



# OFFSHORING AMERICA'S DRUGSTORE

*Walgreens May Move its Corporate Address to a Tax Haven to Avoid  
Paying Billions in U.S. Taxes*

*June 2014*

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**Americans for Tax Fairness** is a diverse coalition of [400 national and state 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.



**Change to Win Retail Initiatives** is a project of the Change to Win labor federation. Since 2005, it has been an active stakeholder in the pharmacy industry, advocating on behalf of workers and the general public for consumer protections, health care access, tax fairness and other safeguards to rebuild the middle class.

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# EXECUTIVE SUMMARY



Walgreen Co. is the nation's largest pharmacy retailer with 8,200 stores and locations in all 50 states. It is America's drugstore, and Walgreens pharmacies play a key role in providing healthcare to our communities.

Yet Walgreens recently stated that it may soon renounce its American "corporate citizenship" by offshoring its place of incorporation to Switzerland, a tax haven. The reason for doing this is clear: to avoid paying its fair share of taxes. (The drug maker Pfizer recently made headlines by pursuing a similar reincorporation with AstraZeneca in Great Britain for the same tax purpose.)

This reincorporation would take place primarily on paper – essentially a change of its corporate address. In all likelihood, Walgreens would not move its headquarters, employees or supply chains to Switzerland. But it could cost U.S. taxpayers \$4 billion over five years, leaving other businesses and American families to pick up the tab.

This tax maneuver is made possible by a loophole that allows American companies to reincorporate offshore, typically in a tax haven, when just 20% of its stock is owned outside of the United States. This process is known as an *inversion*. Walgreens may be able to meet this criterion through its merger with the Swiss company Alliance Boots (AB), Europe's largest pharmaceutical wholesaler and retailer. AB has itself been criticized widely for aggressively avoiding taxes, especially by reincorporating from the United Kingdom to Switzerland in 2008.

If Walgreens renounces its American corporate citizenship in an inversion, it would continue to take full advantage of all the benefits it gets from operating in America, where almost all of its \$72 billion in annual sales and nearly \$2.5 billion in profit are generated.

Our research shows that Walgreens relies heavily on the U.S. taxpayer for its profits, and that an inversion would deprive our country of significant resources while giving the company an unfair advantage over its competitors:

- **If Walgreens changes its corporate address to Switzerland, it could cost U.S. taxpayers more than \$4 billion in lost tax revenue over five years.** Analysts at equity research firms have said that the company's income tax rate could be cut to 20%; Walgreens currently pays about a 30% tax rate. This lost tax revenue is enough to pay for one-and-a-half years of prescriptions for the entire veterans population at the V.A., or pay for health coverage for 3.5 million children for a year.
- **Walgreens receives a quarter of its income from taxpayers through government programs.** Of Walgreens' \$72 billion in 2013 sales, an estimated \$16.7 billion, or 23%, came from Medicare and Medicaid.
- **Walgreens' corporate inversion would affect Illinois taxpayers. In 2012, the state awarded Walgreens \$46 million in tax breaks over 10 years.** But an inversion could reduce the company's already low state income tax rate.
- **U.S. taxpayers spent \$11 million subsidizing executive bonuses at Walgreens over the last five years.** Walgreens' top executives have collectively earned more than \$60 million in compensation over the last five years. Because of a loophole that allows certain "performance-based" stock and incentive compensation to be tax deductible, it cost U.S. taxpayers \$11 million to subsidize Walgreens' executive bonuses.
- **By changing its country of incorporation to Switzerland, Walgreens will have an unfair advantage over its competitors.** Walgreens average U.S. tax rate was 31% from 2008 to 2012. Its chief competitor, CVS Caremark, paid a higher tax rate of 34% over those same years, but it has made no move to reincorporate offshore.

President Obama has proposed legislation to make it very difficult for U.S. companies to reincorporate overseas, and several leading members of Congress have recently proposed similar measures to end this tax avoidance scheme.

Corporate tax avoidance is facing growing opposition this year as Walgreens executives and then the company's shareholders make critical decisions about whether Walgreens will continue to be an American corporation. For the company, it is a public relations dilemma and potentially a challenge to its business. When Walgreens abandons America, will American consumers abandon Walgreens? ■

# BACKGROUND ON WALGREENS' CORPORATE INVERSION

**A** [corporate inversion](#) is a technical maneuver in which an existing U.S. corporation changes its country of residence through a merger with an often smaller foreign-owned business. After the inversion, the original U.S. company becomes a subsidiary of the foreign parent company, yet the foreign company is controlled by the shareholders of the original U.S. corporation. This is often done because the tax rate paid by the foreign parent corporation will be lower, and a U.S. company can avoid paying taxes on its foreign-source income if it has reincorporated in a country with a territorial tax system.<sup>1</sup>

Under U.S. tax law, a [corporation successfully completes this maneuver](#) if domestic owners retain less than 80% of outstanding stock following a transaction, or if the U.S. company moves “substantial business activities” equaling at least 25% of operations to another country.<sup>2</sup> Thus, with just a 20% change in ownership, a company can become “foreign” even if it largely operates in and is controlled from America. After an inversion, a company’s U.S. operations are supposed to be subject to U.S. taxes, but many companies use additional artificial restructuring and financial manipulation to reduce their taxes.

In June 2012, [Walgreens announced an agreement](#) to purchase Alliance Boots (AB), Europe’s largest drug wholesaler and retailer, through a two-step transaction valued at over \$20 billion.<sup>3</sup> Two months later, Walgreens completed the first step of the deal and acquired a [45% equity stake](#) in AB for a combination of stock and cash.<sup>4</sup> Starting in February 2015, it has an option to buy the remaining 55%.<sup>5</sup> Walgreens shareholders must vote on the deal before that point.

In April 2014, Walgreens acknowledged that it is seriously exploring an inversion.<sup>6</sup> [News reports](#) indicate that Stefano Pessina, an Italian billionaire who is Executive Chairman of AB and now Walgreens’ largest shareholder, and a group of large hedge funds that own stakes in Walgreens are driving the initiative to invert.<sup>7</sup> They want Walgreens to join the ranks of other companies that have used inversions to avoid U.S. taxes such as Transocean, Actavis and Aon.<sup>8</sup>

An inversion could become possible when Walgreens completes the second step of the transaction. Today, AB is still majority controlled by private equity giant Kohlberg Kravis Roberts (KKR) and Executive Chairman Pessina. Once Walgreens exercises its option to purchase the remainder of AB, KKR and Pessina will collectively hold more than 20% of Walgreens' outstanding shares.<sup>9</sup>

Walgreens management is reportedly unsure of whether their two-step transfer of stock will meet the statutory requirements for inversion, so company management reportedly indicated that they might even go so far as to renegotiate the second step of the deal so that there is a transfer of 20% of stock at that point (and a smaller amount of cash), thus clearing the way for inversion.<sup>10</sup>

## ALLIANCE BOOTS: A HISTORY OF NOT PAYING ITS FAIR SHARE

Alliance Boots is an aggressive tax avoider – the company has come under fire in Europe for using tax havens and accounting tricks to avoid paying its fair share.

After going private in Europe's largest ever leveraged buyout, AB made headlines in 2008 after it reincorporated from the United Kingdom to Switzerland, **which is widely considered a tax haven**.<sup>11</sup> The Swiss company is owned by a Gibraltar-based holding company, which is jointly controlled by Pessina and KKR.

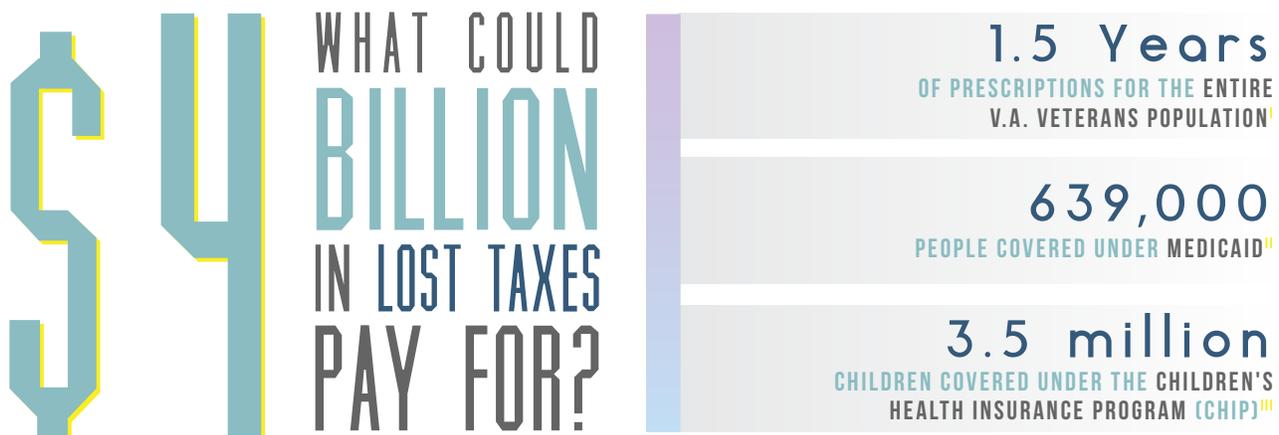
In addition to tax havens, AB has not shied away from exploiting other tax loopholes. The company has taken aggressive steps to lower its British tax bill, including by taking on a mountain of debt – roughly £9 billion, or \$15.3 billion. Under Britain's debt interest deduction the company was able to **reduce its British tax bill** by more than £1.1 billion, or \$1.87 billion, over a six year period.<sup>12</sup>

# WALGREENS' INVERSION WILL TAKE BILLIONS FROM OUR COMMUNITIES

**T**hree equities research firms – Deutsche Bank, JP Morgan and UBS – estimate that an inversion could bring Walgreens tax rate down to around 20%. It could add anywhere from 10% to 18% to its net profit starting in 2016, the first full year after the merger with Alliance Boots.<sup>13</sup>

This means that Walgreens could potentially avoid between \$580 million and nearly \$1 billion in taxes annually. Based on the average of estimates from these three firms (\$754 million) and factoring in moderate profit growth, that adds up to more than \$4 billion in lost tax revenues over five years, most of which would likely have been paid in the United States.

*[See Appendix I for an explanation of this estimate.]*



<sup>i</sup> In 2012, the U.S. Department of Veterans Affairs reported spending \$2.684 billion on prescription medications. Centers for Medicare & Medicaid Services, National Health Expenditures, by type of service and source of funds. Available at: <https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsHistorical.html>.

<sup>ii</sup> The Henry J. Kaiser Family Foundation, "Medicaid Per Enrollee Spending: Variation Across States" (Feb. 4, 2014). Medicaid spending per enrollee was \$6,253 (nationwide average) in FY2010. <http://kff.org/report-section/medicaid-per-enrollee-spending-variation-across-states-appendices-8550/>.

<sup>iii</sup> The Congressional Budget Office reports that in 2013, average federal spending on benefit payments per child enrollee was \$1,120. Congressional Budget Office, "Detail of Spending and Enrollment for the Children's Health Insurance Program for CBO's April 2014 Baseline (By fiscal year)". <http://www.cbo.gov/sites/default/files/cbofiles/attachments/44189-2014-04-CHIP.pdf>.

# WALGREENS GENERATES ONE-QUARTER OF ITS INCOME FROM GOV'T PROGRAMS



Walgreens depends on American consumers and our tax dollars to make its business successful. We estimate that the company received \$16.7 billion in revenue from government-funded healthcare programs in 2013, which was 23% of Walgreens' \$72 billion in sales that year.<sup>14</sup>

Based on Walgreens' market share, we estimate the company received nearly 20% of the country's \$68 billion in Medicare Part D spending on prescription drugs in 2012, or about \$13 billion. Walgreens reported that Medicaid represented 5.2% of its revenue, or \$3.7 billion, in 2013.<sup>15</sup>

It is only right that a company depending so heavily on taxpayer-funded programs should pay its fair share of taxes on that income.

# WALGREENS WILL HURT ILLINOIS TAXPAYERS

**F**ederal taxpayers are not the only big losers if Walgreens changes its corporate address to Switzerland. The income taxes that the company pays to state tax authorities may decrease. The company can shift profits away from its state tax bases if it engages in [earnings stripping maneuvers](#),<sup>16</sup> such as allocation of Alliance Boots' [\\$8.5 billion debt to Walgreen Co.](#)<sup>17</sup>

If Walgreens goes ahead with an inversion, it would be an affront to Illinois taxpayers. In 2012, the state awarded Walgreens a package valued at [\\$46 million in tax credits](#) over ten years in exchange for job creation. In awarding these credits, Illinois Governor Pat Quinn commended Walgreens' "deep roots in Illinois."<sup>18</sup>

## ARE WALGREENS ILLINOIS ROOTS REALLY SO DEEP?

"We are proud of our Illinois heritage... Just as our stores and pharmacies are health and daily living anchors for the communities we serve, we as a company are now recommitted to serving as an economic anchor for northeastern Illinois. A state and workforce that has served us so well for more than a century will now see our footprint grow even larger."<sup>19</sup>

– **Greg Wasson**, Walgreens CEO, upon receiving \$46 million in Illinois tax credits in August 2012

"[W]e don't sit around and not try to optimize taxes every day ... We're not averse to looking at [inversion], right, for sure ... it obviously saves people a lot of tax payments, right? We've never been a proponent of paying more taxes than we have to."<sup>20</sup>

– **Rick Hans**, Walgreens Vice President of Investor Relations and Finance, April 30 2014

# U.S. TAXPAYERS SUBSIDIZE WALGREENS' BONUSES FOR EXECUTIVES



Walgreens has also benefitted from \$11 million in tax subsidies for its outsized executive compensation packages over the last five years. Federal law caps the amount corporations can deduct from their income taxes for executive pay at no more than **\$1 million per executive**, to discourage excessive executive compensation.<sup>21</sup> However, a tax loophole allows certain **“performance-based” stock and incentive compensation** to be tax deductible above that level.<sup>22</sup> In effect, the larger the executive payouts, the less Walgreens pays in taxes.

Walgreens CEO Greg Wasson made **\$13.7 million in total compensation in fiscal 2013**, an increase of 13% over the previous year, despite flat sales since 2011.<sup>23</sup> Over the past five years, Walgreens’ top executives have collectively earned \$61.9 million in compensation, of which \$31.5 million is classified as “performance based” compensation. This \$31.5 million in bonuses is fully tax deductible to Walgreens, saving the company \$11 million over the last five years.

*[See Appendix II and Appendix III for an explanation of this estimate.]*

# WALGREENS' INVERSION WOULD GIVE IT AN UNFAIR ADVANTAGE OVER COMPETITORS

**T**here are no business performance reasons for Walgreens to change its corporate address to Switzerland. It's a very healthy company with \$72 billion in annual sales and [\\$2.5 billion in profits](#).<sup>24</sup>

In fact, none of the shareholders pushing for inversion appear to have cited any benefit to the company besides the [reduction in its tax rate](#).<sup>25</sup> Nor has the company, in its public statements on this issue, noted any reason for a move to Switzerland besides reducing its taxes.

Walgreens paid an average of [31% in federal income taxes from 2008 to 2012](#), according to Citizens for Tax Justice.<sup>26</sup> With an inversion, its tax rate could plummet to 20%, according to equities research firms.<sup>27</sup> On the other hand CVS, a major competitor, paid a higher tax rate – 34% over the same period.<sup>28</sup> These current rates are below the 35% U.S. statutory corporate tax rate, and are in keeping with other major retailers that sell primarily in the United States.

Walgreens benefits greatly from public spending on health care, public infrastructure, and the security and stability of doing business in the United States. A corporate change of address to Switzerland (or another tax haven) would not affect these benefits of doing business here. But it would significantly reduce the amount Walgreens pays in taxes to keep our communities strong. That, in turn, will undercut its competitors – CVS, mom and pop drugstores and other retailers – who are not shirking their duty.

# MOVING OFFSHORE HURTS THE U.S. TAX BASE



When a company completes an inversion, it no longer pays U.S. taxes on its global income and instead is only responsible for paying taxes on income generated in the United States. However, post-inversion companies often take additional measures to lower their taxable income in America. Companies may engage in “earnings stripping” by loading up the U.S. subsidiary with debt, lowering taxable income. Additionally, an inversion may facilitate abusive transfer pricing practices, in which a company prices transactions between a corporate headquarters located in the United States and its related companies located in tax havens to lower the profit booked in the United States and avoid paying its fair share of taxes.<sup>29</sup>

Other companies that have undertaken inversions have achieved significantly lower U.S. tax rates. For example, U.S. drug firm Endo Health Solutions recently bought Paladin Labs, a Canadian company and used the deal to create an entirely new company registered in Ireland, where the 12.5% corporate tax rate was a key selling point touted by Endo executives. Endo management estimated operational and tax savings of \$75 million on an annual basis.<sup>30</sup>

In 2012, industrial equipment manufacturer Eaton Corporation headquartered in Ohio used its acquisition of Irish company Cooper Industries plc to re-incorporate in Ireland. The company estimated that its tax savings from this transaction would be \$160 million annually.<sup>31</sup>

While these companies and a growing number of others have taken advantage of the inversion loophole, Walgreens would likely be the first U.S. retailer to do so.<sup>32</sup> Importantly, Walgreens will still have the large majority of its sales and operations in the U.S. following the takeover of Alliance Boots.

# POLITICAL OPPOSITION TO CORPORATE INVERSIONS IS GROWING

**M**embers of both political parties have expressed distaste for the idea of American companies renouncing their incorporation in the United States to avoid paying their fair share of taxes.

[President Obama's budget](#) proposed changes that would make inversions very difficult for companies that have the majority of their operations and ownership in the United States.<sup>33</sup> Among other things, the proposal would prevent such companies from reincorporating abroad if they are owned by at least 50% of the former U.S. parent's stockholders (the current threshold is 80%). Obama would also require that the new foreign corporation be primarily managed and controlled from outside the United States so long as it has substantial U.S. operations.<sup>34</sup> Under the terms of the Alliance Boots transaction, Walgreens would likely not meet these standards for an inversion.

[Senator Charles Grassley](#) (R-IA), a senior member of the Senate Finance Committee, has said: "These corporate expatriations aren't illegal. But they're sure immoral."<sup>35</sup> Senate Finance Committee Chairman [Senator Ron Wyden](#) (D-OR) recently wrote in *The Wall Street Journal*, "while their shareholders may secure a temporary win, workers, taxpayers and this country all lose. America's tax base erodes at a cost of hundreds of millions of dollars in revenue, increasing the burden on other companies and individuals."<sup>36</sup>

Twenty senators recently introduced legislation ([S. 2360](#)) that would restrict inversions for the next two years in a manner similar to the President's proposal.<sup>37</sup> A companion bill in the House of Representatives ([H.R. 4679](#)), sponsored by Rep. Sander Levin (D-MI), would not lapse in 2016.<sup>38</sup> It would raise [\\$19.5 billion over 10 years](#), according to the Joint Committee on Taxation.<sup>39</sup>

Upon introducing the Senate bill, primary sponsor [Senator Carl Levin](#) (D-MI) said, "These transactions are about tax avoidance, plain and simple. The Treasury is bleeding red ink, and we can't wait for comprehensive tax reform to stop the bleeding. Our legislation would clamp down on this loophole to prevent corporations from shifting their tax burden onto their competitors and average Americans while Congress is considering comprehensive tax reform."<sup>40</sup>

# CONCLUSION: WALGREENS AT A CROSSROADS



Walgreens is at a crossroads. It can reincorporate in Switzerland, paving the way for possible massive tax avoidance by shifting its profits to a tax haven, or it can remain an Illinois company with a commitment to the thousands of communities in which it operates.

Walgreens commitment to our communities and critical public services we all rely on is in question when it contemplates moving offshore to avoid paying its fair share of taxes.

As a retail company that trades on its trusted brand, Walgreens knows that its customers do not want their corner drugstore to send the money they spend on toothpaste to a tax haven.

Corporate tax avoidance is facing growing opposition this year as Walgreens executives and then the company's shareholders make critical decisions about whether Walgreens will continue to be an American corporation. For the company, it is a public relations dilemma and potentially a challenge to its business.

When Walgreens abandons America, will American consumers abandon Walgreens? ■

# APPENDIX I: METHODOLOGY FOR CALCULATING TAX IMPACT OF A WALGREENS INVERSION

To project the tax impact of a Walgreens inversion three equities research firms estimates were used. The estimates are quantified in terms of the impact on earnings per share (EPS). We multiply the EPS impact by the number of outstanding shares expected in FY16, which gives a total amount of tax savings. Reduced taxes mean reduced expenses for Walgreens, and each dollar of tax savings correlates to a dollar of increased profit.

The three securities firms have stated the following:

- **UBS:** “A successful immediate tax inversion would up FY16 EPS from \$5.15 to \$5.68.”<sup>41</sup> The difference between \$5.15 and \$5.68 is \$0.53.
- **Deutsche Bank:** “We estimate the potential benefit from tax inversion is \$0.55 to \$0.70 [EPS], with greater upside if the final tax rate is closer to 20%.”<sup>42</sup> The midpoint of this range is \$0.625 EPS.
- **JP Morgan North America Equity Research:** “However, should the company be successful in a tax inversion, we estimate that every 1% reduction in the combined tax rate can drive a nearly 1.5% benefit to EPS.<sup>43</sup> As such, a reduction from a ~32% blended tax rate to a hypothetical 20% rate could drive a ~18% increase in annual EPS.” Using a low estimate of \$5 EPS in FY 2016, 18% benefit translates into a benefit of \$.90 EPS.

We multiply the earnings per share figure by the number of outstanding shares expected in 2016 to extrapolate a total dollar figure for tax savings. We then grow that amount by 10% each year over five years, which reflects the lower end of earnings growth predicted by the three equities analysts.

<b>Analyst</b>	<b>2016 EPS Impact</b>		<b>EPS Impact * 1.1 Billion Shares<sup>47</sup></b>
<b>UBS</b>	\$0.53	Difference between \$5.15 and \$5.68	\$583 million
<b>Deutsche Bank</b>	\$0.625	Mid-point of range from \$0.55 - \$0.77	\$688 million
<b>JP Morgan</b>	\$0.90	18% EPS benefit of \$5.00 EPS = \$0.90	\$990 million
		Average of analysts' estimates for 2016	<b>\$754 million</b>
		2017 impact with 10% earnings growth	\$829 million
		2018 impact with 10% earnings growth	\$912 million
		2019 impact with 10% earnings growth	\$1,003 million
		2020 impact with 10% earnings growth	\$1,103 million
		<b>Total tax impact over five years</b>	<b>\$4,600 million</b>

# APPENDIX II: PAY SUBSIDIES AMONG WALGREENS TOP EXECUTIVES, 2009 - 2013

For a spreadsheet showing the basis for the calculations in the table, click [this link](#).

Years Analyzed	Executive	Position	Total Taxable Compensation in Year Surveyed	Portion of Compensation that is "Performance-based"	Value of Walgreens Executive Pay Subsidy
5	Gregory Wasson	President & Chief Executive Officer	\$24,537,206	\$16,704,122	\$5,846,443
5	Mark A. Wagner	President, Community Management	\$11,266,175	\$6,266,175	\$2,193,161
3	Kermit Crawford	President, Pharmacy, Health and Wellness	\$6,828,363	\$3,828,363	\$1,339,927
1	Thomas J. Sabatino, Jr.	Executive Vice President, General Counsel and Corporate Secretary	\$1,616,241	\$616,241	\$215,684
1	Joseph C. Magnacca	President, Daily Living Products and Solutions	\$2,359,117	\$168,717	\$59,051
2	Timothy J. Theriault	Senior Vice President and Chief Information Officer	\$2,988,334	\$688,334	\$240,917
2	Stanley B. Blaylock	Senior Vice President and President of Walgreens Health Services	\$3,229,805	\$500,496	\$175,174
2	George J. Reidel	Senior Vice President, Pharmacy Innovation and Purchasing	\$3,455,462	\$727,023	\$254,458
1	Kathleen Wilson-Thompson	Senior Vice President and Chief Human Resources Officer	\$1,135,426	0	0
1	Jeffrey A. Rein	Former Chairman and Chief Executive Officer	\$3,439,630	\$2,000,029	\$700,010
1	Alan G. McNally	Chairman and Former Acting CEO	\$1,050,262	\$50,262	\$17,592
<b>TOTAL</b>			<b>\$61,905,921</b>	<b>\$31,549,762</b>	<b>\$11,042,417</b>

Analysis provided by Sarah Anderson, director of the Global Economy Project, Institute for Policy Studies.  
Source: Walgreen Co. proxy statements (2009-2013) filed with the Securities and Exchange Commission.

# APPENDIX III: PAY SUBSIDIES SOURCES & METHODOLOGY

## 1. *Walgreens Top Executives*

Walgreens' corporate proxy statements for 2009 to 2013 accessed in May 2014. All executives listed in the proxy statements were included except the chief financial officers, as their compensation is currently exempted from the relevant tax loophole (see #3 below).

## 2. *Total Taxable Compensation*

Analysis based on Walgreen Co. corporate proxy statements. To analyze the tax implications, we included forms of pay that were taxable for the corporation in the years surveyed: salary, bonus, non-equity incentives, perks and the value of options realized and vested stock. Corporations do not deduct the expense of stock options until the year in which they are exercised and do not deduct the expense of stock award grants until the year they "vest" (i.e., become the property of the employee).

## 3. *Portion of compensation that is "performance-based"*

Internal Revenue Code Section 162(m) imposes a \$1 million deduction limit for compensation to a company's CEO and its three other highest-paid executive officers (excluding the CFO), unless the compensation is "performance-based" and provided under a plan that has been approved by the shareholders. The following is an analysis of how components of compensation packages are treated under this section of the tax code:

**Bonus:** Although we use the term "bonus" in the body of this report to refer to performance pay, the specific type of compensation labeled "bonus" in the summary compensation table of corporate proxy statements is generally not considered performance-based. This is because the type of bonus reported here is typically a cash payout awarded at the board's discretion rather than pursuant to a written plan approved by shareholders, one of the conditions for qualifying as performance-based under Section 162(m). At Walgreens, none of the annual cash bonuses were configured to be 162(m)-compliant.

**Non-equity incentive plan compensation:** Similar to a bonus, but paid under a written plan and thus considered performance-based under Section 162(m).

**Stock options:** Considered performance-based under Section 162(m). We included the value of options exercised, rather than the estimated value of a stock options grant, since options are not taxable until an executive exercises them.

**Stock grants:** Considered performance-based under 162(m) only when tied to specific performance benchmarks. Time-based restricted stock units do not qualify for the performance-based exemption. Like stock options, stock grants are not taxable in the year they are granted, but rather when they vest. When proxy statements did not clarify whether stock grants had been structured to qualify for a deduction under 162(m), we did not include them in our calculations of executive pay subsidies.

Salary, perks, pensions and nonqualified deferred compensation are not considered performance-based under Section 162(m).

#### 4. ***Value of Walgreens executive pay subsidy***

Corporations can deduct up to \$1 million of each executive's compensation whether it qualifies as performance-based or not. Thus, when executives earned less than \$1 million in non-performance-based pay, we deducted the difference from the performance pay total. To compute the tax break on qualifying performance pay, we applied the federal corporate tax rate of 35 percent.

As with most tax matters, there is some gray area in the tax code when it comes to deductions for executive compensation. Some companies note in their proxy statements that the IRS may challenge some of a firm's claimed deductions. Unfortunately, due to lack of transparency in corporate taxation, such challenges are not public information.

# ENDNOTES

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2. 26 U.S.C. § 7874; 26 C.F.R. § 1.7874-3T.
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