Tax Havens and the Taxation of Transnational Corporations

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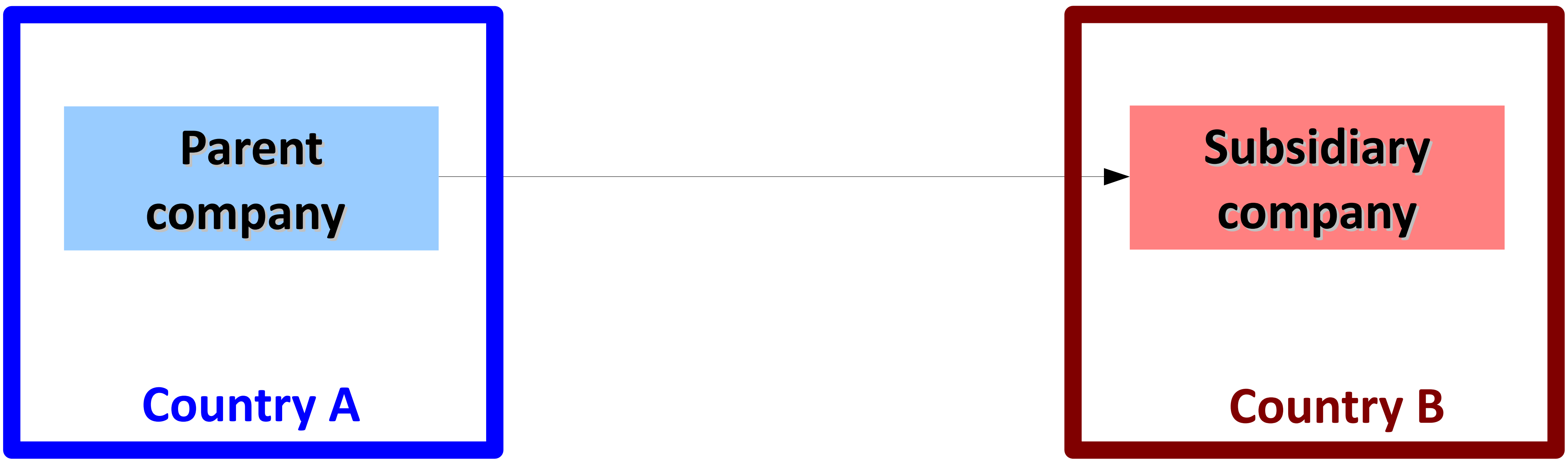
Taxation of corporations (in Germany)

Taxation depends on:

1. Tax rate

2. Tax base: normally only profits taxed, i.e. turnover minus deductible costs

Transnational corporations (TNCs): Who gets taxes?



Problem: What is economic value and where is it created?

Tax havens / Secrecy jurisdictions / Offshore centers

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Seychelles offshore structures can provide you with many investment opportunities and tax advantages. Most common reasons for selecting Seychelles are:

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- Tax efficiency **= 1. (ALMOST) NO TAXES**
- Limited liability
- Minimum compliance requirements
- Privacy
- Asset protection **= 2. INTRANSPARENCY**
- Minimum administrative requirements **= 3. NO/LITTLE REGULATION**
- Flexible company legislation
- Many opportunities for international business

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Source: http://www.seychellescompany.com

Production shift

- Production shifted to low-tax countries (or preferential tax zones)
- Revenue losses: states cannot tax beneficiaries, tax competition
- Unfairness: transnational companies favored
- Wrong incentives: investments determined by taxes, not efficiency

Parent company

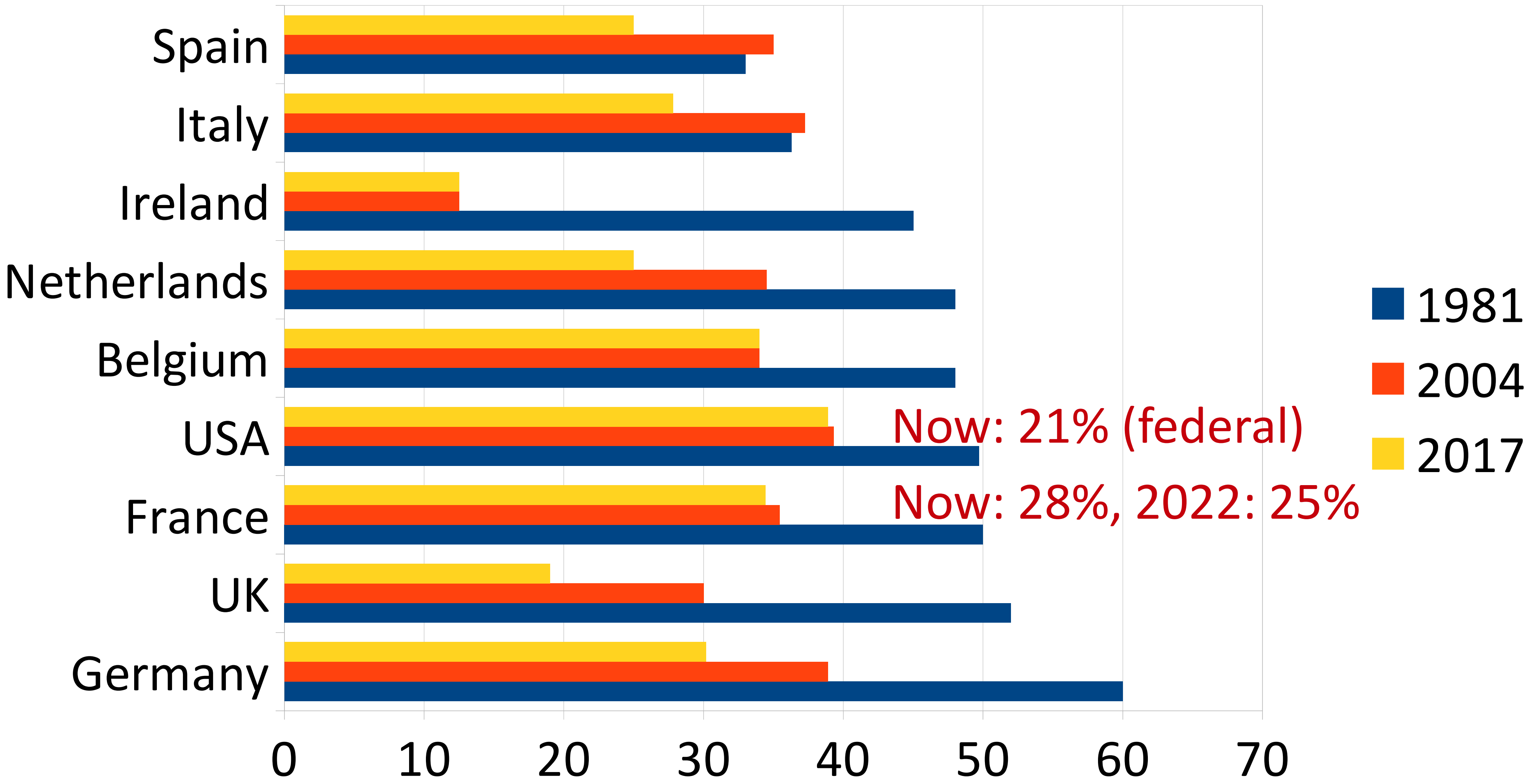
Country A:
high corporate tax

Subsidiary company

Country B:
low corporate tax

Photo: Tiia Monto / Wikimedia Commons

Tax competition: tax rates for corporate profits



But: Tax base broadened, thus revenues much more stable than rates

(see e.g. Kumar, M. / Quinn, D.: Globalization and Corporate Taxation, IMF Working Paper 12/252, Oct. 2012)

However: Profits risen, thus taxes should have; more companies

Source graph: OECD

How many companies fit into ONE house?

200.000

1209 Orange Street, Wilmington (Delaware)

Source: www.guardian.co.uk

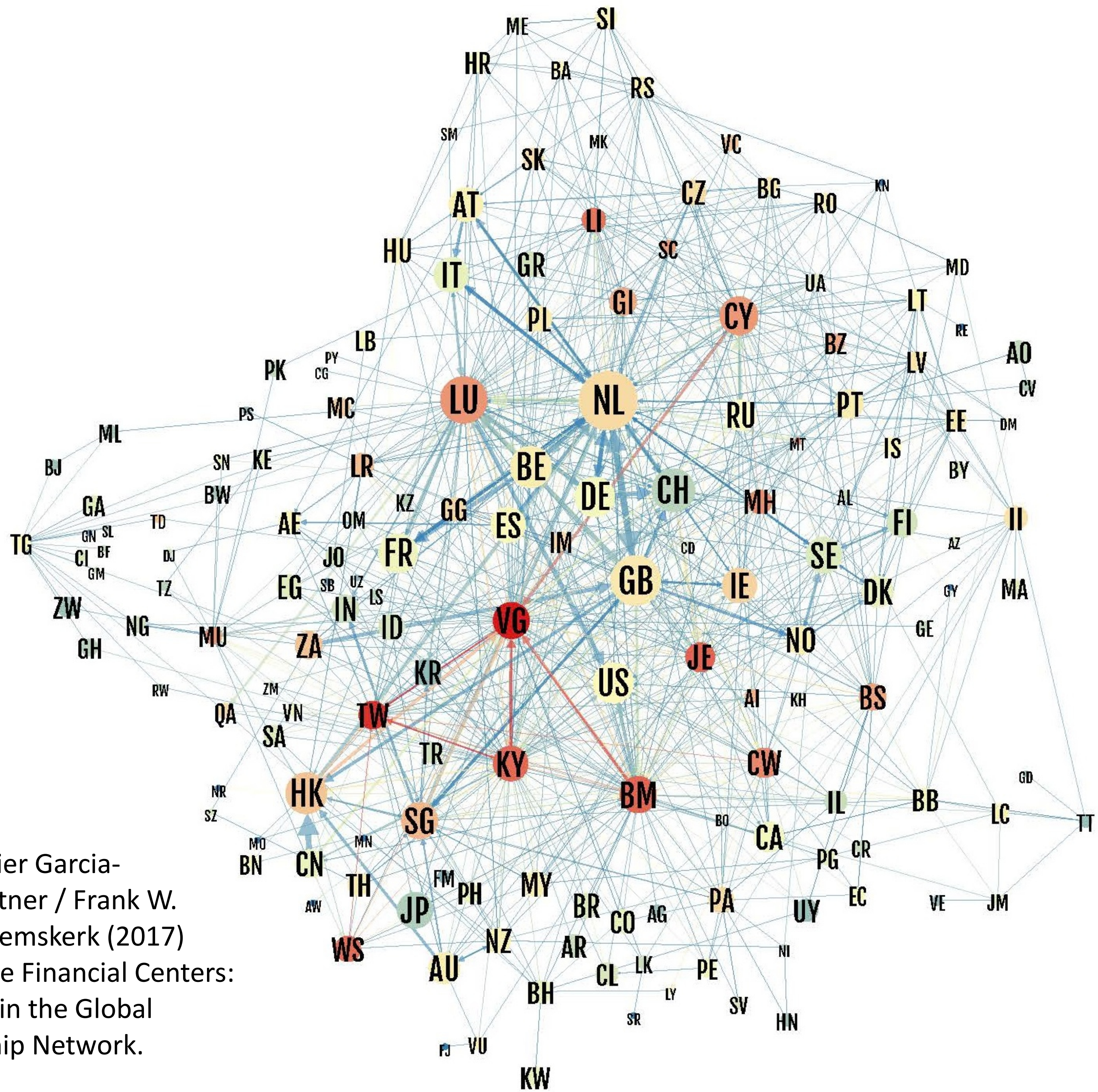
Foreign Direct Investments (2014)

Ingoing	USD million
Netherlands	4.013.479
USA	2.901.059
Luxembourg	2.345.920
China	2.331.755
UK	1.744.718
Hong Kong	1.333.687
Germany	830.662
Singapur	806.768
Switzerland	798.624
France	729.147

Outgoing	USD million
USA	4.920.653
Netherlands	4.833.186
Luxembourg	2.979.976
UK	1.513.125
Germany	1.415.863
China	1.310.133
France	1.279.089
Japan	1.169.075
Switzerland	1.064.130
Canada	714.555

Source: IMF

The spider-web of corporate ownership



Quelle: Quelle: Javier Garcia-Bernardo / Jan Fichtner / Frank W. Takes / Eelke M. Heemskerk (2017) Uncovering Offshore Financial Centers: Conduits and Sinks in the Global Corporate Ownership Network.

Figures on tax avoidance

- **General:** difficult to estimate due to
  - lack of transparency of TNC's operations, holdings etc.
  - line between legal and illegal practices hard to draw

- **Global:**
  - OECD (2015): 100-240 billion USD tax loss annually
  - Cobham/Jansky (2017): 500 billion USD tax loss annually

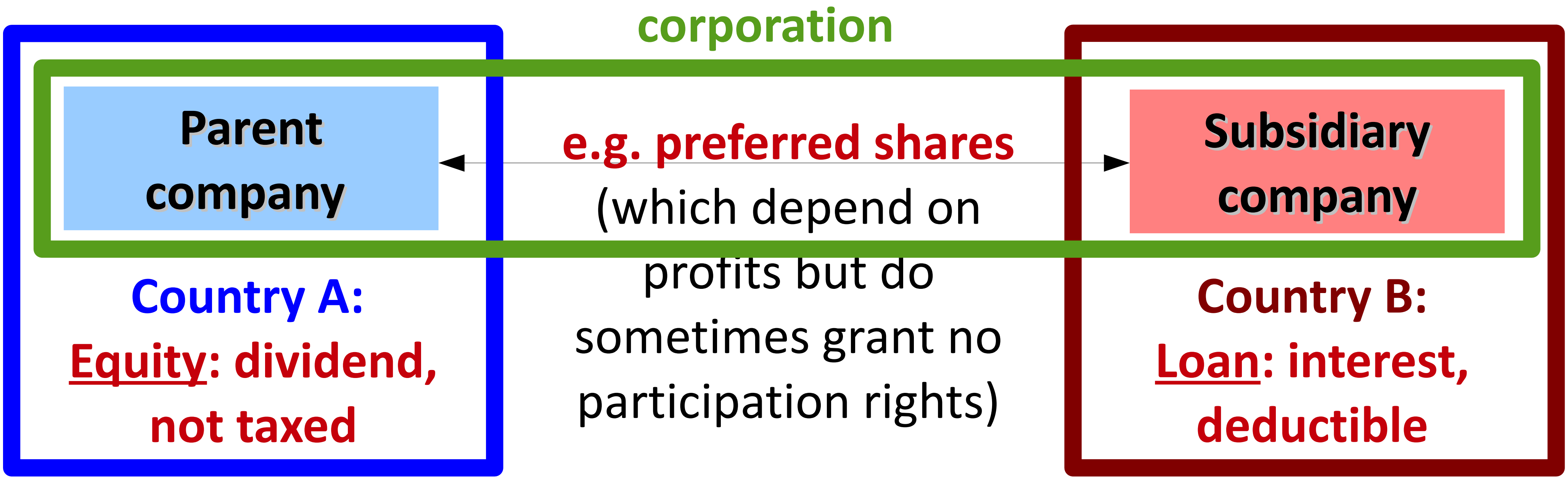
- **Developing Countries:**
  - UNCTAD (2015): 100 billion USD tax loss annually

Paper shift (1): transfer pricing (abuse)

- Large part of international trade within corporations
- Goods and intellectual property rights (licences, patents etc.) sold/bought below/over appropriate price
- Also possible with credits/loans
- Use of shell companies without real economic activity

Paper shift (2): hybrid mismatch

- Abuse of different legal views in two different countries, resulting in double non-taxation



Example 1: SAB Miller or Who pays taxes?

Shop-keeper Marta from Accra (Ghana):

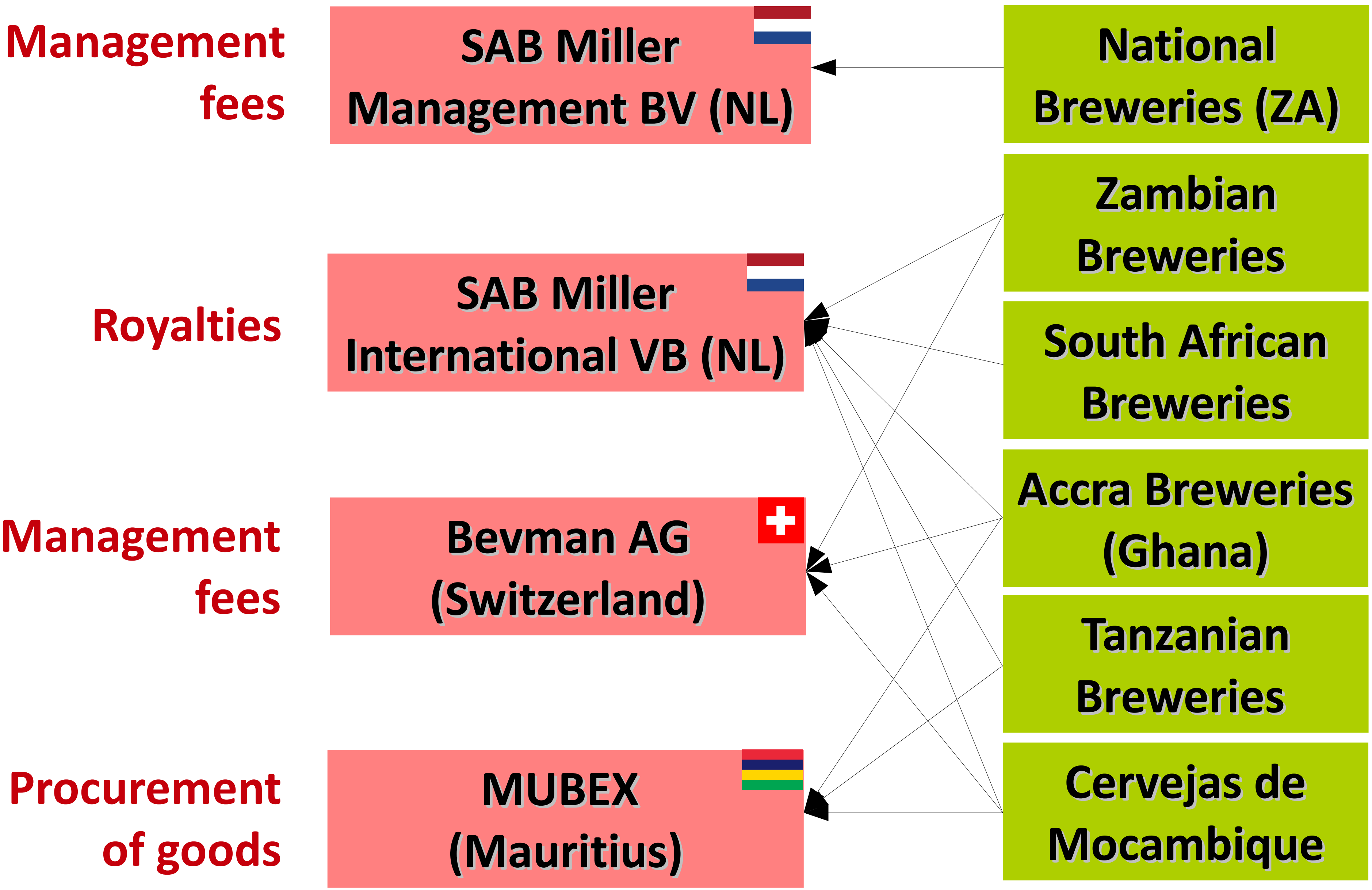
£47 taxes (2009)

Accra Brewery (subsidiary of SAB Miller):

£0 taxes (2009)

Source: Action Aid

Example 1: SAB Miller – holding structure



Source: Martin Hearson, Action Aid (2011): Country-by-country reporting and tax avoidance: two case studies.

Example 2: Starbucks or Switzerland's commodities

Source: European Commission

Example 3: Glencore or The Ressource Course

GLENCORE

Glencore International AG (Zug, Switzerland)

100%

Glencore Finance (Bermuda)

81,2%

First Quantum Minerals Ltd. (Canada)

FIRST QUANTUM MINERALS LTD.

100%

Skyblue enterprise inc. (Virgin Islands)

18,8%

Carlisa Investments (Virgin Islands)

90%

ZCCM (Zambian state owned company)

ZCCM Investment Holdings Plc

ZCCM-IH

10%

Mopani Copper Mine (Zambia)

Source: eurodad Presentation (2011): Country-by-country reporting and tax avoidance; Photo: photosmith2011/Flickr

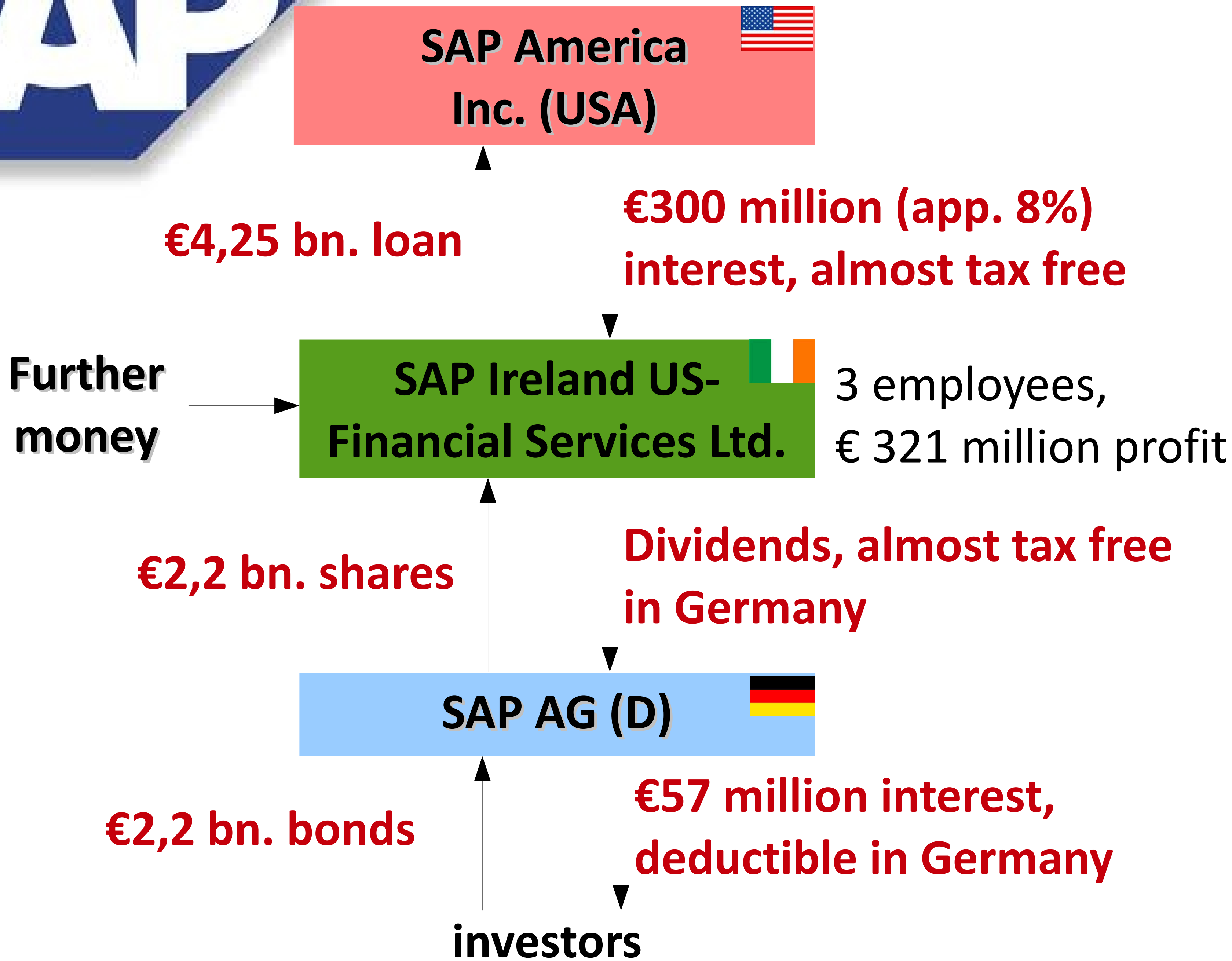
Example 3: Glencore (2) – investigating TNCs

Leaked 2011 audit (draft) commissioned by Zambia found various tax evasion elements related to Mopani Copper Mines:

- Unreasonable high operating and labour costs: „At least USD 50 million of the USD 90 million is thus unexplainable.“
- Unreasonable low production: „not to be trusted that Mopani has an extraction %-age of cobalt that is half that of other producers.“
- Copper/cobalt sold at deflated prices compared to London Metal Exchange prices (for MCM sales to Glencore International)
- Unreasonable use of derivatives: „The hedging pattern ... is more equal to moving taxable revenue out of the country than true hedging.“

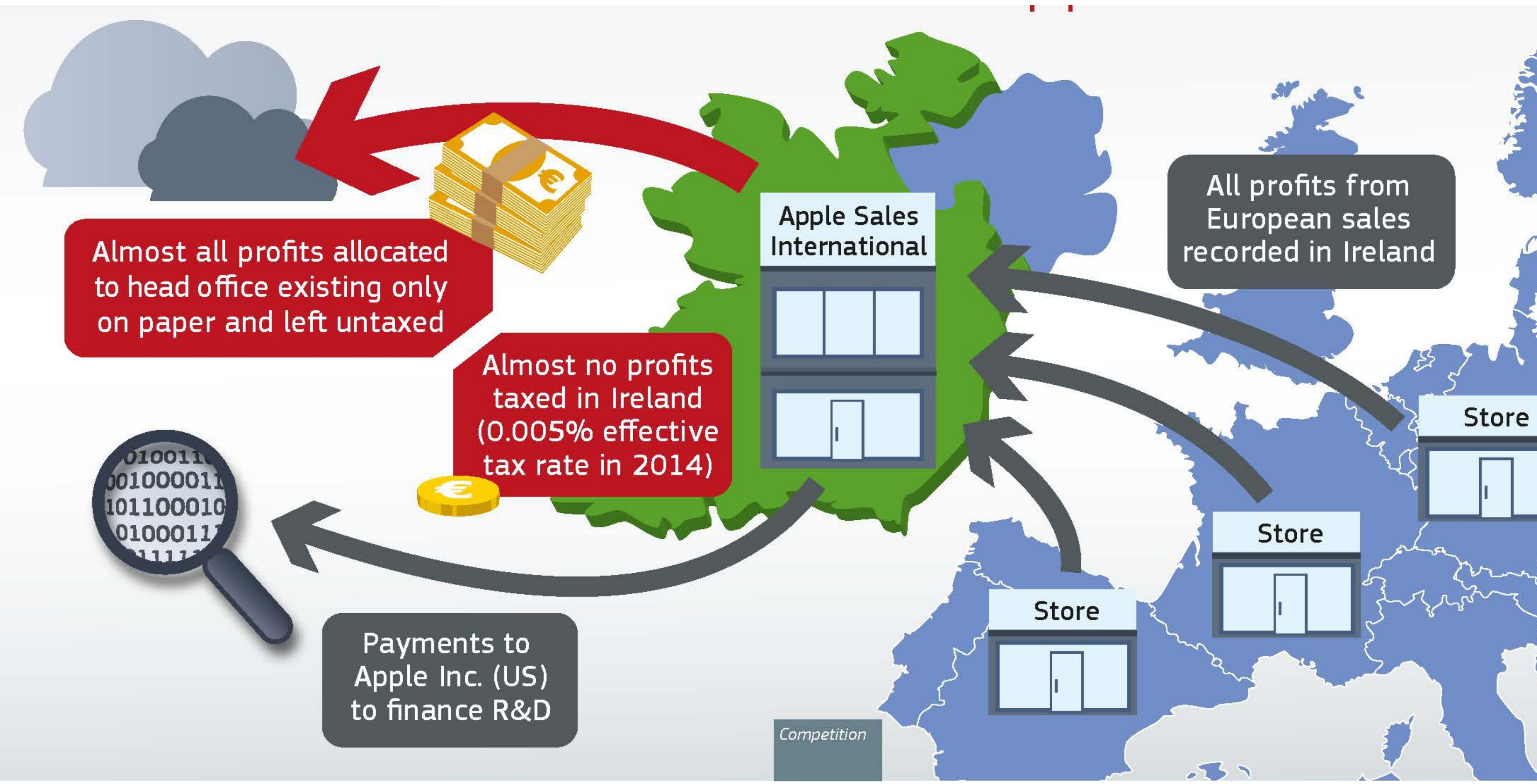
ActionAid: Estimated tax loss of $175 million from 2003 to 2008; Glencore denies wrongdoing; 2018: Zambia increases mining taxes

Example 4: SAP or How to lend yourself expensively



Source: Tom Bergin (2013): How a German tech giant trims its U.S. tax bill. Reuters.

Example 5: Apple or The tax Nirwana



EC 2016: Ireland granted illegal tax benefits of €13bn to Apple

2014 Apple seeks alternatives to Ireland and asks tax haven law firm Appleby: "Is there a credible opposition party or movement that may replace the current government?" - Finally, Jersey was chosen but details unknown

Sources: European Commission, Süddeutsche Zeitung („Paradise Papers“)

Solutions: Who rules the global tax world?

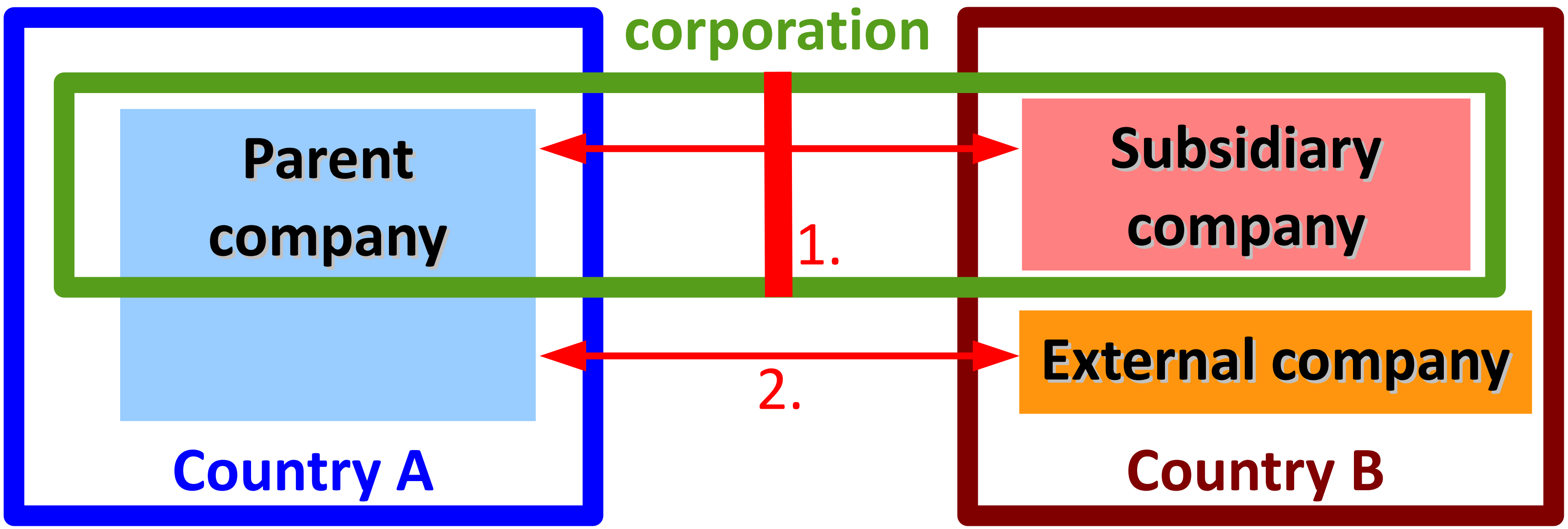
Dominant after World War II, Governmental committee

G20/OECD project against “Base Erosion and Profit Shifting” (BEPS), results approved by G20 in 2015, since 2016 “inclusive framework” with now 125 countries

Predecessor League of Nations was dominant before World War II but UN now only has Expert Committee

Solutions (1): Arm's length principle (ALP)

- 1. Separation principle: subsidiaries as separate taxable entities
- 2. Arm's length principle: internal prices equal to external ones



- International standard: OECD, UN, Germany ("Foreign Tax Law")
- Problem: Comparable prices hard to find for intellectual property rights but also loans; separation contradicts integrated value chain
- BEPS: More substance required, for interest: cap 10-30% of EBITDA

Solutions (2): Double Taxation Agreements (DTAs)

- General:

  - Mutual recognition of taxes to prevent double taxation, but now also increasingly dealing with double non-taxation

  - Subsidiaries as separate entities (but only taxed if they count as permanent establishment), arm's length principle

  - If profits taxed in one country, taxes can be deducted in other („credit method“) or are tax-free there („exemption method“)

- Model Agreements: OECD and UN; former based on OECD model, but better for developing countries, e.g. more in favor of source taxation and broader definition of permanent establishments

- Globally: about 3.000 bilateral tax treaties

- BEPS requires test to verify the economic substance of an enterprise, since 2017 in first multilateral agreement (now 85 states)

Solutions (3): Anti-avoidance rules (from BEPS project)

- Harmful tax practices: E.g. if one country grants tax benefits for specific income like patent royalties: BEPS requires a real economic activity like research linked to any tax benefit (better than before but will still lead to further harmful tax competition); since 2015 various new „BEPS conform“ benefit regimes: undermine corporate taxes
- Hybrid mismatch arrangements: If one state does not tax, other can do; EU changed law on dividends in 2014 but not law on royalties
- Controlled Foreign Companies (CFC) rules: "shell companies" are disregarded for tax purposes; weak BEPS result due to US and UK pressure; CFC rules exist in many countries but within EU hardly applicable (2005 "Cadbury Schweppes" court ruling)
- Avoidance of permanent establishment (PE) status: PE condition for taxation; until recently certain activities exempted (e.g. warehouses – like Amazon's), now no activity per se excluded, only if auxiliary

Solutions (4): (Public) country-by-country reporting

- General: Reporting of tax payments and corporate figures (assets, staff, sales etc.) that can serve as tax base, by each country
- Public reports for commodity firms (USA, EU, Extractives Industries Transparency Initiative) and banks (EU)
- BEPS: Reporting, but only for authorities, not public, started 2016

A model template for the Country-by-Country Report

Table 1. Overview of allocation of income, taxes and business activities by tax jurisdiction

Name of the MNE group:
Fiscal year concerned:

Tax Jurisdiction	Revenues			Profit (Loss) Before Income Tax	Income Tax Paid (on cash basis)	Income Tax Accrued – Current Year	Stated capital	Accumulated earnings	Number of Employees	Tangible Assets other than Cash and Cash Equivalents
	Unrelated Party	Related Party	Total							

GUIDANCE ON TRANSFER PRICING DOCUMENTATION AND COUNTRY-BY-COUNTRY REPORTING © OECD 2014

Solutions (4): Country-by-country reporting example

Mopani Copper Mine: Zambian EITI information on mines:

ZMK million	Mineral Royalty	Corporate Tax	Other	Total
Kashanshi	72.023	372.571	365.592	810.186
Konkola	58.226	883	246.713	315.822
Mopani	76.012	0	108.979	184.991

Mopani Copper Mine: Information from Grant Thornton audit:

Year	Mopani Staff	
	Costs (USD million)	Numbers
2005	104	9.000
2007	209	9.000

Solutions (5): System change through Unitary Taxation

- Corporation with all its subsidiaries treated as one unit/entity, with country-by-country reporting
- Profit of entire corporation distributed to countries according to apportionment formula which can relies on weighted features such as assets, wages, sales
- BEPS/G20 exluded as option
- Exists at state level in USA, Canada, e.a.
- EU: Proposal for Common Consolidated Corporate Tax Base (CCCTB) by European Commission in 2016 (after a previous proposal from 2011 failed)

Further reading: Piciotto, S. (2012): Towards Unitary Taxation of Transnational Coporations. Tax Justice Network.

Current debates: digital economy and minimum tax

- Digital economy: BEPS Reports 2015/2018 with almost no binding decisions, OECD will propose measures 2020, national measures:

VAT (for foreign services)	e.g. Japan 8 %, Australia 2017, South Korea 2015
PE: No activity per se out	BEPS decision, OECD tax treaty
PE: Digital presence	e.g. Saudi Arabia 2015, Italy 2017, EU proposal
Source taxes	e.g. Italy 2017 25 %
Equalization levy (similar to VAT but taxes paid by corporations)	e.g. France, India 2016 (6 %), UK 2015 (25 %), Australia 2017 (40 %), EU proposal (3%)

- Minimum tax: New US tax law, Germany champions at EU and OECD

Thank you
for your attention!

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