GILEAD SCIENCES:

PRICE GOUGER, **TAX DODGER**

AMERICANS FOR TaxFairness

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Credits

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AMERICANS FOR TaxFairness

Americans for Tax Fairness is a diverse coalition of 425 national and state endorsing organizations that collectively represent tens of millions of members. The organization was formed on the belief that the country needs comprehensive, progressive tax reform that results in greater revenue to meet our growing needs. ATF is playing a central role in Washington and in the states on federal tax-reform issues.

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GILEAD SCIENCES: PRICE GOUGER, TAX DODGER

TABLE OF CONTENTS

KEY FINDINGS

Prescription drug maker Gilead Sciences is raking in billions of dollars a year in windfall profits from public health programs and consumers for exorbitantly priced hepatitis C (HCV) medications developed with taxpayer dollars. It then shifts those profits to offshore tax havens, allowing it to dodge nearly $10 billion in U.S. taxes by the end of 2015.

Taxpayers subsidized the development of Gilead's HCV drugs, yet now pay sky-high prices for them through Medicare, Medicaid, the Department of Veterans Affairs, private insurance and from their own pockets. The Food and Drug Administration assures Gilead's products are safe, and the American patent and legal systems ensure that the corporation's huge profits are protected. But despite all the benefits Gilead has received from taxpayers, Congress maintains a loophole-ridden tax system that has allowed the company to dodge taxes that pay for those benefits, leaving other taxpayers to pick up its tab.

California-based Gilead is the sixth most valuable pharmaceutical company in the world, with a market value of $146 billion last year.[1] Its enormous profits come primarily from two life-saving HCV drugs. Sovaldi went on the market in December 2013 at a cost of $1,000 per pill, or $84,000 for a full 12-week treatment. The actual manufacturing cost for a 12-week course of Sovaldi has been estimated at between $100 and $1,400.

> *"Taxpayers subsidized the development of Gilead's HCV drugs, yet now pay sky-high prices for them through Medicare, Medicaid, private insurance and from their own pockets."*

A combination treatment known as Harvoni, which pairs Sovaldi with another drug, debuted a year later at $1,125 per pill, or $94,500 for a full treatment. Competition and negotiations with purchasers have since forced the price of Gilead's drugs down significantly from their original list prices, but the prices are still high enough to be considered profiteering and to cause hardship for consumers. And in June, 2016, the company announced that it would be pricing its newest HCV drug, Epclusa, at almost $75,000 per treatment, or about $900 per pill.

An estimated 2.7 to 3.9 million Americans suffer from hepatitis C, many of them undiagnosed.[2] A recent study found that in the last decade HCV overtook HIV as a cause of death in the United States[3] (although that was prior to the widespread use of the new HCV treatments). Hepatitis C can cause a fatal failure of the liver, and is particularly common among older Americans, including Vietnam War veterans.

The Department of Veterans Affairs has until very recently[4] been unable to afford enough of the drugs to treat every veteran who needs them.[5] Similarly, the drugs' high cost in 2014 limited treatment to less than 3% of the 700,000 Medicaid recipients who carry the disease.[6]

Altogether, America's public and private sectors spent more money on Sovaldi in 2014—nearly $8 billion—than on any other prescription drug.[7] That year the head of the nation's health insurance trade association estimated treating every HCV patient at Gilead's list prices would cost $268 billion—roughly equal to what the United States spends on all prescription drugs.[8] Even after allowing for discounts, the total bill would still be a staggering $110 billion, according to a medical-research organization's estimate.[9]

Gilead is making a fortune selling essential drugs to the very government and taxpayers that helped pay to develop them, and then dodging taxes on the resulting profits. Congress should stop this assault on the American people's health and pocketbooks by curbing the company's flagrant drug-price gouging and tax dodging.

Following are this report's key findings:

- **Gilead's sales and profits have soared since its two life-enhancing HCV treatments came to market while its tax rate has plummeted.** Gilead's worldwide revenues recently *tripled*—from $11.2 billion in 2013 to $32.6 billion in 2015. (Sovaldi and Harvoni combined represented 56% of total revenue in 2014 and 2015, with nearly $32 billion in sales.) Corporate pre-tax profits soared even more: rising from $4.2 billion to $21.7 billion from 2013 to 2015, a *five-fold* increase. By 2015, Gilead's after-tax profit margin was an astonishing 55%. Unfortunately for U.S. taxpayers, over the same period Gilead's worldwide effective tax rate plummeted by 40%—dropping from 27.3% in 2013 to 16.4% in 2015.

- **U.S. taxpayers are paying a lot—at least $5 billion a year—to treat patients with Gilead's overpriced HCV drugs while hundreds of thousands of patients go untreated because of the costs.** In 2014, participants in Medicare Part D, the federally-subsidized drug insurance program for the elderly and disabled, spent $3.8 billion. Medicaid, the federal-state health program for the poor, spent $1.3 billion. Hundreds of millions of dollars more were spent by federal agencies caring for veterans and prisoners, two groups at particularly high risk for hepatitis C. Despite those huge expenditures, hundreds of thousands of hep C sufferers were denied treatment because public programs could not afford enough of Gilead's overpriced drugs.

- **Gilead's offshore profits have soared in tandem with its HCV sales, and it is using a tax loophole to avoid paying $10 billion in U.S. taxes owed on them.** As HCV sales skyrocketed, Gilead's *accumulated* offshore profits, on which it is able to defer paying U.S. taxes, climbed to $28.5 billion in 2015—more than *triple* the $8.6 billion it held offshore in 2013. According to its Securities and Exchange Commission (SEC) filings, the company has deferred paying U.S. taxes of $9.7 billion on those offshore profits. Its SEC filings also indicate that Gilead paid a tax rate to foreign governments of just 1% last year, suggesting virtually all of its offshore profits are stashed in tax havens.

- **As sales of its HCV drugs exploded, Gilead appears to have engaged in a massive shift of American profits offshore to dodge U.S. taxes.** Four indicators trace the shift. First, in 2013 Gilead transferred the economic rights to its U.S. patent for Sovaldi to an Irish subsidiary, most likely creating a patent licensing arrangement enabling it to report lower U.S. profits and therefore pay much less in taxes. Second, between 2013 and 2015 Gilead's overall revenues soared by about $20 billion, as did its *offshore profits*, even though two-thirds of the company's *sales* were in the United States. Third, during the same period the company recorded more offshore profits than offshore revenues. For instance, in 2015, Gilead reported that it made $13.7 billion in foreign profits on $11.4 billion in foreign revenues. Finally, the company reported the reverse on its domestic finances, claiming that over the last three years, the U.S. share of its overall revenues had grown far in excess of the U.S. share of its overall profits.

- **Gilead's offshore tax dodging is part of a much bigger problem.** Gilead is one of many American pharmaceutical companies and other multinational firms using tax havens to dodge their U.S. tax obligations. In 2015 alone, American corporations held $2.4 trillion in offshore profits, deferring payment of some $700 billion in U.S. taxes. Pharmaceutical companies are the second biggest industry using this tax loophole—they hold an estimated 20% of the profits offshore.

"Gilead paid a tax rate to foreign governments of just 1% last year, suggesting virtually all of its offshore profits are stashed in tax havens."

- **Gilead has also dodged $2 billion in taxes through a loophole that facilitates fat executive pay packages.** In the last three years, Gilead has avoided $1.3 billion in U.S. taxes—$2 billion altogether since 2006—by exploiting a tax break on issuing stock options to its executives. Essentially, the loophole allows the company to take tax deductions for its option-based compensation in amounts greater than the compensation expenses actually shown on its books.

- **U.S. taxpayers supported the development of Gilead's blockbuster hep C drugs.** This report identifies at least $4.2 million in federal support for hepatitis-related research that appears to have aided in the development of Gilead's HCV treatments. Pharmasset, the company that originally developed Sovaldi, was founded by a nearly full-time federal employee, Raymond Schinazi, who personally received at least $2.7 million in U.S. taxpayer dollars for hepatitis-related research, including to develop HCV cures. Separately, Pharmasset received at least $1 million in hepatitis-related federal research grants, nearly all of it targeted at treating HCV, and about $500,000 in tax credits for hep C drug development. Despite these millions of dollars in taxpayer subsidies, Schinazi's company privately patented Sovaldi and sold it—along with the rest of the company—to Gilead, resulting in a reported personal payday for the founder of $400 million.

- **Gilead uses foreign tax havens to lower its U.S. taxes, but charges Americans much more for its HCV drugs than it does foreign consumers.** It appears that by funneling profits through the tax haven of Ireland, and perhaps through other tax havens, Gilead trims billions of dollars from its U.S. tax bill. Yet Gilead's HCV drugs sell for a tiny fraction of the U.S. price in many foreign countries.

- **Gilead spends more enriching executives and shareholders than developing new drugs.** Between 2005 and 2014, the company spent nearly 20% more on stock buybacks ($17 billion) than it did on research and development ($14.4 billion). Only one other of 19 leading drug companies studied spent more on stock buybacks than it did on R&D over that period. If Gilead and other drug companies succeed in getting Congress to enact a sweetheart tax deal that allows them to bring their offshore profits back at a fraction of what they owe, they will undoubtedly engage in an even bigger stock buyback program, an unproductive use of corporate profits that exacerbates our nation's wealth and income inequality.

- **Gilead's long-time CEO became a billionaire as the company reaped huge profits from its overpriced hep C drugs and through tax avoidance**. In 2014, John C. Martin was the fourth highest paid billionaire CEO in the country. His 2014 compensation of nearly $200 million reflected a huge surge in the company's stock price, inflated in part through stock buybacks, price gouging, and tax dodging.

- **If the two principal tax loopholes that Gilead exploits were closed, the $10 billion raised from this one company could do a lot of good.** We could double to two million the number of low-income kids and pregnant women served in a year by the highly successful Head Start program. Or help seven million households stay warm over three winters through the LIHEAP program. Or ensure one-and-a-half years of nutritional assistance to 8.5 million participants in the Women, Infants and Children (WIC) program.

- **Recommendation for ending Gilead's price gouging of essential HCV drugs.** Some experts recommend that the federal government use its existing authority to infringe on private patents in the public interest to make Gilead's life-saving hepatitis drugs available to all who need them. It could arrange for the manufacture of Gilead's hepatitis C medications by generic pharmaceutical firms, making the drugs much more affordable, even after paying Gilead a reasonable royalty.

- **Recommendations for ending Gilead's tax dodging.** Congress should end the deferral loophole, which allows U.S. corporations such as Gilead to defer paying taxes on their foreign earnings until that income is repatriated to America as dividends. It lets U.S. multinationals use every tactic they can to keep their profits offshore where they are indefinitely untaxed by the Treasury. Congress should also restore Subpart F to fully tax passive foreign income. The Treasury Department should finalize its proposed rule requiring corporations to provide country-by-country reporting, including requiring them to make that information public. Congress should pass legislation to make this requirement permanent. Congress should also close the stock options tax loophole that saved Gilead an estimated $2 billion over the last 10 years.

PRICING PATIENTS OUT OF A HEPATITIS CURE

Gilead's HCV drug Sovaldi went on the market in December 2013 priced at one thousand dollars per pill, or $84,000 for a full 12-week treatment. A combination treatment known as Harvoni, which pairs Sovaldi with another drug, debuted a year later at $1,125 per pill, or $94,500 for a full treatment.[10] The actual manufacturing costs for a 12-week course of Sovaldi has been estimated by its developer to be no more than $1,400,[11] and pegged as low as $68 by outside researchers.[12]

Competition from other HCV drugs and negotiations with big public and private purchasers have since forced the price of Gilead's drugs down significantly from their original list prices. However, since such price negotiations are confidential, it's impossible to cite a current, universal market price for Sovaldi or Harvoni. But it is clear that the prices charged are still high enough to be considered profiteering and to cause hardship for public and private purchasers of the drugs.

Gilead has certainly not abandoned aggressive pricing. It's newest entry in the HCV market, the recently FDA-approved Epclusa, will debut at $74,760 for a 12-week treatment, or about $900 a pill.[13] Like Harvoni, Epclusa is not an entirely new medication, but rather a combination of Sovaldi and another drug. The manufacturing expense is presumably not significantly higher than the cost of making Sovaldi alone, which as noted above, is a tiny fraction of the sales price.

Gilead's exorbitant hepatitis-drug prices have sparked a bipartisan Congressional inquiry[14] and even a threat of litigation from the Massachusetts attorney general.[15] The sky-high cost of Sovaldi and Harvoni has particularly strained public health systems serving veterans and the poor—two populations particularly at risk for hepatitis C. Both systems have had to severely restrict access to these life-saving drugs.

In 2014, the first full year Sovaldi was available, state Medicaid programs—despite spending $1.3 billion on Gilead's medications—could afford to treat fewer than one in 40 infected with HCV.[16] The same year, $3.1 billion was spent on Sovaldi through Medicare Part D to treat just 33,000 patients, and $700,000 was spent on Harvoni to treat around 12,000 more.[17]

Until March of this year, the Department of Veterans Affairs had been forced to ration care, denying many veterans with HCV the drug treatment they needed.[18] The VA has budgeted a billion dollars for this fiscal year, and $1.5 billion for the next,[19] to pay for HCV drugs from Gilead and other companies, with the intention of treating all affected veterans. But whether that will be enough money, and whether all VA centers will officially adhere to the new treatment guidelines, are open questions.

It is clear that Gilead's price gouging has contributed to the denial of treatment to hundreds of thousands of hepatitis C sufferers.[20]

As just one example of the health-care rationing necessitated by Gilead's outrageous pricing: in the fall of 2014, Oregon identified 10,000 Medicaid patients who needed Sovaldi. But because the cost of treating them all would have cost four times the state's entire prescription-drug budget in 2013, it developed a plan to treat just 500 a year.[21]

In February of this year, several public interest groups filed a federal class action lawsuit against the State of Washington on behalf of untreated hep C patients in the state's Medicaid program, claiming the rationing of HCV medications violated federal law.[22] The judge agreed, ordering the state to provide HCV treatment to all Medicaid enrollees who need it.[23] This judgment could have nationwide implications: according to an academic study last year, three-quarters of state Medicaid programs restrict Sovaldi access to only the sickest HCV patients.[24]

Like other pharmaceutical companies selling high-priced medications, Gilead contributes to charities that help patients with out-of-pocket drugs costs. But the purpose isn't entirely charitable: critics point out that by easing the relatively small share of the cost paid by consumers, the companies effectively reduce public pressure to switch medications or demand lower prices overall.[25] So big insurers like Medicare, which pay the bulk of the costs, keep paying for the companies' high-priced products. Gilead, along with two other companies, recently reported receiving a subpoena as part of a federal investigation of this practice.[26]

A major report by leading members of the U.S. Senate Finance Committee determined that Gilead had ignored warnings by health care providers and patients about the hardships that would be caused by its prohibitive pricing.[27] Instead, the company set the price of Sovaldi as high as it thought it could get away with—"accessibility and affordability were pretty much an afterthought," according to Sen. Ron Wyden, one of the investigation's two leaders.[28]

According to an internal company document, in deciding what initial price to put on Sovaldi, Gilead executives focused not on the cost of manufacture or what a reasonable return on their investment would be, but instead on how likely a certain price would be to trigger a Congressional hearing or outraged response from health-care advocates. (They incorrectly guessed that a starting price of $90,000 was “unlikely” to spark a Capitol Hill inquiry.)[29]

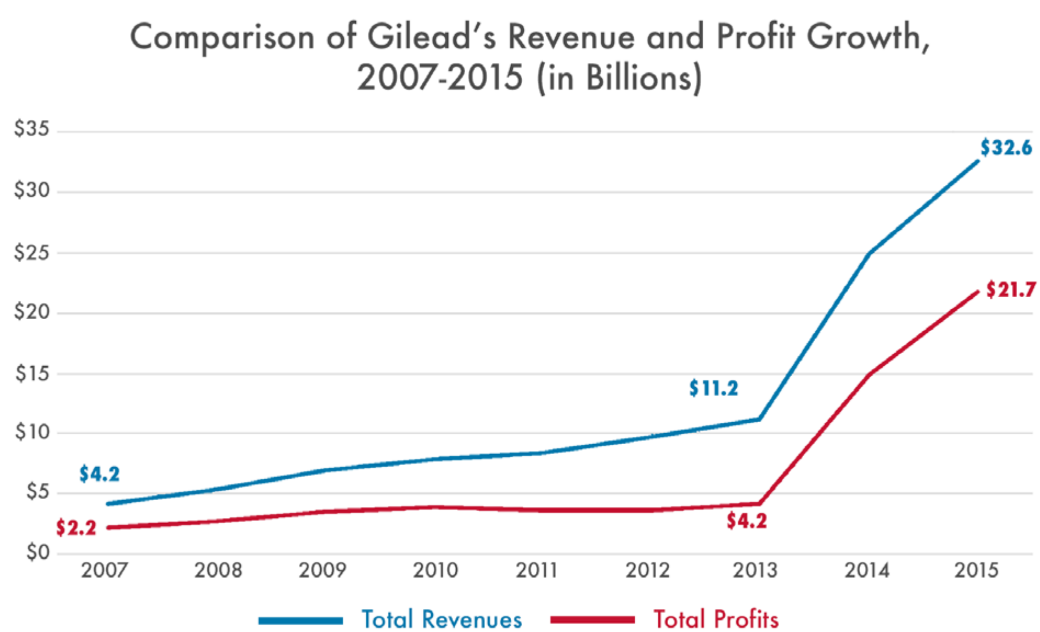
In an internal email quoted in the Senate report a top Gilead executive pressed his colleagues not to “fold to advocacy pressure” on pricing. “Let’s hold our position whatever competitors do or whatever the headlines,” he urged.[30]

GILEAD’S SALES AND PROFITS SOAR FROM HCV DRUGS WHILE ITS TAX RATE PLUMMETS

As Gilead’s two life-enhancing HCV treatments came to market in 2013 and 2014, its revenue and profits soared. Gilead’s worldwide revenues were $11.2 billion in 2013 but nearly *tripled* to $32.6 billion in 2015. [Figure 1] For 2014 and 2015 combined, Sovaldi and Harvoni together represented about 56% of the company’s total revenue, with nearly $32 billion in sales out of $56.6 billion in total company sales over those years.[31]

Corporate profits soared even more. Total corporate pre-tax profits increased *five* times between 2013 and 2015, rising from $4.2 billion to $21.7 billion. Net income after taxes rose even faster—by nearly *six* times—from $3.1 billion to $18.1 billion. By 2015, Gilead’s after-tax profit margin was an astonishing 55%.[32]

Figure 1. Gilead’s Revenues and Profits Skyrocket from Hep C Drugs

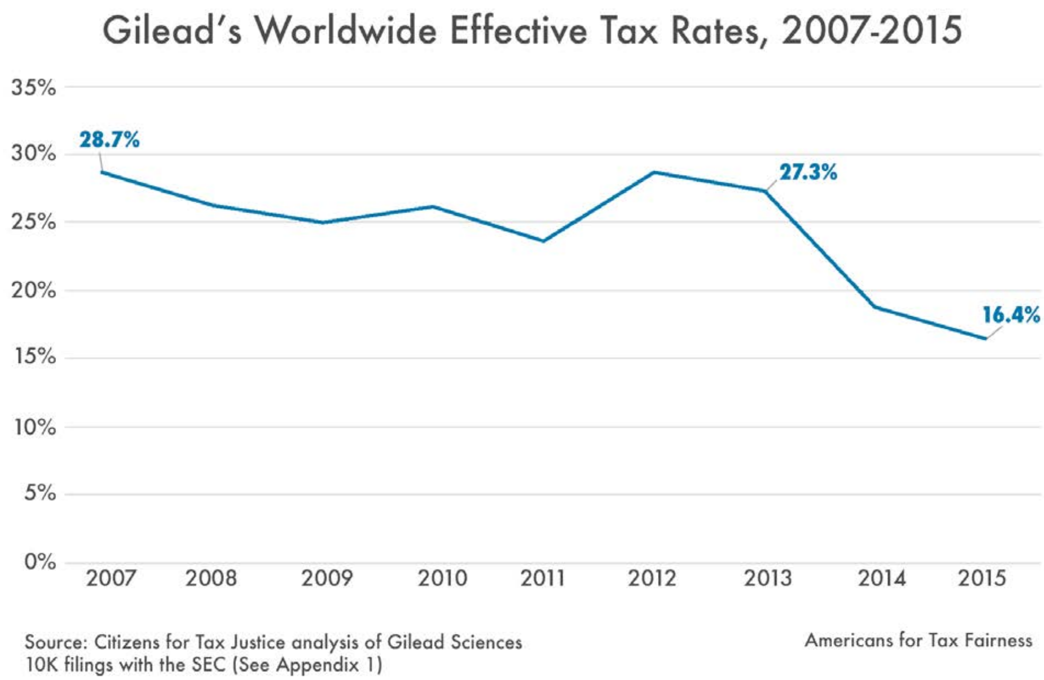


Source: Citizens for Tax Justice analysis of Gilead Sciences 10K filings with the SEC (See Appendix 1)

Americans for Tax Fairness

Unfortunately for U.S. taxpayers, Gilead's tax rate went in the opposite direction of its huge and growing profits. Its worldwide effective tax rate plummeted by 40%—from 27.3% in 2013 to 16.4% in 2015. [Figure 2] (Gilead's effective U.S. tax rate is not made public.)

Figure 2. Gilead's Recent Tax Rates Plummet, 2007-2015



GILEAD'S OFFSHORE PROFIT PIPELINE

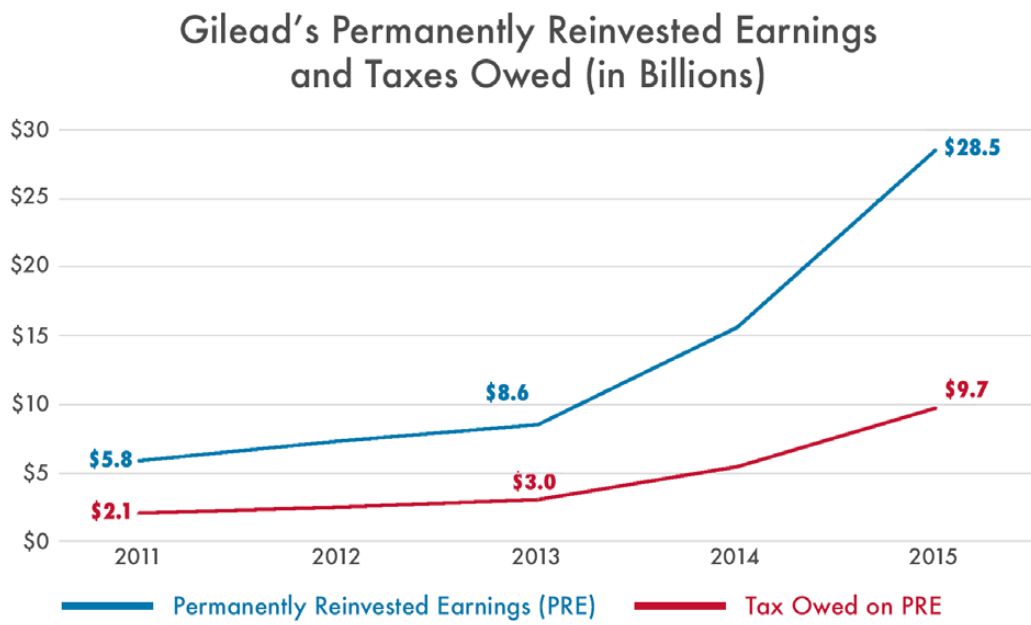
Pharmaceutical companies refer to drugs that are in the development stage and moving towards market as being "in the pipeline." Gilead has created a tax-dodging adjunct: it moves the money it makes charging high drug prices out of reach of U.S. taxation through its own "offshore profits pipeline."

While not as notorious as its drug pricing policies, Gilead's offshore tax avoidance schemes are similarly exploitive—and the two phenomena are connected. The company dodges its fair share of U.S. taxes by moving out of the United States and into foreign tax havens billions of dollars in profits derived from its exorbitant drug prices.

Gilead's recent profits bonanza has allowed it to accumulate a huge stash of profits offshore (known as "permanently reinvested earnings," or PRE), profits on which it can defer paying U.S. taxes. These untaxed profits more than *tripled* between 2013 and 2015, climbing from $8.6 billion to $28.5 billion. [Figure 3]

Gilead estimates the U.S. taxes it owes but has not paid—and many never pay—on its supposedly permanently reinvested earnings at $9.7 billion, according to its SEC filings. Moreover, the tax rate it reported paying to foreign nations on those profits in 2015 was just 1%, an incredibly low rate for any taxpayer much less a highly profitable corporation. [See Appendix 1] That low rate is possible only if most of Gilead's profits are being reported in tax havens that impose little or no corporate income tax.

Figure 3. Gilead's Offshore Profits and Unpaid Taxes Soar from Hep C Drugs



Source: Citizens for Tax Justice analysis of Gilead Sciences 10K filings with the SEC (See Appendix 1)

Americans for Tax Fairness

Gilead characterizes its offshore profits as "permanently and indefinitely reinvested." But if, as appears to be the case, those profits are located in tax havens, they may be more fairly characterized as temporarily stashed to delay paying U.S. taxes.

The reason Gilead gets to decide when, and even whether, to pay its U.S. taxes on its offshore profits is a loophole in corporate tax law called "deferral." While the United States taxes the worldwide profits of American corporations, the taxes on profits kept offshore don't have to be paid until the money is brought home as dividends distributed to the parent company.[33]

Gilead is outpacing its corporate peers in exploiting the deferral loophole. The $13 billion boost in Gilead's reported offshore profits between 2014 and 2015 (rising from $15.6 billion to $28.5 billion) was a bigger dollar increase than all but three of 300 profit-offshoring companies recently surveyed by Citizens for Tax Justice.[34]

LAUNDERING PROFITS THROUGH OFFSHORE TAX HAVENS

According to its 2014 SEC filing, Gilead had 12 foreign subsidiaries in tax havens, including six in Ireland.[35] Virtually all of the profits that Gilead has offshore appear to be stashed in tax havens because Gilead reported paying just a 1% tax rate on them in 2015. [Appendix 1] That extremely low tax rate actually represents an increase from the past decade, when Gilead's foreign tax rate hovered around zero or was even negative.

There are several indicators that Gilead has been shifting its massive HCV drug profits from the United States into tax havens. First, its surging revenues and offshore profits have risen almost in tandem. Second, the company is recording more offshore profits than offshore revenues each year. Third, Gilead's reported U.S. share of its overall revenues far exceeded its reported U.S. share of its overall profits in 2014 and 2015.

Let's start with the growth of revenues and profits. Over the first three years of Gilead's big HCV drug sales—between 2013 and 2015—there was a close and disturbing correlation between the boost in its revenues and the boost in its offshore profit holdings. Both soared by about $20 billion, even though two-thirds of the company's sales were in the United States. [Table 1]

Table 1. Gilead's Hep C Revenues and Profits Are Being Shifted Offshore

$ Billions	2013	2015	$ Increase	% Increase
Total Revenue	$11.2	$32.6	$21.4	191%
Total Pre-Tax Profits	$4.2	$21.7	$17.5	417%
Offshore Profits (PRE)	$8.6	$28.5	$19.9	231%

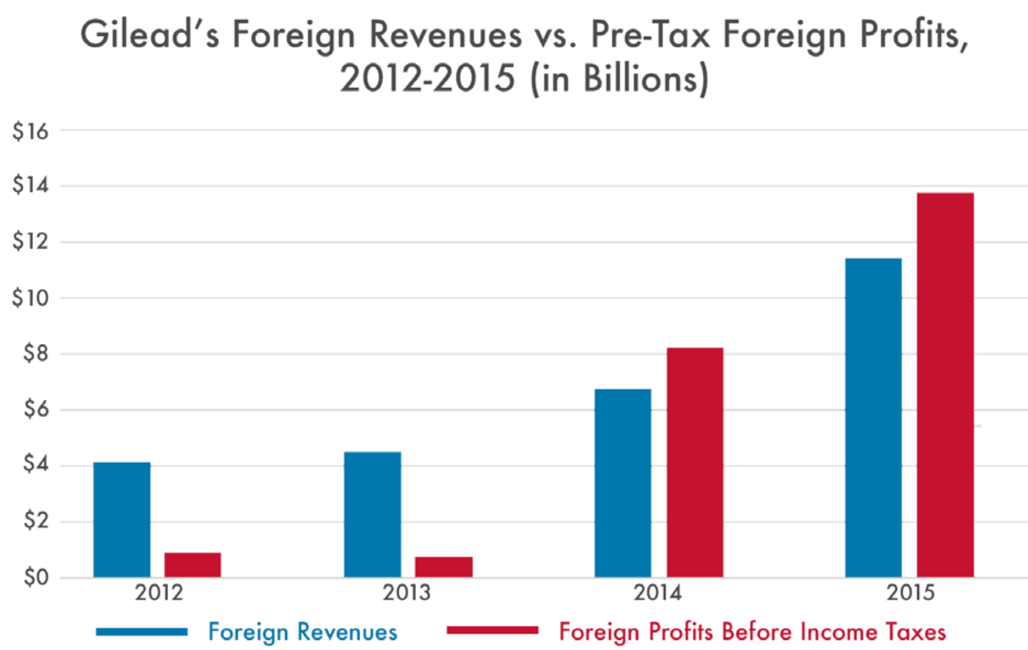
Source: Citizens for Tax Justice analysis of Gilead Sciences 10K filings with the SEC (See Appendix 1)

Although money is fungible and it is impossible to say where any specific dollar goes, the definite impression created by the reported figures is that the company sent the money it was making from its exorbitantly-priced hepatitis C drugs directly to offshore tax havens, out of the reach of the American tax system.

A second indicator of this profit shift is that Gilead reported earning more in profits offshore than it reported in offshore sales. Figure 4 shows that in 2012, before its HCV drugs hit the market, Gilead had pre-tax foreign profits of $885 million on foreign revenues of $4.1 billion, for a very healthy but plausible 22% return on revenues. (Revenues should always be higher than profits, as here, because profits are a subset of revenues: they are what is left over after subtracting expenses.)

However, in 2014—after its HCV treatments went on sale—Gilead recorded $8.2 billion in foreign profits (before taxes) from just $6.7 billion in foreign revenues. It did it again in 2015—reporting more offshore profits ($13.7 billion) than offshore revenues ($11.4 billion). The most likely explanation for such inverted results is that some of the allegedly offshore profits actually came from somewhere else—in this case, the United States.

Figure 4. Gilead's Foreign Profits Exceed Foreign Revenues



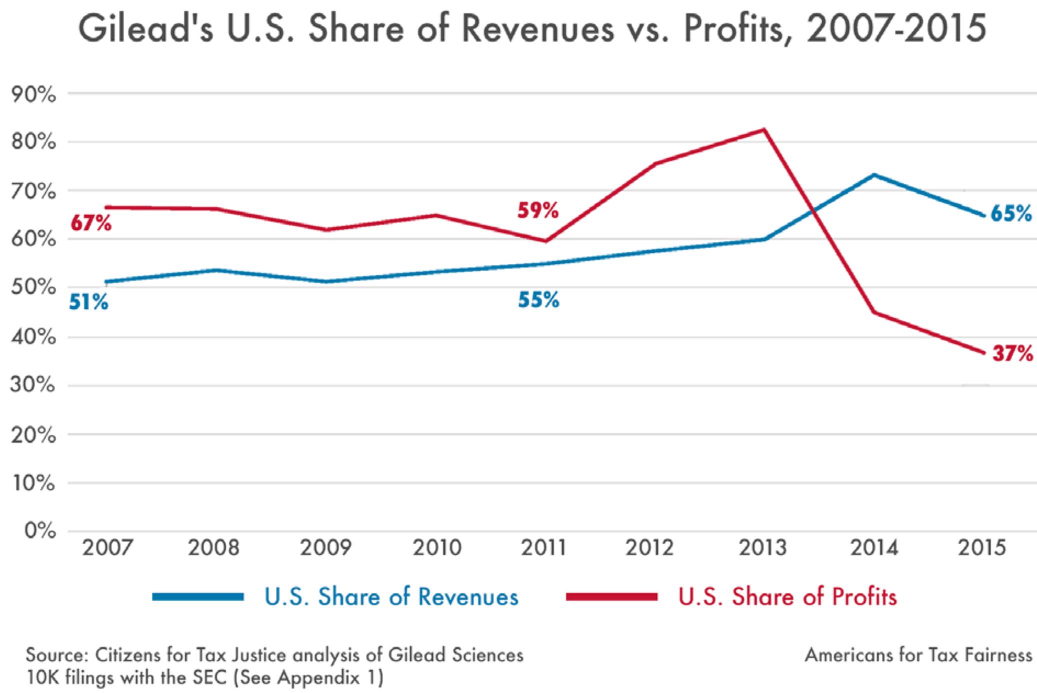
Source: Citizens for Tax Justice analysis of Gilead Sciences 10K filings with the SEC (See Appendix 1)

Americans for Tax Fairness

A third clue is offered by Gilead's U.S. revenues and profits as a percentage of its worldwide revenues and profits. These figures provide a reverse angle on the company's massive increase in foreign profits due to profit-shifting. As recently as 2011, the U.S. share of Gilead's global revenues and profits before taxes were nearly the same—55% and 59%, respectively. [Figure 5]

However, by 2015, after two years of highly profitable U.S. HCV drug sales, something strange had happened to the relative percentages of domestic revenues and profits. Gilead reported that the U.S. share of its revenues had climbed to 65%, but the U.S. share of its pre-tax profits had plunged to 37%. In other words, Gilead claimed that despite booking two-thirds of its revenues here and charging higher drug prices than anywhere else in the world, it made only about one-third of its profits in the United States.

Figure 5. Gilead's U.S. Profits Plunge as U.S. Revenues Rise Showing Massive Profit Shift



How could that be possible? The most likely explanation is transfer pricing. This accounting trick involves sending valuable assets—such as the license to use prescription drug patents—to a company's offshore subsidiaries. Those subsidiaries can then impose large licensing fees on the U.S. parent company for the right to sell the patented medications in America. The fee costs reduce the reported U.S. profits and resulting taxes, while the fee income goes offshore where it is taxed lightly or not at all.

In early 2013, Gilead's chief financial officer announced on a conference call with stock analysts that the formula for Sovaldi had been "domiciled" in Ireland, a well-known tax haven, which she said would allow the company's tax rate to "decline over time."[36] This meant that Gilead had transferred the economic rights to its Sovaldi patent to an Irish subsidiary and created a patent licensing arrangement that would enable it to report lower U.S. profits and, therefore, pay much less in federal taxes.

Of course, the drug was actually developed in the United States with all the attendant, taxpayer-funded benefits: supported with federal research money, studied and approved by the Food and Drug Administration, and granted an American patent, which receives the full protection of the U.S. legal system.[37]

GILEAD'S OFFSHORE TAX DODGING PART OF A BIGGER PROBLEM

Gilead is far from the only U.S. pharmaceutical company to overprice its U.S. medications, generate huge profits through U.S. public health programs, and then shift the resulting profits offshore to dodge U.S. taxes. Pfizer is just one other example, as revealed by two recent Americans for Tax Fairness reports.[38] Investigations in recent years have disclosed a host of other U.S. multinational corporations engaging in similar offshore profit-shifting schemes.[39]

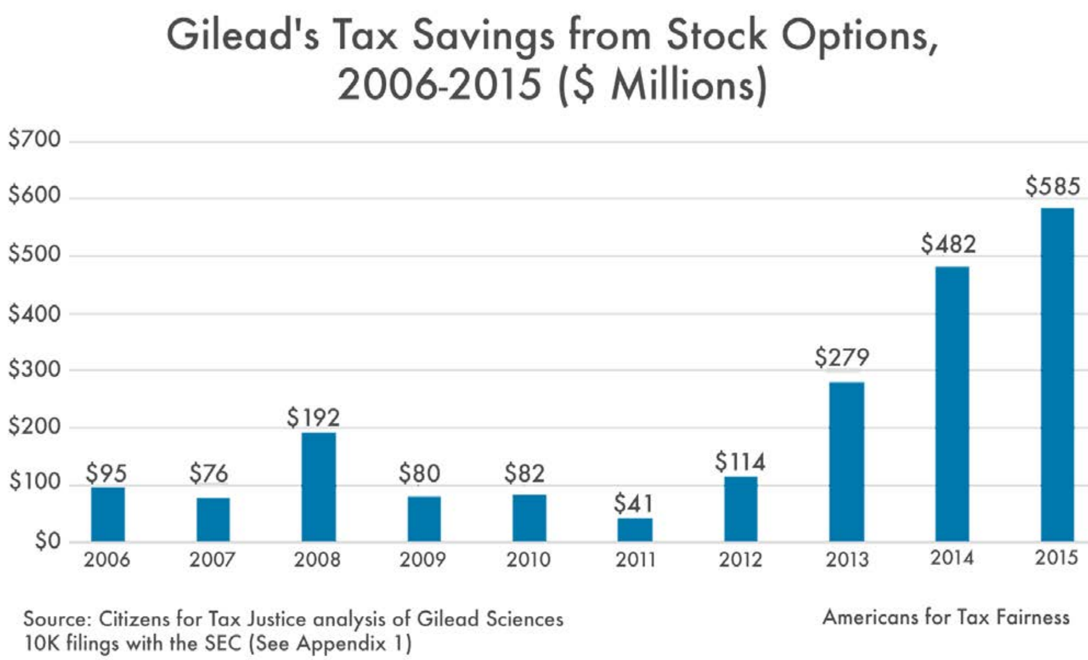
Altogether, at the end of 2015 American corporations reported $2.4 trillion in profits stashed offshore, on which they owe up to $700 billion in U.S. taxes, according to Citizens for Tax Justice.[40] At least 55% of those profits are in tax havens.[41] Nearly 40% of offshore profits belong to just 10 firms.[42]

Health care companies, primarily prescription drug firms, hold one-fifth of offshore earnings.[43] Out of 300 Fortune 500 companies with offshore profits, Gilead is ranked number 23 with $28.5 billion in profits overseas going untaxed here at home.[44]

TAXPAYERS SUBSIDIZE LUCRATIVE EXECUTIVE STOCK OPTIONS

Gilead avoids paying U.S. taxes on its U.S. profits not only by employing offshore profit shifting, but also by vigorously pursuing a domestic tax dodge involving the company's use of stock options as a form of executive pay. Using this one special tax break, Gilead has reduced its federal and state tax bills by $1.3 billion over the last three years—and by over $2 billion in the past decade. [Figure 6]

Figure 6. $2 Billion in Taxpayer Subsidies Through Gilead Executives' Stock Options



Stock options are a popular way to compensate corporate executives, especially because they allow companies to get around a tax rule that generally limits the deductibility of corporate salaries to $1 million per employee. Options confer the right to buy a stock or other security at a set price over a specified period of time. If when the option is used ("exercised") the set price is lower than the market price, the owner of the option makes a profit equal to the difference.

The stock options tax loophole lets corporations deduct stock-option expenses on their tax returns in amounts greater than the expenses shown on their books, which is what the compensation actually costs them. The book expense is governed by accounting rules that require corporations to report the compensation expense at the time the stock options are granted to executives. But the tax code allows corporations to deduct the value of the options at the time they are exercised, which typically results in a much higher deduction because of the stock-price appreciation in the years since the options were granted. The result is corporations typically take tax deductions worth much more than the stock option costs shown on their own books.[45]

Gilead has routinely issued stock options to its executives as part of their compensation packages. Due to its increased stock price, Gilead's stock-option pay and corresponding stock-option tax deductions have exploded since 2012, quadrupling in value over the last three years. In 2015 alone, its stock options cut the company's tax bill by $585 million.

PUBLIC ORIGINS OF GILEAD'S PRIVATE PROFITS

That public health agencies and American patients are struggling to afford Gilead's overpriced HCV medications, and that the company is dodging federal taxes on huge profits from those medications, are particularly troubling considering taxpayer dollars played a role in the development of the two drugs.

The drug that would eventually be marketed as Sovaldi was developed by a small company called Pharmasset. It was founded by Raymond Schinazi, who was a "seven-eighths" (or nearly full-time) employee of the Department of Veterans Affairs.[46] In other words, he was pulling in a government paycheck while his company was developing the blockbuster cure. Schinazi worked at the VA for 29 years.[47]

In addition, his free-lance research work for the VA (done through a lab associated with Emory University in Atlanta) focused on viruses like HCV and was supported by federal research grants.[48] Schinazi received National Institutes of Health (NIH) funding for hepatitis C research at least as far back as 1996.[49] An ATF analysis of NIH grants awarded to Schinazi and to Pharmasset between 1992 and 2011 for what appear to be hepatitis-related research show a total of $3.7 million, a significant sum. [Appendix 2] The bulk of the NIH money—$2.7 million—went to Schinazi.

Schinazi also received nearly $3 million in NIH grants for research on other viruses—with a focus on HIV—at the same time that he was working on hepatitis cures. Since the same class of antiviral drugs is effective in treating HIV and both hepatitis C and B,[50] this grant money would also have contributed to the science that led to the discovery of Sovaldi.

All in all, for every type of research—not just into hepatitis or viruses in general—Schinazi and Pharmasset together received nearly $11 million in NIH grants between 1992 and 2011.[51] Since research areas tend to overlap, that higher figure may give a more accurate picture of the level of NIH support behind the development of Gilead's blockbuster HCV drugs.

Pharmasset also received nearly half a million dollars more[52] in specific HCV-research funding through a tax credit program established by the Affordable Care Act to encourage therapeutic innovation in smaller companies.[53]

So possible taxpayer support for the development of these drugs is $4.2 million by a conservative estimate, and much more if research support is considered more broadly.

One of the divisions of NIH, the National Institute of Allergies and Infectious Diseases, touted its close working relationship with Gilead on its website: "Thanks to research led by NIAID and Gilead Sciences, new therapies are now available that can cure even complicated cases of hepatitis C without serious side effects."[54]

Given this multimillion-dollar public investment, the chairman of a Congressional committee publicly questioned why these life-saving drugs don't belong to the American people.[55] In response, the Department of Veterans Affairs announced that it did not claim any ownership rights because it was not its employee Schinazi who *personally* discovered the drugs, but rather the company, Pharmasset, that he established.[56]

But this VA analysis begs the larger question of the public's rights to the discovery—not through a particular grant or agency, but by the federal government's general support for hep C research. For decades, Washington not only provided Schinazi with a stable research position, but also provided multimillion-dollar grants for his private HCV research. It is possible that taxpayers further subsidized his research efforts through R&D tax credits awarded to Pharmasset.

When, in 2011, Gilead bought Pharmasset and its HCV medications for $11 billion,[57] Schinazi's personal share of the sales price was reported to be $400 million.[58]

OTHER GILEAD DRUG PRICE GOUGING

A large share of our nation's total drug costs are paid through the Medicare Part D subsidized prescription-drug plan. Over a recent four-year span, the prices paid through Part D for three leading Gilead drugs besides Sovaldi and Harvoni went up an average of 28%, or three times the inflation rate for that period. [Table 2]

Table 2. Prices Paid for Other Leading Gilead Drugs Through Medicare Part D

Rx Drug	Treatment	2010	2014	% Increase	Exceeds 10% Inflation Rate By
Atripla	HIV/AIDS	$52.42	$68.69	**31%**	3 times
Letairis	Pulmonary Hypertension	$188.26	$236.88	**26%**	2.5 times
Truvada	HIV/AIDS	$33.99	$43.47	**28%**	3 times
	AVERAGE INCREASE			**28%**	3 times

Sources: Medicare Drug Spending Dashboard[59] and Bureau of Labor Statistics[60]

GILEAD'S HCV DRUG PRICES ARE MUCH LOWER IN OTHER COUNTRIES

Even though Gilead's HCV drugs were developed in the United States with substantial and ongoing public support, Americans through their government and insurance carriers pay much more for those drugs than do citizens in other countries. As noted above, half of Gilead's tax-haven subsidiaries are Irish, and Ireland is where the company has "domiciled" the formula behind its HCV drugs, allowing it to dodge U.S. taxes through transfer pricing.

Yet the Irish pay less than half as much for Harvoni as it was originally priced here.[61] In other countries, the price difference is much starker. In March 2014, the company announced it would be selling Sovaldi in Egypt for $900 for a 12-week treatment—about 1% of the U.S. price.[62] In September of that year, Gilead licensed pharmaceutical companies in India to make a generic version of Sovaldi for sale in some 100 underdeveloped countries.[63] As a result of the competition, by December 2015 generic Sovaldi was selling in India for as little as $4 a pill.[64]

OTHER USES OF THE REVENUE FROM THE TAXES GILEAD IS NOT PAYING

Corporate tax dodging like Gilead's isn't just unfair to other businesses and individuals paying their fair share of taxes—it deprives Americans of resources needed for important public purposes. Gilead has indefinitely delayed paying $9.7 billion on its offshore profits thanks to the "deferral" tax loophole. The company also dodges about $200 million more a year, on average, through the stock-options loophole. That's a lot of revenue that could be put to good use.

For instance, for $10 billion we could:

- Double to two million the number of low-income kids and pregnant women served by the highly successful Head Start program, at a cost of about $9 billion a year.[65]
- Help seven million households stay warm over three winters through the Low Income Home Energy Assistance Program (LIHEAP), at a cost of about $3 billion a year.[66]
- Ensure one-and-a-half years of nutritional assistance to 8.5 million participants in the Women, Infants and Children (WIC) program, at a cost of $6.6 billion a year.[67]

STOCK BUYBACKS: WHERE MOST GILEAD PROFITS WILL GO

Gilead and other pharmaceutical companies often justify their sky-high prices by claiming they need the money to discover the next big cure through research and development.[68] But a recent academic study found that most big drug companies actually spend more improving the investment returns of shareholders and executives through financial largesse than they do improving the health of patients through groundbreaking research.[69]

They sweeten those investment returns by paying cash dividends and by buying back the company's own stock, which has the effect of increasing the price of the shares that remain in the market, enriching those who own them.

The study of 19 leading pharmaceutical firms found that, between 2005 and 2014, Gilead spent $14.4 billion for R&D compared with $17 billion to buy back its own shares. (Until recently, Gilead paid no dividends.[70]) That's 20% more spent on stock buybacks than on drug research. Only one other company spent more money boosting its stock price through buybacks than it did seeking medical breakthroughs (and in that other case, just by a little).

Because corporate executives receive so much of their compensation in the form of stock and stock options, they are also among the biggest beneficiaries of stock buyback programs.

In 2004, Congress passed legislation that allowed companies to repatriate their offshore profits at the steeply discounted tax rate of 5.25%. More than $300 billion was returned to the United States at the lower tax rate. Lawmakers predicted companies would use this tax-cut windfall to stimulate the economy and create jobs through a wave of new investments. Unfortunately, the tax break was a bust at growing the economy and one study estimated that about 90 cents of every dollar repatriated was used for stock buybacks.[71]

Gilead is probably accumulating its big offshore stash of profits in anticipation of another tax giveaway by Congress, which the company could then use to jack up stock prices rather than make productive investments or find life-saving cures.

THE BIGGEST WINNER OF ALL: GILEAD'S CEO

Gilead's long-time CEO John C. Martin, who stepped down in March 2016 after 20 years in the job, likely benefitted more than any other individual from the company's price gouging, tax dodging, and resulting share price increases of the past few years.

Between 2006 and 2014, Martin was always among the three highest-paid pharmaceutical CEOs in the country—three of those years, he was Number 1.[72] His total yearly compensation grew from an outrageous $32.5 million in 2006 to an outlandish $192.8 million in 2014. The largest share of his compensation came from stock and stock option awards whose value reflected the company's rising stock price. In fact, the proportion of his pay that was stock-based fell below 90% in only one year.

In 2009, Martin was the 6th highest paid CEO among company chiefs of all industries,[73] and in 2011 he was No. 10.[74] While his salary and bonus in 2011 were an impressive $4 million, 83% of his compensation came from price gains in his Gilead stock holdings.

The astronomical price tags on Gilead's HCV cures boosted Gilead's stock price[75] and Martin's net worth with it. By 2014, he was worth over a billion dollars.[76] And he was still being paid handsomely by Gilead: that year he was the nation's 4th best-paid billionaire CEO.[77] Due to the stock option tax loophole, American taxpayers subsidized his gargantuan salary each year, further widening the income and wealth gaps that plague the U.S. economy.

RECOMMENDATIONS FOR REFORM

Stopping Gilead's Price Gouging

As an organization focused on tax issues, Americans for Tax Fairness lacks the expertise to offer recommendations for how to stop Gilead's drug-price gouging. The suggestions below, therefore, are from groups that are leaders in the fight for affordable prescription drugs.

Some experts propose using an existing federal law that allows the government to use patented inventions with or without the consent of the patent holder, as long as the holder is fairly compensated.[78] In the past, the Defense Department has used these so-called Section 1498 powers to gain access to night-vision goggles and lead-free bullets.[79]

This exception to the patent laws allows public access to vital inventions at reasonable prices, just as the principle of "eminent domain" allows public access to land necessary for public projects, as long as fair compensation is provided to the owner.[80]

Applying this law to prescription drugs, the federal government would arrange for the manufacture of the medicine by generic drug makers, with the patent holder, in this case Gilead, receiving a royalty from the sales.

A recent scholarly journal article noted that if the government set the treatment price at $1,000 and provided a standard 10% (in this case, $100) royalty to Gilead, four million patients could be treated for $4.4 billion.[81] That is less than federal programs have been spending to treat just a fraction of the affected population.

Even if the company received a much steeper royalty of $1,000 per patient, the total cost to the government would only be $1,200 per patient—assuming a $200-per-treatment manufacturing cost—as noted in Congressional testimony by Public Citizen.[82] At either price the drugs could be made available to all who need them, unlike now.

U.S. Sen. Bernie Sanders in May 2015 urged the Department of Veterans Affairs to exercise this patent-breaking power on behalf of affected veterans.[83]

Ending Offshore Profit Shifting and Tax Dodging

End the Deferral Loophole

The way to stop Gilead's tactic of declaring profits stashed in tax havens to be permanently reinvested offshore and thereby indefinitely delay paying U.S. taxes on them is to close the deferral loophole. The United States would finally be paid the money it's due while Gilead and other big companies would lose a principal incentive to accumulate future profits offshore.

As previously explained, deferral allows U.S. corporations to defer paying taxes on their foreign earnings until that income is repatriated to this nation as dividends to the parent company. This loophole (including the costs of the active financing exception tax break that applies to profits from offshore banking and finance) loses about $900 billion in public revenue over 10 years, according to government studies.[84] Sen. Sanders and Rep. Jan Schakowsky (D-IL) have both introduced the Corporate Tax Dodging Prevention Act, which would end the deferral loophole—S. 922 and H.R. 1790.[85]

Deferral is a central cause of the low effective tax rates paid by U.S. multinationals. It is why those corporations currently hold $2.4 trillion in accumulated profits offshore. Ending deferral would take away the impetus for corporations to shift production, jobs and profits offshore, especially to tax havens. It would also eliminate one of the many disadvantages U.S. domestic-oriented firms face competing with their American multinational rivals.

Repeal of deferral should include the requirement that companies fully pay the U.S. taxes they owe on accumulated offshore profits—in Gilead's case, those unpaid taxes totaled $9.7 billion as of last year. There is no justification for giving Gilead or other corporations a complete or partial tax amnesty on those profits, as has been proposed, since they've known all along they would eventually have to pay the bill due.

Restore Subpart F to Fully Tax Passive Foreign Income

In the absence of ending deferral, an alternative would be to fix the part of the tax code meant to exclude certain kinds of corporate income from the benefit of deferral.

Passive foreign income like interest and royalty payments—so-called Subpart F income—is supposed to be taxed every year, just like domestic income. Subpart F of the tax code was put into place by President John F. Kennedy to fight tax-haven profit shifting. Successful for decades, it was eventually weakened by multiple loopholes, the worst of which are known as the "Check the Box" regulation and the "CFC Look-Through Rule."[86]

Closing those loopholes, which benefit only a narrow group of U.S. multinationals, would raise an estimated $78 billion over 10 years.[87] Legislation to do that is sponsored in Congress as S. 174 by Sheldon Whitehouse (D-R.I.) and as H.R. 297 by Rep. Lloyd Doggett (D-Texas).[88]

Require Corporations to Provide Country-By-Country Reporting

As this report shows, Gilead, like many multinational corporations, is engaged in a massive offshore shell game shifting billions of U.S. profits offshore to dodge taxes.

Yet no taxing authority, including the IRS, has reliable and timely information about where, on a country-by-country basis, multinationals do business, declare profits, and pay taxes. Requiring U.S. multinationals to disclose that information on an annual basis would help expose offshore profit shifting and tax dodging.

Recently, the Treasury Department proposed a new regulation along these lines, although it did not propose to make the reports publicly available.[89] Americans for Tax Fairness testified in favor of the proposal, urging that the rule be finalized as soon as possible, and that the data be made available to policymakers, the academic community, and the taxpaying public so they can begin to get meaningful understanding of corporate tax practices.[90]

Close the Stock Options Tax Loophole

The stock options tax loophole that cut Gilead's tax bill by $2 billion over 10 years can be closed by requiring companies to deduct the stock option compensation expense shown on their books and no more. Citizens for Tax Justice estimates that big American companies dodge about $13 billion a year in taxes through the stock options loophole.[91] A bipartisan bill to close this loophole has been introduced in Congress for years.[92] Congress's tax scorekeeper estimates this measure would raise $25 billion over 10 years.[93]

A Final Recommendation: Fixing Two Problems with One Solution

The purpose of this report is to add Gilead's tax dodging to its price gouging as a target of public outrage and reform, as well as to describe the connection between the two abuses. The author of a law journal article due out this year,[94] Andrew Blair-Stanek, has also recognized the connection and even devised a solution that simultaneously addresses prohibitively priced drugs and tax dodging through offshore transfer pricing.

As noted above, transfer pricing occurs when a parent corporation severely undervalues intellectual property—such as a drug formula—it "sells" to an offshore subsidiary, and then the subsidiary licenses that property back to the parent at a huge premium. The effect is to minimize the amount of money coming to the United States, where it faces taxation, and maximize the amount of money going to offshore tax havens, where it faces little or none.

But Blair-Stanek has devised a strategy to discourage cheap valuations that underlie transfer pricing, forcing down drug prices at the same time. As described earlier, the U.S. government has the power to override patents—such as on drug formulas—when necessary for the public good, as long as the patent holder is fairly compensated. In the case of companies that have sent their valuable patents offshore with ridiculous price tags attached, he would have the government use that undervalued price as the "reasonable" compensation.

Pharmaceutical companies like Gilead that severely overprice important medications would either have to assign realistic prices to their offshored drug patents—thereby spoiling their transfer-pricing tax dodge—or accept a tiny price for those patents, minimizing the cost of government intervention and thus making their drugs even more affordable. Very possibly, companies would strike a balance between the two, curbing both their tax dodging and price gouging.

APPENDIX 1: GILEAD SCIENCES SUPPORTING DATA FOR FIGURES 1–6

	$ Millions										
	2015	**2014**	**2013**	**2012**	**2011**	**2010**	**2009**	**2008**	**2007**	**2006**	
Domestic Revenues	21,234	18,182	6,695	5,592	4,608	4,224	3,599	2,857	2,166	1,467	
Foreign Revenues	11,405	6,708	4,507	4,111	3,777	3,725	3,412	2,478	2,064	1,559	
Total Revenues	32,639	24,890	11,202	9,703	8,385	7,949	7,011	5,336	4,230	3,026	
Domestic Profits Before Income Taxes	7,953	6,678	3,470	2,727	2,171	2,544	2,172	1,773	1,471	-1,100	
Foreign Profits Before Income Taxes	13,706	8,178	738	885	1,480	1,370	1,330	900	740	462	
Total Profits	21,659	14,856	4,208	3,612	3,651	3,914	3,502	2,673	2,211	-638	
Reported Domestic Share of Revenues	65%	73%	60%	58%	55%	53%	51%	54%	51%	48%	
Reported Domestic Share of Profits	37%	45%	82%	76%	59%	65%	62%	66%	67%	172%	
Worldwide Effective Tax Rate	16.4%	18.8%	27.3%	28.7%	23.6%	26.2%	25.0%	26.3%	28.7%	-86.5%	
Permanently Reinvested Earnings (PRE)	28,500	15,600	8,550	7,250	5,840	4,480	3,190	1,940	1,100	405	
Tax Owed on PRE	9,700	5,500	3,000	2,540	2,050	1,600	1,140	678	386	142	
Current Foreign Tax Rate on PRE	1.0%	-0.3%	-0.1%	0.0%	-0.1%	-0.7%	-0.7%	0.0%	-0.1%	0.0%	
											Total
Tax Benefit from Excess Stock Options	585	482	279	114	41	82	80	192	76	95	2,026

Sources: Gilead Sciences 2015 10-K filings with the U.S. Securities and Exchange Commission for multiple years. For 2013-2015 go to: http://www.sec.gov/cgi-bin/viewer?action=view&cik=882095&accession_number=0000882095-16-000039&xbrl_type=v#
For Revenues see “Notes to Financial Statements” tab, then “Segment Information” tab, and then “Revenues by Geographic Region” section.
For Profits (Income), Worldwide Effective Tax Rate and PRE data see “Notes to Financial Statements, Income Taxes” tab.
For “Tax Benefit from Excess Stock Options” see “Financial Statements” tab, then “Consolidated Statements of Cash Flows” tab and the line item “Excess tax benefits from stock-based compensation.”

APPENDIX 2: HEPATITIS-RELATED NIH GRANTS RECEIVED BY RAYMOND SCHINAZI OR PHARMASSET, 1992-2011

NOTE: Online accessible records compiled here begin in 1992, and Pharmasset was purchased by Gilead in 2011.

Project Title	Project Leader or Organization	Fiscal Year	Total Cost
Animal models of hepatitis C	Schinazi	1996	$50,000
Nucleosides with dual AntiHIV and HBV activity	Schinazi	1997	$154,642
Nucleosides with dual AntiHIV and HBV activity	Schinazi	1998	$205,182
Nucleosides with dual AntiHIV and HBV activity	Schinazi	1999	$164,061
Nucleosides with dual AntiHIV and HBV activity	Schinazi	2000	$192,000
Racivir for treatment of hepatitis B and HIV infections	Pharmasset	2000	$142,000
Nucleosides with dual AntiHIV and HBV activity	Schinazi	2001	$192,000
Antivirals against HBV	Pharmasset	2001	$147,584
Nucleosides with dual AntiHIV and HBV activity	Schinazi	2002	$194,177
Nucleosides with dual AntiHIV and HBV activity	Schinazi	2002	$24,884
Modified nucleosides for hepatitis C virus	Pharmasset	2002	$162,200
Nucleosides with dual AntiHIV and HBV activity	Schinazi	2003	$195,507
Novel class of compounds for treatment of HCV infections	Pharmasset	2003	$175,000
Nucleosides with dual AntiHIV and HBV activity	Schinazi	2004	$192,000
Nucleosides with dual AntiHIV and HBV activity	Schinazi	2004	$72,723
2'-and/or 4'-c-modified nucleosides as Anti-HCV agents	Pharmasset	2004	$189,277
Nucleosides with dual AntiHIV and HBV activity	Schinazi	2005	$225,925
2'-and/or 4'-c-modified nucleosides as Anti-HCV agents	Pharmasset	2005	$194,954
Nucleosides with dual AntiHIV and HBV activity	Schinazi	2006	$220,615
Nucleosides with dual AntiHIV and HBV activity	Schinazi	2007	$214,217
Nucleosides with dual AntiHIV and HBV activity	Schinazi	2008	$210,146
Nucleosides with dual AntiHIV and HBV activity	Schinazi	2009	$210,146
		TOTAL	**$3,729,241**
		SCHINAZI	**$2,718,225**
		PHARMASSET	**$1,011,016**

Source: National Institutes of Health, Research Portfolio Online Reporting Tools (RePORT)
https://projectreporter.nih.gov/reporter.cfm;jsessionid=717220C199794E17D03F61947E3DB965.RePORTER?CFID=7911439&CFTOKEN=61998895

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Americans for Tax Fairness is a diverse coalition of 425 national and state endorsing organizations that collectively represent tens of millions of members. The organization was formed on the belief that the country needs comprehensive, progressive tax reform that results in greater revenue to meet our growing needs. ATF is playing a central role in Washington and in the states on federal tax-reform issues.

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