American Patients, American Companies, Offshore Profits

Senate Finance Committee Democratic Staff Memorandum, May 11, 2023

The 2017 Republican tax law was a massive giveaway to megacorporations and the wealthy. In particular, its international tax provisions favored billion-dollar multinationals over American workers and families, with a huge reduction in the U.S. tax rate on foreign earnings and new incentives to offshore jobs and stash profits in tax havens.

Few industries benefited more than Big Pharma.

The pharmaceutical industry reaps huge shares of its revenue from U.S. patients by charging sky-high prices for essential prescription drugs – prices often far higher than it charges foreign patients for the same products. A significant share of these pharmaceutical sales are made to American taxpayers through bedrock federal health programs including Medicare and Medicaid. Billions of taxpayer dollars also go to support pharmaceutical research. Yet the pharmaceutical industry pays tax rates that barely exceed single-digits, and the lion’s share of Big Pharma profits show up offshore, yielding massive tax savings.

The American public deserves to know how Big Pharma does it.

The ongoing Senate Finance Committee Democratic staff investigation of Big Pharma’s tax practices pulls the curtain back on an industry that excels at shifting profits offshore to avoid tax. Through offshoring intellectual property (IP), aggressive transfer pricing, foreign manufacturing, and other techniques, Big Pharma is able to put most of its income – and sometimes every single dollar of profit – into offshore subsidiaries.

Under the global intangible low-taxed income (GILTI) regime Republicans created in 2017, these offshore profits can access a special low tax rate and take advantage of “global blending” of foreign income to minimize any additional tax. These provisions significantly cut pharmaceutical companies' tax rate, sometimes into just single-digits, creating a huge incentive to put profit, investments, and jobs offshore. The industry’s average effective tax rate is an astonishingly low 11.6 percent – a 40 percent decrease from years prior to the 2017 Republican tax law.

This system needs significant reform to ensure big corporations pay their fair share, while helping to spur investment in the U.S., not in foreign countries. Until that happens, Big Pharma’s tax games will continue.

The following memorandum provides a sampling of the findings of the Finance Committee Democratic staff investigation. A final report detailing the full extent of the Committee’s findings is expected to be released later this year.
The 2017 Republican tax law was a huge tax cut for giant pharmaceutical corporations

The 2017 Republican tax law was a massive tax cut for giant pharmaceutical corporations. These companies now commonly pay lower tax rates than small business owners, school teachers, and firefighters. The Joint Committee on Taxation (JCT) provided the Committee data analyzing the average effective tax rates of large multinational pharmaceutical corporations for years prior to the 2017 tax law and years after the 2017 tax law. The tax cut for Big Pharma is astonishing.

Table #1: Average effective tax rate, U.S. pharmaceutical corporations

<table>
<thead>
<tr>
<th>Year</th>
<th>Pharmaceutical industry average effective tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014-2016</td>
<td>19.6%</td>
</tr>
<tr>
<td>2019-2020</td>
<td>11.6%</td>
</tr>
</tbody>
</table>

The 2017 Republican tax law cut Big Pharma’s tax rate by more than 40 percent, and these companies now pay tax rates that are barely above single-digits on average. While the 2017 Republican tax law provided a massive tax break to megacorporations in every business sector, the magnitude of the cut for Big Pharma makes it one the biggest beneficiaries. This has resulted in billions of dollars in tax savings for pharmaceutical corporations.

The data across all pharmaceutical companies from JCT aligns with the public data the Committee analyzed. In 2021, the effective tax rate of every single one of the seven largest pharmaceutical corporations in the United States was lower than 15 percent, and substantially lower than the statutory corporate tax rate of 21 percent. The Committee believes these rates are in large part a result of the flawed design of the international provisions of the 2017 Republican tax law.

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1 The data underlying the tax rate calculation are drawn from the Compustat database, which is populated from financial statements (e.g., Form 10-K) filed with the Securities and Exchange Commission (“SEC”). The sample is limited to U.S. headquartered companies that appeared in the Compustat database in each year from 2014 to 2020 (i.e., a balanced panel), had positive pre-tax income from foreign operations in at least one of those years, and had at least $100 million in assets in 2016. The effective tax rates presented here are weighted by income and calculated using observations with positive pre-tax income. The effective tax rate is calculated as worldwide taxes paid divided by worldwide pre-tax income as reported on Form 10-K.
Table #2: Effective tax rate of seven largest U.S. pharmaceutical corporations (2021)<sup>2</sup>

<table>
<thead>
<tr>
<th>Company</th>
<th>Abbott</th>
<th>AbbVie</th>
<th>Amgen</th>
<th>BMS</th>
<th>Johnson &amp; Johnson</th>
<th>Merck</th>
<th>Pfizer</th>
</tr>
</thead>
<tbody>
<tr>
<td>ETR</td>
<td>13.9%</td>
<td>12.5%</td>
<td>12.1%</td>
<td>13.4%</td>
<td>8.3%</td>
<td>11%</td>
<td>7.6%</td>
</tr>
<tr>
<td>Income (billions)</td>
<td>$8.2B</td>
<td>$12.9B</td>
<td>$6.7B</td>
<td>$8.1B</td>
<td>$22.7B</td>
<td>$13.9B</td>
<td>$24.3B</td>
</tr>
</tbody>
</table>

U.S. pharmaceutical corporations book most of their profits offshore for tax purposes

Over several years, the Democratic staff of the Senate Finance Committee obtained tax information from several large U.S. pharmaceutical corporations related to the use of offshore subsidiaries. In particular, the Committee focused on determining the percentage of the companies’ income for tax purposes that was reported by foreign subsidiaries, or “controlled foreign corporations” (CFCs).<sup>3</sup> The income reported by CFCs generally reflects income that is offshore.

As part of this effort, the Committee published an interim report in 2022 detailing the extent to which pharmaceutical giant AbbVie used offshore subsidiaries to avoid paying billions of dollars in taxes on prescription drug sales.<sup>4</sup> That report highlighted how in 2020, 99 percent of AbbVie’s taxable income was reported by offshore subsidiaries. This means that despite being headquartered in the U.S. and generating 75 percent of its sales from U.S. patients, only one percent of AbbVie’s taxable income was subject to the U.S. corporate income tax rate of 21 percent. The 99 percent of AbbVie’s income in 2020 that was reported by offshore subsidiaries was likely able to access the substantially lower GILTI rate of 10.5 percent.

Since the publication of the AbbVie report, the Committee obtained similar information from four other large U.S. pharmaceutical corporations: Abbott Laboratories (Abbott), Amgen, Bristol Myers Squibb (BMS), and Merck. While the Committee will make more of this information public in a comprehensive final report expected later this year, the Committee is including data obtained for 2019 in this hearing memorandum. This information confirms the finding that major U.S. pharmaceutical corporations book most – and sometimes nearly all – of their profits offshore for tax purposes. By minimizing the amount of profits subject to the 21 percent U.S. corporate income tax, these companies are able to save billions of dollars in taxes on sales of high-cost prescription drugs.

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<sup>2</sup> Largest firms was determined by total revenue. Data are from each company’s 2021 annual report.

<sup>3</sup> A CFC is a foreign corporation that is majority owned by U.S. shareholders that own at least 10 percent of a foreign corporation. While not all CFCs would be a foreign subsidiary as commonly understood, it is generally thought that the vast majority of CFC income is through traditional, wholly-owned, foreign subsidiaries.

The substantial majority of profits being booked offshore stands in stark contrast to who is paying for the drugs these companies make: American patients. The U.S. is typically the largest customer for major pharmaceutical corporations, and in the case of some pharma companies, makes up more than two-thirds of total revenue. This creates a structure sometimes described as “round-tripping.” The sale is made to an American patient by an American-headquartered company, but the profit from that sale is shifted offshore.\(^5\)

The data presented in the table below makes clear that the 2017 Republican tax law’s flawed international provisions enabled Big Pharma’s continued shifting of profits overseas.

**Table #3: Percentage of sales to U.S. patients, and percentage of income in the U.S. and offshore for tax purposes (2019)**\(^6\)

<table>
<thead>
<tr>
<th>Company</th>
<th>Sales to U.S. patients(^7)</th>
<th>Income reported in U.S.</th>
<th>Income reported offshore</th>
</tr>
</thead>
<tbody>
<tr>
<td>AbbVie</td>
<td>72%</td>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>Abbott(^8)</td>
<td>36%</td>
<td>13%</td>
<td>87%</td>
</tr>
<tr>
<td>Merck</td>
<td>43%</td>
<td>16%</td>
<td>84%</td>
</tr>
<tr>
<td>BMS</td>
<td>60%</td>
<td>17%</td>
<td>83%</td>
</tr>
<tr>
<td>Amgen</td>
<td>74%</td>
<td>40%</td>
<td>60%</td>
</tr>
</tbody>
</table>

\(^5\) As an example of how this may work, the U.S. customer buys the pharmaceutical product from a U.S. sales arm of the U.S. pharmaceutical company. That U.S. sales arm purchased the product from the offshore CFC of that same pharmaceutical company. Little-if-any profit from the sale is left in the U.S. sales entity, and most of the profit is reported by the CFC, which gets the benefit of the lower GILTI tax rate. The CFC then is able to distribute that profit, generally tax free, to its U.S. parent company. The profit makes a round trip – from the U.S. sales arm, to the offshore CFC, and then back to the U.S. parent.

\(^6\) The income considered reported offshore by the Committee was calculated in two ways, based on what was received from the company. One method was the sum of subpart F income, GILTI, and the section 78 gross up, as determined on the relevant tax return forms. This includes income that would not be included in taxable income due to the section 250 deduction from GILTI. For other companies, this was calculated as the difference between taxable income minus taxable income excluding income from CFCs, plus the 250 deduction from GILTI. Both methods should equal roughly the same result for a company. Total income was calculated as taxable income plus the total 250 deduction, including from GILTI and FDII. The income exempt from tax under the net deemed tangible income return provisions should also be treated as income of a CFC for tax purposes, but this data point was not received from all companies. As such, it was excluded for consistency purposes. Had it been included for the companies that we received it from, the share of income from CFCs only would have increased marginally. AbbVie’s data did not include the additional section 250 deductions, but given AbbVie was technically in excess of 100 percent offshore, the percentage would have been unlikely to change.

\(^7\) Sales to U.S. patients refers to U.S. sales as a percentage of worldwide revenue for each company. So if the number is 75 percent, that means that 75 percent of the company’s worldwide sales that year were made to U.S. customers. This information is readily available in each company’s annual report (10-K filing with SEC).

\(^8\) Abbott, the manufacturer of baby formula brand Similac, refused to respond to a follow-up request for additional information regarding the amount of its 250 deduction, and that data is not included in this calculation. As such, it is likely that the percentage of income booked offshore is higher than the amount currently listed.
All of these Big Pharma companies are American. One-third to over-two-thirds of their revenue comes from American patients. Yet, in most cases, over 80 percent of their profits are showing up offshore.

According to new data provided to the Committee by JCT, these companies do not appear to be outliers among Big Pharma companies. In fact, according to JCT, **75 percent of all Big Pharma income is reported offshore for tax purposes**. Even compared to other multinationals, Big Pharma’s profit shifting is extreme. Averaging across many multinational corporations, Big Pharma’s share of offshore income far surpassed both non-manufacturing companies and manufacturers outside of the pharmaceutical industry.

### Table #4: Percentage of income offshore for tax purposes (average for 2019-2020)

<table>
<thead>
<tr>
<th>Industry</th>
<th>Income reported offshore</th>
</tr>
</thead>
<tbody>
<tr>
<td>non-manufacturing</td>
<td>22%</td>
</tr>
<tr>
<td>manufacturing, excluding pharma</td>
<td>45%</td>
</tr>
<tr>
<td>pharmaceutical</td>
<td>75%</td>
</tr>
</tbody>
</table>

**Billions of dollars in American sales of blockbuster prescription drugs like Keytruda are taxed as offshore income**

As a result of the giveaways of the international provisions of the 2017 Republican tax law, profits from U.S. sales of certain blockbuster drugs are being taxed almost exclusively at low offshore rates. A good example of this is Merck’s Keytruda, a cancer fighting drug that is so lucrative it would be a Fortune 200 company on its own. Merck charges an annual list price of **$175,000 per year, per patient** for Keytruda, making it extraordinarily expensive for patients and taxpayers. Over the four years 2018-2021, the U.S. government has spent an astounding $12 billion under Medicare to help patients cover the cost of Keytruda, effectively subsidizing a major portion of Merck’s profits for the drug.

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9 Firms included in this analysis had at least $100 million in assets in 2016, were in the sample each year from 2014 to 2020, were not majority foreign owned, and had multinational operations. Ratios are reported as the average for years 2019 and 2020.

10 The methodology for determining offshore income was similar to that used by the Finance Committee. The differences were that the net deemed tangible income return was added into the numerator and denominator, and any net operating loss that reduced total income was added back to the denominator.

11 The Centers for Medicare and Medicaid Services (CMS) Medicare spending by drug database tracks federal spending for major prescription drugs through Medicare Part B and D.
Between 2019 and 2022 Merck sold $37.1 billion worth of Keytruda in the United States, yet little-if-any of the profits generated by those sales were taxed in the U.S. Rather, the profits from Keytruda sales to U.S. patients are taxed offshore, likely benefitting from the lower GILTI rate of 10.5 percent, just half of the statutory corporate income tax rate of 21 percent. Merck provided information indicating that this is because the IP rights for Keytruda are exclusively located in the Netherlands and the drug is manufactured in Ireland.

In a response to the Committee, Merck stated that with respect to Keytruda, “...because its patents have always been owned outside the United States, Merck’s operating profit attributable to Keytruda IP rights is taxed in jurisdictions outside the United States.” Merck also added that as Keytruda sales increased by 55 percent from 2019 to 2021, Keytruda “became an even larger portion of Merck’s overall profits and [Keytruda’s] expansion increased the portion of Merck’s overall income subject to tax outside the United States.”

This is also the case for AbbVie’s blockbuster rheumatoid arthritis drug Humira. As pointed out in the interim report last year, AbbVie owns the IP rights in a subsidiary located in Bermuda and manufactures the product in Puerto Rico. Since income from entities based in Puerto Rico is treated as foreign for tax purposes, income from Humira is taxed not at the U.S. corporate rate of 21 percent, but the much lower GILTI rate of 10.5 percent.

The IRS is challenging certain profit shifting structures by Big Pharma, including Amgen

Pharma giant Amgen is currently in litigation with the Internal Revenue Service (IRS) that may result in the company owing billions in additional taxes. As part of that dispute, the IRS is claiming that Amgen inappropriately shifted $24 billion in income to subsidiaries in Puerto Rico, which is treated as foreign for tax purposes. Unlike some other pharma companies, Amgen retains IP rights in the U.S., but still manages to offshore a significant share of its profits. Rather than transfer the IP, Amgen licenses to Puerto Rico-based CFCs the rights to manufacture and sell its products in the U.S. and globally. This distinct structure still allowed Amgen to have 60 percent of its profit show up in CFCs treated as foreign for tax purposes, even as 74 percent of its sales were to U.S. patients. The IRS is seeking $10.7 billion in back taxes and penalties.

Responses provided by Amgen to the Committee suggest that the structure being challenged by the IRS, which enables Amgen to generate a lion’s share of its profits in foreign tax jurisdictions, remains in place today. In a letter to the Committee, attorneys for Amgen stated that, “While the litigation currently involves Amgen’s 2010 – 2015 tax years, many of the same core issues remain in the post-TCJA years (2018 and beyond).”

While Amgen is disputing the tax bill with the IRS, the company’s profits have simultaneously been heavily subsidized through significant federal spending in the form of Medicare Part B and D reimbursements. According to public data compiled by the Committee, the United States government has spent an astounding $27.3 billion between 2018 – 2021

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12 Merck sales of Keytruda in the U.S. according to 10-K filings with the SEC: $6.3 billion in 2019, $8.4 billion in 2020, $9.8 billion in 2021 and $12.7 billion in 2022.
through Medicare part B and D to help patients cover the cost of prescription drugs manufactured by Amgen. These drugs include blockbuster arthritis treatment Enbrel, for which Amgen charges over $8,000 per month – equating to over $100,000 a year per patient – showcasing how prescription drug sales to U.S. patients are the company’s biggest profit driver.

In 2021, Amgen generated 38 times more Enbrel sales revenue in the United States than the entire rest of the world combined. That year, Amgen sold more than $4 billion worth of Enbrel in the U.S. compared to just $113 million in the rest of the world. Since acquiring the rights to Enbrel in 2002, Amgen has raised its price 27 times and made more than $70 billion from sales of Enbrel. The Committee has confirmed that, while over 95 percent of the sales of Enbrel are in the U.S, 40 percent of the profits are reported in jurisdictions considered foreign for tax purposes, likely allowing the company to avoid hundreds of millions in corporate income taxes. Without reforms to our international tax system, this is likely to grow into billions of dollars in tax avoidance.

13 The Committee reached the $27.3 billion figure by aggregating data from the public Medicare Part B and D spending databases at the Center for Medicare and Medicaid Services (CMS). For this calculation, the Committee added up all Medicare Part B and D spending from 2018 – 2021 for the following drugs manufactured and sold by Amgen: Enbrel, Prolia, Otezla, Xgeva, Neulasta, Aranesp, Repatha and Kyprolis.