Tax Havens and the Taxation of Transnational Corporations

Markus Henn
Board Member, Netzwerk Steuergerechtigkeit Deutschland
Contact: markus.henn@weed-online.org

7 January 2019, Berlin, HWR
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?
Seychelles offshore structures can provide you with many investment opportunities and tax advantages. Most common reasons for selecting Seychelles are:

- Political and economic stability
- Tax efficiency
- Limited liability
- Minimum compliance requirements
- Privacy
- Asset protection
- Minimum administrative requirements
- Flexible company legislation
- Many opportunities for international business

= 1. (ALMOST) NO TAXES

= 2. INTRANSPARENCY

= 3. NO/LITTLE REGULATION

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
Tax competition: tax rates for corporate profits


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)

<table>
<thead>
<tr>
<th>Ingoing</th>
<th>USD million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Netherlands</td>
<td>4,013,479</td>
</tr>
<tr>
<td>USA</td>
<td>2,901,059</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>2,345,920</td>
</tr>
<tr>
<td>China</td>
<td>2,331,755</td>
</tr>
<tr>
<td>UK</td>
<td>1,744,718</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>1,333,687</td>
</tr>
<tr>
<td>Germany</td>
<td>830,662</td>
</tr>
<tr>
<td>Singapour</td>
<td>806,768</td>
</tr>
<tr>
<td>Switzerland</td>
<td>798,624</td>
</tr>
<tr>
<td>France</td>
<td>729,147</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Outgoing</th>
<th>USD million</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>4,920,653</td>
</tr>
<tr>
<td>Netherlands</td>
<td>4,833,186</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>2,979,976</td>
</tr>
<tr>
<td>UK</td>
<td>1,513,125</td>
</tr>
<tr>
<td>Germany</td>
<td>1,415,863</td>
</tr>
<tr>
<td>China</td>
<td>1,310,133</td>
</tr>
<tr>
<td>France</td>
<td>1,279,089</td>
</tr>
<tr>
<td>Japan</td>
<td>1,169,075</td>
</tr>
<tr>
<td>Switzerland</td>
<td>1,064,130</td>
</tr>
<tr>
<td>Canada</td>
<td>714,555</td>
</tr>
</tbody>
</table>

Source: IMF
The spider-web of corporate ownership

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

Country A: high tax → costs
Country B: low tax → profits
Paper shift (2): hybrid mismatch

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

**Country A:**
- **Equity:** dividend, not taxed

**Country B:**
- **Loan:** interest, deductible

**Parent company**
- **E.g. preferred shares** (which depend on profits but do sometimes grant no participation rights)

**Subsidiary company**
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

Management fees
- SAB Miller Management BV (NL)
- National Breweries (ZA)
- Zambian Breweries
- South African Breweries
- Accra Breweries (Ghana)
- Tanzanian Breweries
- Cervejas de Mocambique

Royalties
- SAB Miller International VB (NL)

Management fees
- Bevman AG (Switzerland)

Procurement of goods
- MUBEX (Mauritius)

Example 2: Starbucks or Switzerland's commodities

Starbucks obtained illegal tax advantage from the Netherlands

Source: European Commission
Example 3: Glencore or The Ressource Course

Glencore International AG (Zug, Switzerland) → 100% → Glencore Finance (Bermuda) → 81,2% → Carlisa Investments (Virgin Islands) → 90% → Mopani Copper Mine (Zambia)

First Quantum Minerals Ltd. (Canada) → 100% → Skyblue enterprise inc. (Virgin Islands) → 18,8% → ZCCM (Zambian state owned company) → 10%
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

SAP AG (D)

SAP America Inc. (USA)

- €2,2 bn. bonds
- €300 million (app. 8%) interest, almost tax free

SAP Ireland US-Financial Services Ltd.

- €4,25 bn. loan
- 3 employees, €321 million profit
- €2,2 bn. shares
- Dividends, almost tax free in Germany

SAP AG (D)

- €4,25 bn. loan
- €57 million interest, deductible in Germany

 investors
Example 5: Apple or The tax Nirwana

Almost all profits allocated to head office existing only on paper and left untaxed

Almost no profits taxed in Ireland (0.005% effective tax rate in 2014)

Payments to Apple Inc. (US) to finance R&D

Apple Sales International

All profits from European sales recorded in Ireland

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

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

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

<table>
<thead>
<tr>
<th>Tax Jurisdiction</th>
<th>Revenues</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Unrelated Party</td>
<td>Related Party</td>
<td>Total</td>
<td>Profit (Loss) Before Income Tax</td>
<td>Income Tax Paid (on cash basis)</td>
<td>Income Tax Accrued – Current Year</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

name of the MNE group: Fiscal year concerned:

<table>
<thead>
<tr>
<th>Tax Jurisdiction</th>
<th>Revenues</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Unrelated Party</td>
<td>Related Party</td>
<td>Total</td>
<td>Profit (Loss) Before Income Tax</td>
<td>Income Tax Paid (on cash basis)</td>
<td>Income Tax Accrued – Current Year</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Mopani Copper Mine: Zambian EITI information on mines:

<table>
<thead>
<tr>
<th>ZMK million</th>
<th>Mineral Royalty</th>
<th>Corporate Tax</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kashanshi</td>
<td>72.023</td>
<td>372.571</td>
<td>365.592</td>
<td>810.186</td>
</tr>
<tr>
<td>Konkola</td>
<td>58.226</td>
<td>883</td>
<td>246.713</td>
<td>315.822</td>
</tr>
<tr>
<td>Mopani</td>
<td>76.012</td>
<td>0</td>
<td>108.979</td>
<td>184.991</td>
</tr>
</tbody>
</table>

### Mopani Copper Mine: Information from Grant Thornton audit:

<table>
<thead>
<tr>
<th>Year</th>
<th>Mopani Staff</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Costs (USD million)</td>
</tr>
<tr>
<td>2005</td>
<td>104</td>
</tr>
<tr>
<td>2007</td>
<td>209</td>
</tr>
</tbody>
</table>
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 rely on weighted features such as assets, wages, sales
- BEPS/G20 excluded 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)

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:

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

• **Minimum tax:** New US tax law, Germany champions at EU and OECD
Thank you for your attention!

www.weed-online.org
www.netzwerk-steuergerechtigkeit.de

markus.henn@weed-online.org