The Mechanics of Aggressive Tax Planning by Multinational Corporations

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Some NGO Investigations

• ActionAid (2010, 2\textsuperscript{nd} edition 2012) \textit{Calling Time}

  – Report into the tax structures employed by SABMiller (the world’s second largest beer company with a dominant share of the African market) in its interactions with Ghana
• ActionAid (2013) *Sweet Nothings*

  – Investigation into Associated British Food’s Zambian subsidiary, Zambia Sugar
General Pattern

• Intellectual property (in this case brand names) held in zero-tax overseas jurisdictions
• Huge management fees paid to Swiss, Irish and Mauritian subsidiaries
• ‘Treaty Shopping’:
  – Large loans from South African and US commercial banks, borrowed to finance expansion in Zambia, were routed through Ireland despite being borrowed in Zambian currency and repaid via a bank account held by the Irish company in Zambia

  – Takes advantage of a clause in the Ireland-Zambia tax treaty that prevents the Zambian government imposing withholding taxes on such interest payments
1998 OECD definition of ‘tax haven’

• Four criteria:
  
  – (i) No (or only very low rates of) tax

This criterion on its own is not sufficient

• Revenue-maximising corporation tax rate is lower for smaller, poorer, more peripheral, late industrialising economies
OECD criterion 2

– (ii) Lack of transparency (special deals available)
OECD criterion 3

– (iii) **Secrecy laws** preventing the effective exchange of information for tax purposes with other governments
## Jurisdictions Ranked in Terms of Secrecy Score

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Criterion 4

• (iv): no substantial activities

– Vetoed by administration of George W. Bush!
Why?

• New York Times headline of May 30 2000:

EU Complains that Use of Tax Havens gives US Firms a Competitive Advantage

– “... illegal effort to subsidize US exports by making them more competitive”
Structures employed by some US MNCs
Origins of Caribbean tax regimes

- During the 1920s and 1930s, Switzerland, Liechtenstein, Jersey, Panama and the Caribbean began to develop the characteristics of tax havens.

- **Off the shelf companies:** New Jersey and Delaware in late C19th.

- ‘Virtual' residency (incorporation without tax residency): UK law court rulings culminating in 1929 case.
• **Tax-exempt holding company:** Luxembourg, 1929.

• **Banking secrecy:** Swiss Banking Act of 1934

• **Eurodollar market**
  – From 1957 Bank of England decided that transactions undertaken by UK banks on behalf of lenders and borrowers who were not located in the UK were not subject to UK regulation. However since they took place in London, no other authority could regulate them either
Brief history of US tax policy

• Until 1962, foreign subsidiaries of US corporations were able to avoid US taxation so long as their profits remained offshore ("deferral")
• **Kennedy Administration** proposed to switch to a different principle
  – that overseas income of US corporations should be taxed exactly the same as income earned in the US

• **Congressional Republicans** argued that this would damage the international competitiveness of US MNCs (who would face higher total taxes than many of their foreign competitors)
• US State Department also has an interest in the debate
The 1962 compromise

- US taxes cannot be deferred on passive income (royalties etc.... i.e. the income deriving from ownership of intellectual property)

- “Subpart F”
US has been gridlocked on deferral ever since....

- Irish Times; Oct 11, 1975:
  
  “Keating Warns US of Tax Risk to Development”
  
  (Justin Keating, Minister for Industry & Commerce)

  – “US Legislature discussing deferral of US taxation by overseas subsidiaries of US corporations...”
• New IRS regulations ("check the box") introduced in 1997 paved the way for creative tax-avoidance planning options.

• "... thwarts the application of Subpart F"
• The IRS rapidly tried to row back on “check the box” but corporate lobbying prevented this

• Instead, was written into law (as the Look-Through Rule)
Check-the-box tax regulations issued by the Treasury Department in 1997, and the CFC Look-Through Rule enacted by Congress as a temporary measure in 2004, have reduced the effectiveness of the anti-deferral rules of Subpart F and have further facilitated the increase in offshore profit shifting, which has gained significant momentum over the last 15 years. On
• “Check the box” (CTB) allows certain foreign entities to be amalgamated for US tax purposes.

• Gave rise to the *hybrid entity*: marriage of holding company and operating company
• The holding company and the operating company are both incorporated in Ireland so by US law they are Irish companies.

• Irish law is different. The two companies are American because that’s where ownership and control resides.

• The operating company is tax resident in Ireland because it has substantive operations here. The holding company is not, because it doesn’t!
Did Ireland relax its laws when US “check the box” rules came in?

• No. Finance Act 1999 tightened them.
• Ireland’s low corporation tax regime originated in 1956 as ‘export profits tax relief’
• Ireland’s low corporation tax regime is “the unique and essential foundation stone of Ireland’s foreign investment boom”

– Padraic White, Managing Director of the IDA (1981-90)