

Wiping out Wisconsin taxes

By David Cay Johnston

Thomson Reuters—The author is a Reuters columnist. The opinions expressed are his own.

Aug. 26, 2011 (Reuters) - The heirs of the SC Johnson fortune, the richest family in Wisconsin with four multi-billionaires according to Forbes, paid not a penny of Wisconsin corporate income tax on profits from their global household products business and two smaller companies from 2000 through 2008, public records show.

The smaller companies made more than \$400 million in Wisconsin profit. Indications are the much larger household products firm, which is privately held and does not disclose its profits, netted more than a billion dollars, and possibly many billions.

"How did the Johnson companies pull in such profits without having a penny of Wisconsin taxable income?" asked Jack Norman, research director for the Institute for Wisconsin's Future in the August issue of its "Who Does Not Pay Taxes?" newsletter.

Now thanks to a 15-page document prepared in April 2008 by PricewaterhouseCoopers we have an answer -- at least for the family's main holding, SC Johnson & Son, Inc, makers of world famous household products ranging from Raid bug spray to Ziploc bags.

Reuters received the document unsolicited. Besides making suggestions for the future, it describes how the company avoided taxes in the past.

The conclusion? That Wisconsin taxable profits could well have been converted into tax-deductible expenses by paying royalties and interest to family-owned subsidiaries in low-tax and no-tax jurisdictions.

The state tax court held in 2009 that such accounting alchemy was improper when done by Hormel Food Corporation because the transactions had no purpose except to make state taxes go away. (<http://www.wisbar.org/res/txap/2010p/07-i-17.pdf>)

HORMEL FOOD STANDARD

The question the PwC document raises is whether the Johnsons will be held to the same standard by the Wisconsin tax authorities as Hormel Food. Why must ordinary Wisconsin businesses and individuals bear the burden of state government while the richest family in the state runs tax-free enterprises?

SC Johnson & Son, Inc paid no state corporate income tax from 2000 through 2008, Norman found by searching state tax records available to anyone for \$4. The Charles Stewart Mott, Ford and other foundations finance the nonprofit institute where Norman works.

The company has told market researchers its revenues run close to \$9 billion per year.

One of the two smaller companies, Diversey Inc, a cleaning solutions maker controlled by the Johnsons, made the family \$360 million in profit from 2000 through 2009. No state income tax was paid, public records show.

The other smaller family enterprise, Johnson Outdoors Inc, reported profits of \$42 million in 2000 through 2008 and paid no state income tax, public records show.

A fourth family business, Johnson Bank, did pay state income tax. On \$219 million of profits from 2000 through 2009 the bank paid \$3 million or 1.4 percent compared to the statutory tax rate of 7.9 percent.

The PwC document offers powerful evidence that tax avoidance, not economic substance, enabled the main family business to escape Wisconsin state taxes. Without economic substance, companies can just move symbols around on paper and manufacture unlimited tax deductions.

Entitled "State and Local Tax Observations and Considerations," the document shows how the Johnson family escaped all Wisconsin corporate income tax on its SC Johnson & Son, Inc business and shows how to shield future profits from tax.

TAX ADVICE

The document states on its cover, in boldface type, that to the extent it is tax advice "this document was not intended or written to be used, and cannot be used for the purpose of avoiding U.S. federal, state or local penalties."

The pages that follow are carefully drafted to make observations without recommending them, a subtle but potentially significant distinction should the IRS Office of Professional Responsibility or the state accounting ethics boards in Wisconsin or Illinois (where the document's authors work) take an interest in what PwC wrote. The document also shows how competing consumer products companies arrange their affairs.

Christopher R. Beard, a Johnson company spokesman, declined comment on the PwC document except to acknowledge the document's authenticity and to characterize the document as recommending tax strategies. In an email Beard wrote me that "SC Johnson did not implement the PwC recommendations."

Beard said Johnson-owned businesses pay taxes in other jurisdictions.

As of June 30, 2006, the PwC analysis shows, SC Johnson was collecting \$155 million in annual royalties from its foreign subsidiaries. On top of this the parent company had another \$3 million of Wisconsin state income, the PwC analysis showed.

SC Johnson was able to wipe out this \$158 million in taxable profit along the following lines:

- * It made a huge inter-company loan to its Puerto Rico affiliate, which it transferred to a new Delaware entity called "SNW Company." Interest on the loan was \$60 million in 2006, the document said, an expense that would be tax-deductible in Wisconsin. The principle amount is not revealed. If the Johnsons paid 10 percent interest from their Wisconsin pocket to their Puerto Rico and Delaware pockets, such an above-market interest rate and the artificial creation of an expense in Wisconsin could indicate a tax-motivated transaction.

- * The PwC report cites a \$31 million royalty paid by the Wisconsin parent company to SC Johnson Home Storage, a Delaware subsidiary, and a \$77 million "mark up adjustment" paid by the same Delaware subsidiary. These would be deductible as Wisconsin expenses.

That comes to \$168 million funneled out of Wisconsin, wiping out the \$158 million of income subject to tax. The company also had past operating losses it was still carrying and a \$1.5 million annual research and development tax credit.

OTHER MEASURES

The document also discusses such tactics as controlling the profit margins of subsidiaries to influence where taxes are due. The theory of arm's length transactions is that, for tax and transfer pricing

purposes, a company can only charge itself internally what it would pay an independent vendor. It is hard to imagine any independent vendor agreeing to limit its own profit margin, another example of tax-motivated behavior.

PwC also discussed how re-registering various intellectual property in Europe, Mexico and Canada could help avoid taxes on 55 percent of the royalties paid to the Wisconsin parent. It also cites the use of a new Swiss entity to funnel royalties on intellectual property.

All of this is significant in the context of what the Wisconsin Tax Appeals Commission held in Hormel Foods:

"Reducing taxes is a perfectly legitimate business goal so long as it is not the primary purpose for a transaction. In this case, the evidence shows that Hormel's other alleged purposes for engaging in the challenged transactions were a mere 'fig leaf' covering its real purpose, which was tax avoidance."

So, will SC Johnson be held to the same standard as Hormel and, at a minimum, face a thorough audit by the state and the IRS? Or will the richest family in Wisconsin get favored treatment while everyone else bears the burden of state government?