Tax Havens and the Taxation of Transnational Corporations

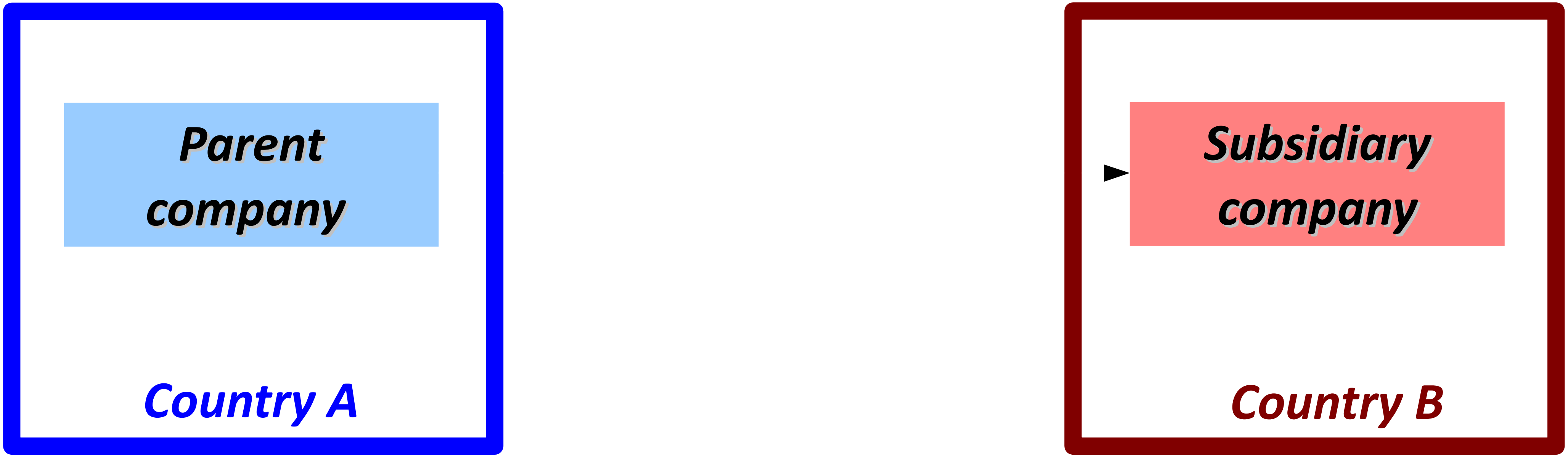
weed

Markus Henn
Project Officer Financial Markets,
World Economy, Ecology & Development – WEED
Coordinator, *Tax Justice Network Germany*
Contact: markus.henn@weed-online.org

tax justice network

9 January 2013, Berlin, HWR

Transnational corporations (TNCs): Who gets taxes?



How many companies fit into ONE house?

200.000

1209 Orange Street, Wilmington (Delaware)

source: www.guardian.co.uk

Tax havens / Secrecy jurisdictions / Offshore centers

Seychelles Company

Privacy Policy IBC FAQ Contact us Downloads

Offshore News | Our Services | About Seychelles | Offshore Information

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

= 1. (ALMOST) NO TAXES

- Minimum compliance requirements
- Privacy
- Asset protection

= 2. INTRANSPARENCY

- Minimum administrative requirements
- Flexible company legislation

= 3. NO/LITTLE REGULATION

- Many opportunities for international business
- Investment opportunities

Other attractive features include modern and developed trust legislation, efficient aircraft and shipping registries, provisions for the formation and domiciliation of mutual funds and captive insurance companies, and Free Trade Zone for manufacturing and service companies, benefiting from zero taxation, application procedures and availability of work and resident permits.

source: http://www.seychellescompany.com tax justice network

Financial Secrecy Index

Home | Rankings | Significance | Data | About TJN | News | Links | Contact | Donate

Latest Blogs

- Whose development is it? An investigation into the Mozal smelter in Mozambique
- From Third World Network: Siphoning the South's Resources
- Our latest Taxcast
- CTJ: Poorest 60% of Americans Get Just 18% of the Tax Cuts in the Fiscal Cliff Deal
- Quote of the day - money laundering

Financial Secrecy Index

2011 Results

Download: PDF | Excel

RANK	Secrecy Jurisdiction	FSI - Value	Secrecy Score	Global Scale Weight
1	Switzerland	1879.2	78	0.061
2	Cayman Islands	1646.7	77	0.046
3	Luxembourg	1621.2	68	0.131
4	Hong Kong	1370.7	73	0.042
5	USA	1160.1	58	0.208
6	Singapore	1118.0	71	0.031
7	Jersey	750.1	78	0.004
8	Japan	693.6	64	0.018
9	Germany	669.8	57	0.046
10	Bahrain	660.3	78	0.003

source: www.financialsecrecyindex.com

$1-1,6 trillion

illicit financial flows per year

growth since 1990ies: 9 percent per year

$350-900 USD per year from developing countries

$21-32 trillion hidden in tax havens

Sources: TJN / Raymond Bayker, GFI

Production shift

- ***Production shifted to low-tax countries*** (or preferential tax zones)
- ***Revenue losses:*** states cannot tax beneficiaries, tax competition
- ***Inequality:*** big and transnational companies favoured
- ***Wrong incentives:*** investments determined by tax advantages

Parent company

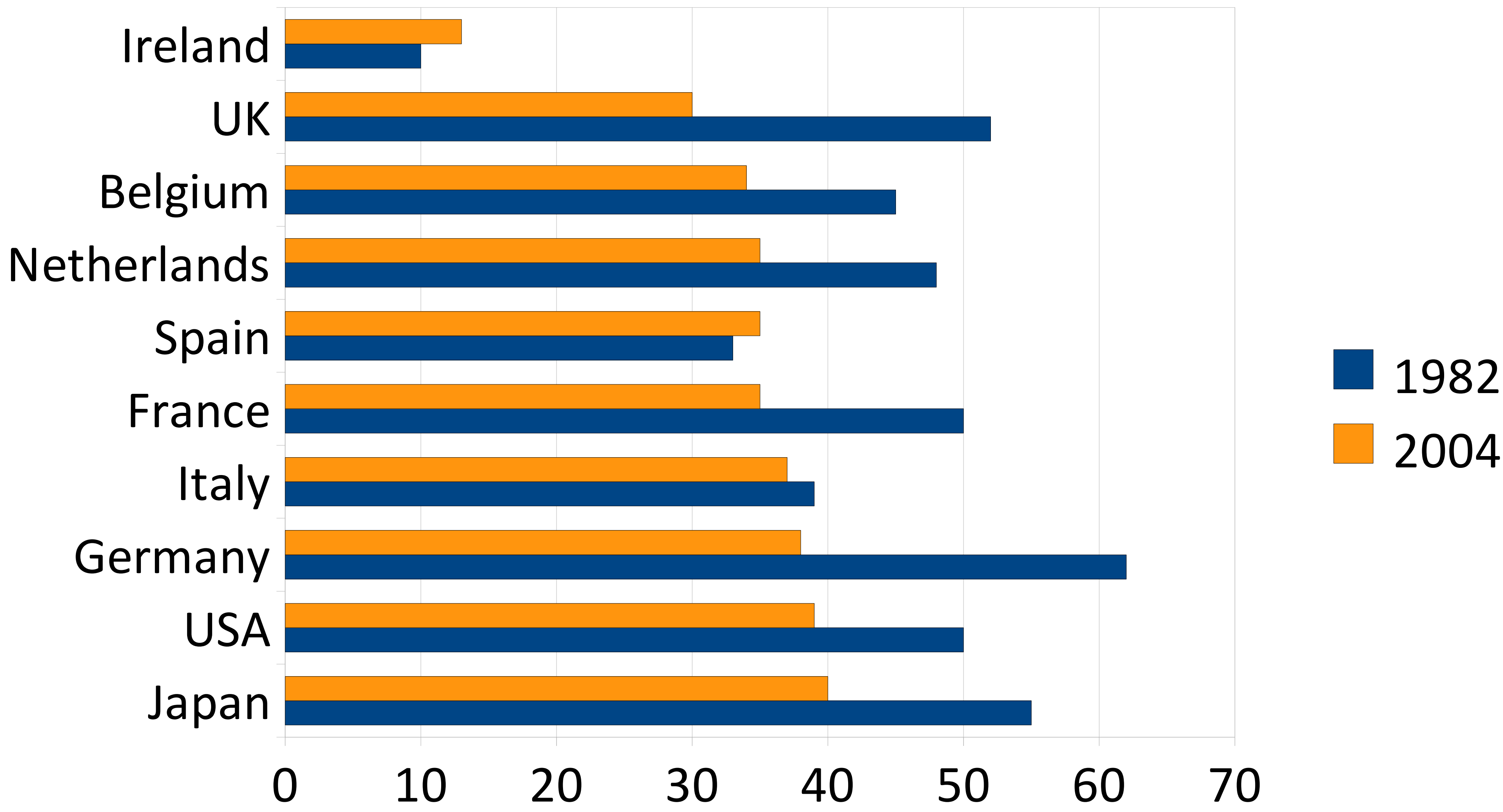
Country A:
high corporate tax

Subsidiary company

Country B:
low corporate tax

Photo: Tiia Monto / Wikimedia Commons

Tax competition: tax rates for corporate profits

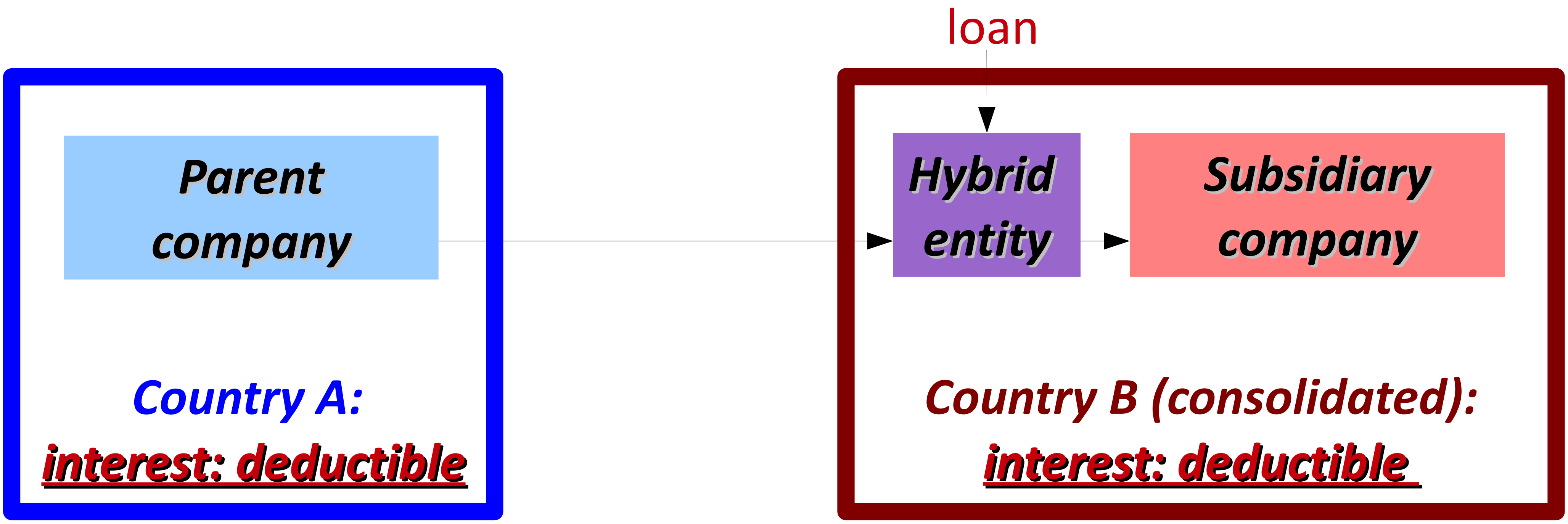


But: Tax base broadened, thus revenues more stable than rates suggest

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

Paper shift: hybrid entity mismatch

- Abuse of entities' different treatment: One country (B) treats a hybrid entity as "non transparent" and thus taxable, the other (A) as „transparent" and non-taxable; this mismatch can be abused by a loan



- Similar model with dual resident corporations

Paper shift: hybrid financial instrument mismatch

- Abuse of financial instruments' different treatment: a company can shape its structure in a way that it can abuse different tax and deductability conditions for so-called hybrid financial instruments

Parent company

Country A:

Equity: dividend, not taxed

e.g. preferred shares

Subsidiary company

Country B:

Loan: interest, deductible

- Similar model: sale and repurchase agreement

Paper shift: transfer pricing (abuse)

- Goods, intellectual property rights (licences, patents etc.), loans/credits, etc. sold/bought/granted below/over appropriate value
- Estimated $100-160 million loss per year for developing countries

Deflated/inflated price

extreme example: a plastic bucket from USA to Pakistan for $972

Parent company

Country A:

high tax → costs

Subsidiary company

Country B:

low tax → profits

Example 1: Glencore – or: the ressource course?

GLENCORE

Glencore International AG (Zug, CH)

↓ 100%

Glencore Finance (Bermuda)

↓ 81,2%

First Quantum Minerals Ltd. (CA)

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

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

Example 1: Glencore (2) – investigating TNCs

Independent Grant Thornton audit commissiond 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: „it is not to be trusted that Mopani has an extraction %-age of cobalt that is half that of other producers.“
- Copper/cobald 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

Example 2: SAB Miller – or: Who pays taxes?

Shop-keeper Marta from Accra (Ghana):

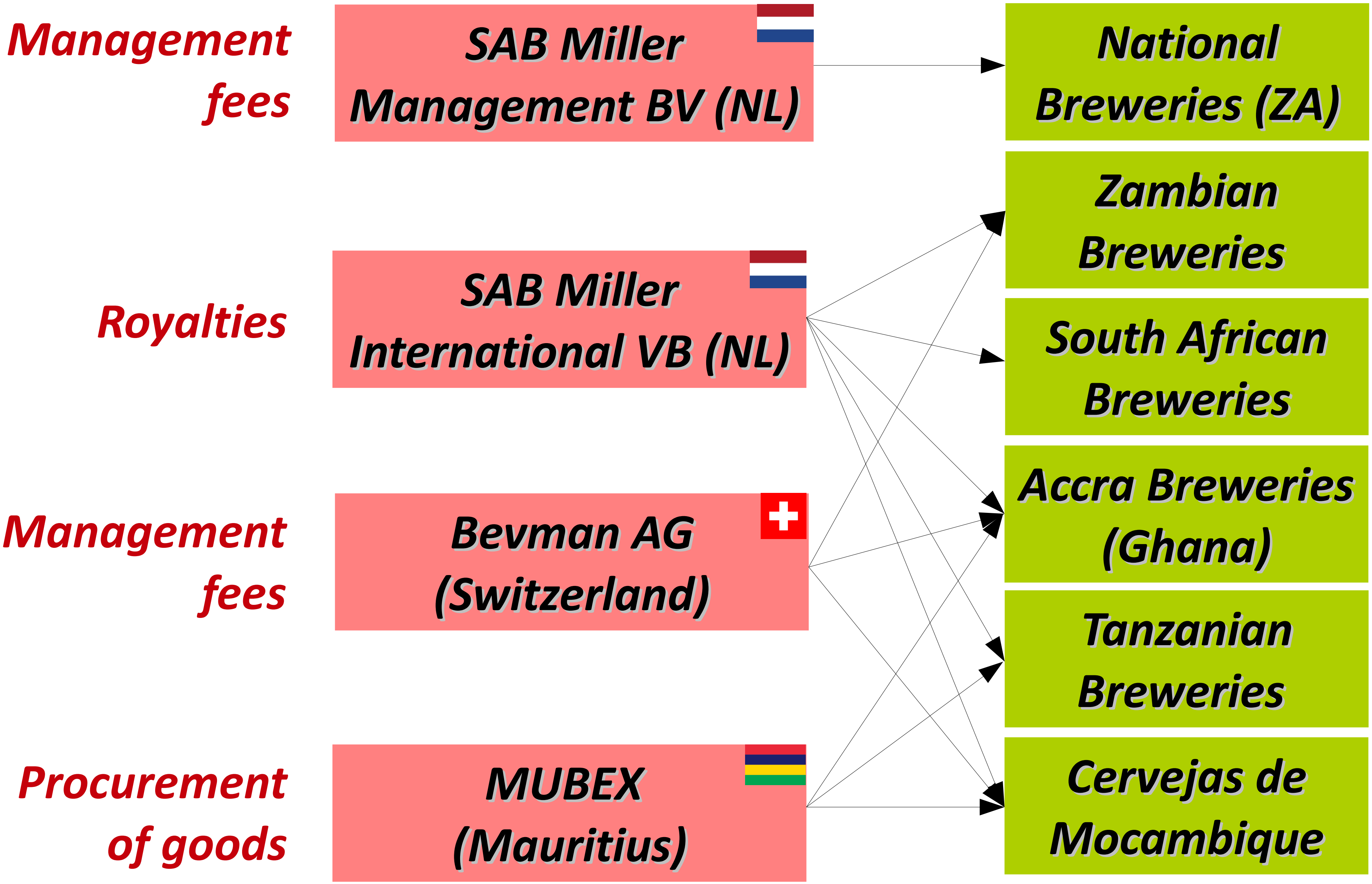
£47 taxes (2009)

Accra Brewery (subsidiary of SAB Miller):

£0 taxes (2009)

Source: Action Aid

Example 2: SAB Miller – holding structure



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

Example 3: Ikea – or: what is a Swedish company?

Ingka Foundation (NL)

Interogo Foundation (LI)

[Kamprad's sons] (Netherlands Antilles)

Ingka Holding Company (NL)

Stichting Ikea Foundation (NL)

payments

Ikano Holding Company (LUX)

Ikea Group

royalties

Inter Ikea Holding Company (LUX)

Inter Ikea Centre Group (DK)

Inter Ikea Systems (NL)

brand

Inter Ikea Finance (LUX)

Vastint Holding (NL)

Source: Spiegel, 50/2012

Figures on TNC tax planning and evasion

- ***General:*** difficult to estimate due to
  - lack of transparency of TNC's operations, holdings etc.
  - line between legal and illegal practices hard to draw
- ***USA:***
  - minimum of $37 billion annually by companies and banks
    (Source: Klinter, S. / Collins, C. / Sklar, H. (2010) Unfair Advantage: The Business Case Against Overseas Tax Havens)
  - 2010: Apple 1% tax (foreign business), Google 3% (Source: FTD / M.A. Sullivan)
- ***UK:*** £840 million tax break annually
  (source: ActionAid (2011): Addicted to tax havens. The secret lifeof the FTSE 100)
- ***Germany:*** even worse than USA to estimate, some attempts:
  - Heckmeyer/Spengel: €60 bn. corporate tax base gap annualy
    (Source: Heckmeyer, J. / Spengel, C. (2008): Ausmaß der Gewinnverlagerung multinationaler Unternehmen – empirische Evidenz und Implikationen für die deutsche Steuerpolitik)
  - Bach/Dwenger: €100 bn. corporate tax base gap annualy
    (Source: Bach, S. / Dwenger (2007): Unternehmensbesteuerung: Trotz hoher Steuersätze mäßiges Aufkommen)

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

- ***General:***

  - Treat each parent/subsidiary company as separate entity

  - Require TNCs to price its internal operations equal to external operations. E.g. a good must be sold at the same price from one subsidiary to another as if it was sold to a customer. Various methods to calculate.

- ***ALP international standard***, e.g. endorsed by ***OECD***

- ***Germany:*** Foreign Tax Law („Außensteuergesetz“)

- ***Problem:*** Equal prices often hard to determine: even difficult for goods, very difficult if not even impossible for intellectual property rights (brands, patents etc.)

Solutions (2): Double Taxation Agreements (DTAs)

- ***General:***

  - Subsidiaries as separate entities, arm's length principle

  - Mutual tax recognition to prevent double taxation, but EC now also looking at double non-taxation

- ***Model Agreements:***

  - OECD: separate entity and ALP approach

  - UN: based on OECD model, adaption for developing countries

- ***Germany:*** Currently 111 DTAs; new one with Liechtenstein (LI) in 2012: patents only accepted if developed in LI; LI abolished its tax privilege for holding companies but still offers taxes of “down to” 10,6% for companies

Solutions (3): Non-Deductability and Source Taxation

- National rules to prevent mismatches, e.g. by restricting deductibility or by general anti-avoidance rules
- Proposal to amend EU directive on interest and royalty payments

Jarass/Obermair (for Germany):

- Taxing all operations at the source, not the profits (as even Unitary Taxation might be undermined by profit shifting)
- No deductibility of loans/credits (prevents profit shifting by artificial loans/credits)
- Restrict consolidation of entities („Steuerliche Organschaft“)
- Restrict loss deductibility

Source: Jarass, L. / Obermair, G.M. (2012): Steuermaßnahmen zur Nachhaltigen Staatsfinanzierung. http://www.jarass.com/Steuer/A/Steuerma%C3%9Fnahmen.pdf

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

- ***General:*** Reporting of corporate payments to governments and of corporate figures (assets, staff, sales etc.) that can serve as tax base
- ***International:*** Extractive Industries Transparency Initiative (EITI): 37 countries take part, 18 compliant

Extractive Industries Transparency Initiative

- ***USA:*** Dodd Frank Act (2010)
- ***EU:*** Ongoing revision of Accounting Directive

Further reading: Murphy, R. (2010): Country-by-Country Reporting. Shining Light into Financial Statements. Edited by TJN.

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): Unitary Taxation: general principles

- Parent company with all its subsidiaries treated as one unit/entity
- Combined report for the corporation required, depicting its entire activity (similar to CBC reporting)
- Profit of the entire corporation is distributed to countries according to an apportionment formula which relies on features that cannot be shifted just on paper, e.g. assets, wages, sales
- Application possible unilaterally even though better multilaterally

Further reading: Piciotto, S. (2012): Towards Unitary Taxation of Transnational Coporations. Edited by TJN.

Solutions (5): Unitary Taxation: examples

- ***USA:***

  - Some US states (California e.a.) have applied for decades, formula one third each feature (assests, wages, sales)

  - Federal rules have adopted elements of unitary taxation: “Controlled Foreign Company” Rule and “Profit Split“ rule

- ***EU:***

  - plans for Common Consolidated Corporote Tax Base (CCCTB)

  - Proposal by European Commission, March 2011 (formula one third each), EP position in April 2012 (different formula), Member States still not agreed, probably coalition of the willing

  - Main problems: voluntary application, only EU member states

Thank you
for your attention!

weed

Weltwirtschaft, Ökologie & Entwicklung
World Economy, Ecology & Development

www.weed-online.org

tax justice network

Netzwerk Steuergerechtigkeit /
Tax Justice Network

www.taxjustice.net

http://steuergerechtigkeit.blogspot.de