Exporting Profits Imports U.S. Tax Reductions for Pfizer, Lilly, Oracle

by on May 13, 2010

By Jesse Drucker May 14 (Bloomberg) — Over the past three years, Pfizer Inc . was an earner without profit in its own country. The maker of the cholesterol medication Lipitor, the world's top-selling prescription drug, reported almost half its revenues in the U.S. for 2007 through 2009, while booking domestic pretax losses totaling $5.2 billion. Abroad, it was another story. A Dutch subsidiary more than made up for New York-based Pfizer's American losses. It reported pretax profits totaling $20.4 billion in 2007 and 2008 — with a tax expense of 5 percent, a seventh of the top U.S. rate. Overseas tax savings increased the drugmaker's net income by $1 billion last year, according to Robert Willens , a tax consultant in New York. Pfizer is one of thousands of American companies that bolster their profits by attributing income to subsidiaries in countries with lower income tax rates, legally cutting their tax bills. Eli Lilly & Co . and Oracle Corp. were among other big companies that helped drive a 70 percent increase in accumulated earnings abroad that weren't taxed in the U.S. from 2006 to 2009, according to data compiled by Bloomberg. "An inordinate concentration of profits in a low-tax country, way out of proportion to actual economic activity, is a sure sign of aggressive tax planning," said Martin Sullivan , a tax economist who formerly worked for the U.S. Treasury and Arthur Andersen LLP. Earnings Increased Willens, the president of Robert Willens LLC, a consulting firm in New York that advises investors on tax issues, analyzed financial filings for last year by Pfizer, Lilly and Oracle and found: — Pfizer increased net income by 13 percent compared with what it would have been without the tax benefit from foreign earnings. The company's $8.6 billion in net income would have been $7.6 billion, Willens said. — Lilly increased its 2009 net income by 21 percent to $4.3 billion from $3.6 billion, Willens found. — Oracle reported $5.6 billion in net income last year, 14 percent more than it would have reported without foreign earnings taxed at lower rates, according to the analysis. To be sure, each of those companies has actual sales abroad, although often in countries with tax rates similar to the U.S., which has an average combined state and federal corporate income tax rate of about 39 percent. Oracle, which reported 44 percent of its sales in the U.S., had 16 percent in Germany, Japan, Canada and France, countries with rates ranging from 30 percent to 39 percent last year. Intellectual Property Dozens of U.S. companies attributed income to foreign subsidiaries in 2008 that exceeded their share of actual sales abroad, according to offshore corporate records and U.S. securities filings compiled by Standard & Poor's

Capital IQ. In some cases, the foreign units employ few or no workers. For pharmaceutical and technology companies it's relatively easy to shift ownership of patents and other intellectual property abroad, said Sheldon S. Cohen , a former IRS commissioner who is now a director at the investment firm Farr, Miller & Washington LLC in Washington. In a typical arrangement, a company will license the overseas rights for a patent developed in the U.S. to a subsidiary in a low-tax country, said Michael C. Durst, special counsel at Steptoe & Johnson LLP, in Washington. That permits income from foreign sales to be attributed to the low-tax country. Treasury Department regulations require that prices paid between subsidiaries, such as licensing fees, be based on what unaffiliated companies would pay. Payments among Pfizer's subsidiaries are supported by economic studies of similar third- party transactions, said Joan Campion , a company spokeswoman. Arm's Length "All our transactions satisfy all arm's-length requirements," Campion said. Charges related to cost-cutting and mergers helped lower Pfizer's U.S. income, she said. The company manufactures Lipitor in Ireland, among other countries. An Irish subsidiary of Oracle that has no employees and paid no income tax in 2006 and 2007 was responsible for roughly a quarter of the parent's pretax income of $10.8 billion in those years, according to Irish records and Oracle's U.S. securities filings. The unit distributes products "primarily in the European market" that were developed by the Redwood City, California-based company and "jointly funded under a cost sharing arrangement," according to its annual report from 2007, the most recent year available. Following the Laws Ken Glueck , a senior vice president for Oracle, declined to answer questions about the company's use of transfer pricing. In an e-mail, he compared transfer pricing to the mortgage-interest deduction that individuals can claim. "Can someone please explain to me how following the tax laws of the United States became a reportable issue for Bloomberg News?" Glueck wrote. In each of the past seven years, Lilly has reported more than half its sales in the U.S. yet more than half its profits overseas. In 2007, a Swiss subsidiary booked pretax income of $3.2 billion — more than 80 percent of the $3.9 billion the parent company reported that year. The Swiss holding company has an Irish manufacturing branch that produces drugs and sells them to affiliated companies, according to its annual report. "Lilly takes great care to ensure that we have properly determined our income and assessed our tax obligations to each jurisdiction in which we do business," said Mark E. Taylor , a company spokesman, in an e-mail. In some years, U.S. profits were reduced by merger-related costs, he said. To contact the reporter on this story: Jesse Drucker in New York at jdrucker4@bloomberg.net .

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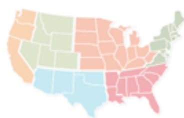

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