return or parts of the return would be made public.*

- Former SEC Commissioner Christopher Cox was fond of saying that "***sunlight is the best disinfectant***."



Corporate Tax Policy Issues

- More granular income tax disclosure - CTJ

A Sensible Benchmark for Corporate Tax Disclosure in Annual Financial Reports

		U.S. profits		Foreign profits		
1	**Pretax profits as reported to shareholders**					
2	**Income taxes on those profits—**	**On US profits**		**On foreign profits**		
(a)	Income taxes paid or payable on return for year, including effects of carrybacks	To US govt	To state govts	To foreign govts	To US govt	To state govts
(b)	Income taxes deferred (not yet paid and not payable on return for year)	By US govt	By state govts	By foreign govts	By US govt	By state govts
3	**Details on income taxes paid and not paid**	**On US profits**		**On foreign profits**		
(a)	List of all significant items reducing or increasing taxable income compared to profits reported above (with dollar amounts)	US federal	state	Foreign govts	US federal	US state
(b)	Taxable income (profits less items listed above)	US federal	state	Foreign govts	US federal	US state
(c)	Tax paid or payable on return for year before credits, including the effects of carrybacks	US federal	state	Foreign govts	US federal	US state
(d)	Credits taken on return for taxable year (listing details and dollar amounts) including the effects of carrybacks	US federal	state	Foreign govts	US federal	US state
(e)	Tax after credits (should equal line 2(a) above)	US federal	state	Foreign govts	US federal	US state

Notes: "Significant" means any item that reduces or increases taxable income by more than 3 percent, or in the case of credits reduces tax before credits by more than 1 percent. Items not listed separately because they are not "significant" should be reported in the aggregate. Tax items that under current reporting are not listed in the tax footnote, for example, tax benefits from stock options, should be included in the tax figures reported under the rules outlined above.

International Tax Planning Landscape

- Remember the words of Justice Brandeis:

  I live in Alexandria Virginia. Near the Supreme Court Chambers is a toll bridge across the Potomac. When in a rush, I pay the dollar toll and get home early. However, I usually drive outside the downtown section of the city and cross the Potomac on a free bridge. This bridge was placed outside the downtown Washington, DC area to serve a useful social service, getting drivers to drive the extra mile and to help alleviate congestion during the rush hour. If I went over the toll bridge and through the barrier without paying the toll, I would be committing tax evasion. If, however, I drive the extra mile and drive outside the city of Washington to the free bridge, I am using a legitimate, logical, and suitable method of tax avoidance, and I am performing a useful social service by doing so. For my tax evasion, I should be punished. For my tax avoidance, I should be commended. The tragedy of life today is that so few people know that the free bridge even exists.