Tax Havens and the Taxation of Transnational Corporations

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Transnational corporations (TNCs): Who gets taxes?

Country A

Parent company

Country B

Subsidiary company
How many companies fit into ONE house?

200,000

1209 Orange Street, Wilmington (Delaware)

source: www.guardian.co.uk

WEED, Tax Havens and Transnational Corporations, 9.1.2013
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
- Investment opportunities

= 1. (ALMOST) NO TAXES

= 2. INTRANSPARENCY

= 3. NO/LITTLE REGULATION
### Financial Secrecy Index

**2011 Results**

<table>
<thead>
<tr>
<th>RANK</th>
<th>Secrecy Jurisdiction</th>
<th>FSI - Value</th>
<th>Secrecy Score</th>
<th>Global Scale Weight</th>
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<tbody>
<tr>
<td>1</td>
<td>Switzerland</td>
<td>1879.2</td>
<td>78</td>
<td>0.061</td>
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<tr>
<td>2</td>
<td>Cayman Islands</td>
<td>1646.7</td>
<td>77</td>
<td>0.046</td>
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<td>Luxembourg</td>
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<td>4</td>
<td>Hong Kong</td>
<td>1370.7</td>
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<td>0.042</td>
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<td>5</td>
<td>USA</td>
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<td>Singapore</td>
<td>1118.0</td>
<td>71</td>
<td>0.031</td>
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<tr>
<td>7</td>
<td>Jersey</td>
<td>750.1</td>
<td>78</td>
<td>0.004</td>
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<td>8</td>
<td>Japan</td>
<td>693.6</td>
<td>64</td>
<td>0.013</td>
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<td>9</td>
<td>Germany</td>
<td>669.8</td>
<td>57</td>
<td>0.045</td>
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<tr>
<td>10</td>
<td>Bahrain</td>
<td>660.3</td>
<td>78</td>
<td>0.003</td>
</tr>
</tbody>
</table>
$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
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

Country A: interest: deductible

Country B (consolidated): interest: deductible

• 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

Subsidiary company

Country B:
Loan: interest, deductible

e.g. preferred shares

- 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

Country A: high tax → costs

Parent company

Country B: low tax → profits

Subsidiary company
Example 1: Glencore – or: the ressource course?

Glencore International AG (Zug, CH) 100%

Glencore Finance (Bermuda) 81.2%

Carlisa Investments (Virgin Islands) 90%

Mopani Copper Mine

First Quantum Minerals Ltd. (CA) 100%

Skyblue enterprise inc. (Virgin Islands) 18.8%

ZCCM (Zambian state owned company) 10%

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

- **Management fees**
  - SAB Miller Management BV (NL)
  - National Breweries (ZA)

- **Royalties**
  - SAB Miller International VB (NL)
  - Zambian Breweries
  - South African Breweries

- **Management fees**
  - Bevman AG (Switzerland)
  - Accra Breweries (Ghana)
  - Tanzanian Breweries

- **Procurement of goods**
  - MUBEX (Mauritius)
  - Cervejas de Mocambique

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

- **Ingka Foundation (NL)**
  - **Ingka Holding Company (NL)**
    - **Ikea Group**
      - **Inter Ikea Systems (NL)**
      - **Vastint Holding (NL)**
      - **Inter Ikea Finance (LUX)**
      - **Inter Ikea Centre Group (DK)**

- **Interogo Foundation (LI)**
  - **Stichting Ikea Foundation (NL)**
  - **Inter Ikea Holding Company (LUX)**
  - **Ikano Holding Company (LUX)**

**Payments** from **Ingka Foundation (NL)** to **Ikea Group**

**Royalties** from **Ikea Group** to **Inter Ikea Centre Group (DK)**, **Inter Ikea Systems (NL)**, **Inter Ikea Finance (LUX)**, and **Vastint Holding (NL)**

Source: Spiegel, 50/2012

WEED, Tax Havens and Transnational Corporations, 9.1.2013
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
  - 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 life of the FTSE 100)

- **Germany**: even worse than USA to estimate, some attempts:
  - Heckmeyer/Spengel: €60 bn. corporate tax base gap annually
  - Bach/Dwenger: €100 bn. corporate tax base gap annually
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

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

• **USA**: Dodd Frank Act (2010)

• **EU**: Ongoing revision of Accounting Directive

## 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>
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<tr>
<td>Konkola</td>
<td>58.226</td>
<td>883</td>
<td>246.713</td>
<td>315.822</td>
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<tr>
<td>Mopani</td>
<td>76.012</td>
<td>0</td>
<td>108.979</td>
<td>184.991</td>
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</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): 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

Solutions (5): Unitary Taxation: examples

• **USA:**
  - Some US states (California e.a.) have applied for decades, formula one third each feature (assets, wages, sales)
  - Federal rules have adopted elements of unitary taxation: “Controlled Foreign Company” Rule and “Profit Split” rule

• **EU:**
  - plans for Common Consolidated Corporate 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!

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www.taxjustice.net

http://steuergerechtigkeit.blogspot.de