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'Cheating of America'

Chrysler Opted Out Of U.S. Tax System

How could Chrysler, one of the Big Three American carmakers, manage to opt out of the U.S. tax system and cease to be an American business?

The tale is told in The Cheating of America ***by Charles Lewis, Bill Allison and the Center for Public Integrity. The merger of Chrysler and Daimler-Benz allowed the new company to become a German corporation, no longer owing U.S. taxes on its overseas profits.***

It was supposed to be a merger of equals, a ballyhooed marriage of German precision engineering and American automotive romance, but the honeymoon enjoyed by Chrysler and Daimler-Benz after their 1998 merger is long over.

DaimlerChrysler's share price has dropped from a high of $108 in January 1999 to just under $50 in mid-May 2001.

DaimlerChrysler

As a German corporation, DaimlerChrysler, with headquarters in Stuttgart, no longer owes U.S. taxes on its overseas profits.

The company is fighting shareholder suits filed by disgruntled Chrysler investors, including an $8 billion suit brought by Kirk Kerkorian and his Tracinda Corp. Chrysler, which has lost more than $3 billion in the last three quarters, July 2000 through March 2001, has announced plans to close six factories, and lay off a fifth of its workforce—some 26,000 people—in a bid to break even next year.

For Chrysler, losing billions is nothing new. The carmaker teetered on the brink of bankruptcy in the 1970s, thanks to superior Japanese imports, its own bad management practices, and new fuel-economy standards mandated by the federal government. It lost $1.1 billion that year, and $1.7 billion the next—at the time a record for corporate ineptitude. Congress and the Carter administration bailed out the company with the Chrysler Corporation Loan Guarantee Act of 1979, a $1.5 billion aid package that kept the struggling carmaker afloat.

Iacocca turned it around

Lee Iacocca, the brash, straight-talking CEO, took the government aid and turned around the company. Chrysler put out the world's first minivan in 1980; the company bought out AMC Corp., maker of the Jeep line of vehicles, and added the grandfather of the sports utility vehicle to its product line. By 1984, the company that had lost billions in the late '70s and the first few years of the '80s turned a profit of $2.4 billion. Iacocca gained fame for his company's resurrection and his attacks on what he considered unfair competition by the foreign carmakers, particularly the Japanese. He starred in more than 60 commercials for Chrysler, many of which hammered home a "Made in America" theme,

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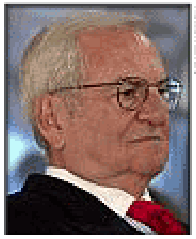
arguing that the domestically manufactured K-cars (Plymouth Reliant, Dodge Aries) and LeBarons were superior to their Japanese rivals.



Iacocca

In 1998, six years after Iacocca left the helm of the company, Chrysler merged with Daimler-Benz A.G., the German manufacturer of Mercedes-Benz cars and trucks. The inherent patriotism of the "Made in America" advertising campaign went the way of the K-car, at least as far as the company's willingness to continue playing by America's rules.

"The U.S. tax system puts global companies at a decisive disadvantage," John Loffredo, the vice president and chief tax counsel for Chrysler and its successor, DaimlerChrysler, told a hearing of the House Ways and Means Committee on June 30, 1999. That was just 20 years after his predecessors had gone, hat in hand, to beg Congress for a bailout. "This issue became a major concern, and when the time came to choose whether the new company should be a U.S. company or a foreign company, management chose a company organized under the laws of Germany."

So Chrysler, one of the Big Three American carmakers, opted out of the U.S. tax system and ceased to be an American business.

Effective tax rate: Just 18 percent

For the record, Chrysler's effective federal tax rate under that disadvantageous U.S. tax system through the '90s was a mere 18 percent—slightly more than half of the statutory rate of 35 percent. The huge net operating losses that Chrysler incurred helped the company avoid paying taxes altogether some years, and steeply reduced its tax bill in others. Adding insult to injury, Chrysler filed a petition in U.S. Tax Court in 1997 claiming it was owed a refund of $49.8 million from 1983 to 1985. The bulk of write-offs, the car manufacturer claimed, were related to costs associated with the government bailout of 1979. In effect, Chrysler was asking other taxpayers to subsidize the bailout a second time. That case is still pending.

DaimlerChrysler

Chrysler argued that its 1983 LeBaron was superior to Japanese rivals.

By choosing to become a German corporation, Chrysler no longer owes U.S. taxes on its overseas profits. From 1990 until it merged with Daimler-Benz AG, Chrysler had taxable overseas income of $3.5 billion. After adjusting for foreign taxes paid, Chrysler still would have owed $590 million on those profits to the U.S. Treasury, assuming that the company paid at the statutory rate set by Congress. Thanks to its choice to be a German company, all the company's future foreign profits—earned by selling Jeeps and Chrysler minivans overseas—will escape U.S. taxation.

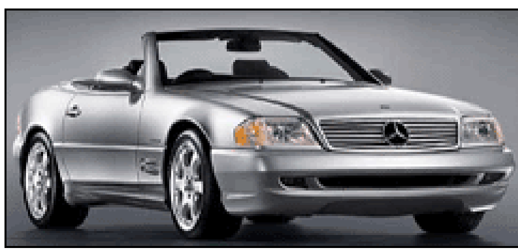
According to Loffredo, the companies considered choosing the United States as their home, but rejected the notion of forming "Chrysler-Daimler." "Daimler being a subsidiary of Chrysler would have opened up for review all of Daimler's operations worldwide to the IRS," he told the Center. "That's something no one should volunteer."

Chrysler will still owe some U.S. taxes. The carmaker will join the nearly 60,000 other corporations with 50 percent or more foreign ownership doing business in the greatest consumer market in the world. In 1995, the last year for which statistics were available, there were some 60,157 returns filed by such corporations. Of those, 19,962—or slightly more than 33 percent—owed some federal income tax.

“I want to make it clear that the former Daimler-Benz has been a good corporate citizen in the U.S. and has paid all taxes believed legally due on its U.S. operations,” Loffredo testified before Congress. “The same is true for the former Chrysler Corporation. In addition, Daimler and Chrysler will continue to be subject to the U.S. tax laws on their U.S. operations and will continue to pay their fair share of U.S. taxes.” The key word in his statement is “believed.”
In 1994, Daimler-Benz filed a petition in U.S. Tax Court, claiming that the fines it paid to the National Highway Traffic Safety Administration for selling cars that failed to meet minimum standards for fuel efficiency should be deductible as “ordinary and necessary business expenses.”

Paid fine for gas guzzlers

Throughout much of the 1980s, most of the Mercedes-Benz luxury sedans that the company sold guzzled more gas than federal regulations permitted. Rather than meet the fuel-economy standards, which have both reduced air pollution and helped to reduce demand for gasoline—thus helping to make it cheaper—Daimler-Benz chose to pay a fine to the government.



DaimlerChrysler

Daimler-Benz said in effect that ordinary taxpayers should foot part of the bill for those who can afford a Mercedes.

That is an option the company had under the Energy Policy and Conservation Act of 1975, which required manufacturers to meet certain mile-per-gallon averages. But nowhere does the act say that a company that chooses not to meet the standards should be able to pass along the costs of that failure to other taxpayers—something that Daimler-Benz argued in its court petition.
Think of it this way: Daimler-Benz was arguing that ordinary taxpayers should foot part of the bill for those wealthy enough to afford a Mercedes-Benz.

In 1988 and 1989, Daimler-Benz’s U.S. subsidiary, Mercedes-Benz of North America Inc., made payments to the National Highway Traffic Safety Administration totaling $65 million; the company deducted those payments on its federal income tax return. “The amounts MBNA paid to NHTSA in 1988 and 1989 are ordinary expenses incurred by MBNA in carrying on its trade or business,” the company argued. “The amounts MBNA paid to NHTSA in 1988 and 1989 are necessary expenses incurred by MBNA in carrying on its trade or business. . . . The amounts MBNA paid to NHTSA in 1988 and 1989 are deductible under section 162 as ordinary and necessary business expenses.”

Mercedes-Benz of North America “engaged exclusively in the importation and distribution of Mercedes-Benz passenger automobiles and parts in the United States,” according to the company’s petition in Tax Court. Those cars, of course, are beyond the means of the average American; in the 1980s, the price for one of those finely engineered German automobiles ranged between $30,000 and $70,000. In 1984, Mercedes-Benz of North America sold more than 79,200 cars in the United States. That year, Mercedes paid $156 million in U.S. taxes. The next year, 1985, Mercedes sold more cars in the United States—just over 86,900 of them. It paid about a third less in taxes—just $99 million. The following year, 1986, Mercedes had its best year in the 1980s, with more than 99,300 new-car sales in the United States.

That year, the company's taxes under the system that Loffredo said put "global companies at a decisive disadvantage," totaled a mere $5.4 million.

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