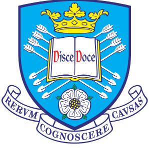

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Paying a 'Fair Share': Multinational Corporations' Perspectives on Taxation.

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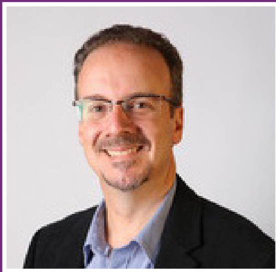
About the authors



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Introduction

States engage in tax competition for the investment and employment opportunities multinational corporations (MNCs) offer. This allows MNCs to reduce their taxation obligations by shifting their profits to states that do not tax them, or tax them very lightly. Sometimes, they can avoid paying tax altogether.

Since the global financial crisis, governments have been challenged by slow economic growth and unsustainable debt levels. They have sought to regain fiscal control by finding ways to increase government revenue whilst reducing spending, often on social services.

Global corporate tax avoidance is estimated to cost governments around the world US$240 billion in foregone revenues each year. It is now an issue that reflects a growing dissatisfaction with the distribution of power and wealth in society. The ability of MNCs to avoid paying their 'fair share' of tax where it is owed, combined with austerity measures being endured by citizens, has led to a public backlash through campaigns waged by tax justice activists, international non-government organisations and the media.

How can MNCs be made to pay their 'fair share' of tax? To explore this question, this Brief argues that:

- Governments must take the lead in developing effective taxation regulations, rather than relying on self-regulation or working with MNCs.

- Global corporate tax avoidance is not caused by market forces. It is caused by regulatory competition between states. They must agree on international regulatory approaches to prevent this.

- While the bailouts and fiscal stimulus measures the global financial crisis necessitated seemed to presage the end of neoliberal globalisation, eight years later they appear to have been more in the nature of temporary measures designed to get national and global economies back 'on track'. But neoliberalism is not the default position if global governance is not possible. This is because

global markets are not free and competitive, but are instead economically and geographically concentrated.

- Wealthy, industrialised countries still account for 80 percent of world output, 70 percent of international trade and make up to 90 percent of foreign direct investments. To be more accurate, it is the corporations from these countries that do so. 84 percent of FT Global 500 corporations are headquartered in just 10 states, with the US alone accounting for nearly half of these.

- Between 1990 and 2013, 81 percent of the value of mergers and acquisition (M&A) purchases were carried out by corporations from these same countries. Those from the US and Europe alone accounted for 67 percent of the total. Over the same period the US and Europe also accounted for 73 percent of M&A sales. Rather than global diffusion in MNCs' operations, the dominant corporations from the world's economically dominant states have been buying each other, further entrenching the geographical concentration of their home bases.

- It is also the case that all the world's major industries are controlled by five corporations at most and around a third of these have one corporation accounting for more than 40 percent of global sales.

- Great market power in the hands of a small number of MNCs headquartered in a small number of powerful states, particularly the US, is the reality. The economic power these MNCs wield, in both geographical and economic terms, is the reason paying tax is verging on becoming voluntary for them, as they notionally shift the jurisdictions in which they earn revenue.

- MNCs like Google, Apple, Amazon and Starbucks that have been widely criticised for minimising their tax payments may perhaps be better conceived as US corporations that control the markets in which they operate at home and abroad. The US is often taken as the exemplar of 'shareholder capitalism'. These corporations' desire to minimise the tax they pay, in pursuit of short-term profitability and shareholder value, is a reflection of their home state's institutional preferences. They face pressure from their shareholders to deliver value regardless of the location of their operations.

- Equally, it may be argued that all MNCs, regardless of the national and organisational preferences of their headquarters, do not seek high taxing jurisdictions when they invest and operate abroad. They can engage in transfer pricing, a prominent tax minimisation practice, to lower the profits of divisions located in a state with higher taxes by reporting the profits in another that has low (or no) tax. This means they do not even have to move their operations. They may stay 'at home', or locate operations wherever they like regardless of tax rates, and then pay tax elsewhere.

- It is difficult to determine what a 'fair share' of corporate tax represents, as some intra-group loans and sales are a normal part of MNC operations. Even so, if MNCs can do business in one jurisdiction while notionally and legally shifting the jurisdiction in which they pay tax to another, then national preferences

and business location choices may effectively be 'de-coupled' from payment of taxes. Tax competition between states combined with transfer pricing allows them to do so.

Part II: Offsetting Reputational Damage

- Although MNCs may be conceived simply as profit maximisers, they also have an interest in acting to ensure their reputations are not tarnished by their actions. If corporations understand that their reputations are precious assets that they may be jeopardising, with consequences for their profitability as a result, then their desire to be seen as good corporate citizens may mitigate their efforts at tax minimisation. They may also avoid the risk of unwanted imposed national and international regulations.

- However, data on how corporate leaders themselves judge corporate reputation reveal their perceptions of what constitutes an 'admirable' firm. The pioneering corporate reputation study is the annual Fortune 500 'World's Most Admired Companies' list. In 2015, the top five most admired corporations as ranked by these corporate leaders were Apple, Google, Berkshire Hathaway, Amazon and Starbucks. They ranked highly for qualities like management quality; quality of products/services offered; and soundness of financial position. *None* of them were ranked in the top five for the criteria of community responsibility. In fact, they did not even rank in the top ten.

- Apple, Google, Amazon and Starbucks have also faced the most high profile public criticism for their aggressive tax minimisation strategies. The greater importance of factors other than community responsibility for them suggests it is unlikely to be a primary driver in considering their taxation obligations.

- They may be emblematic examples of a more general reality. A recent study by Davis *et al.* (2016) finds that corporations with the most extensive corporate social responsibility programmes are those with the most aggressive tax minimisation efforts. It takes no great leap of logic to conclude, as these authors do, that corporate social responsibility activities are primarily intended to offset negative perceptions arising from aggressive tax avoidance.

Part III: Apple's and Google's Strategies

Apple and Google are among the world's most visible corporations in terms of their brand value and their efforts to minimise tax by shifting the territorial jurisdiction of their revenue.

Apple:

- Apple is headquartered in the US with a market capitalisation of US$416 billion. In 2014 the firm's global operations recorded turnover of US$182.7 billion and net profit of US$39.5 billion. Apple's key tax minimisation strategy is the creation of three subsidiaries incorporated in Ireland but which are effectively not registered as a tax resident of any country.

- Putting it simply, Apple pays taxes in the US, but is able legally to claim that most of its profits are earned in other jurisdictions. These jurisdictions, in turn, do not regard these profits as taxable.

- Its subsidiaries collect dividends from most of Apple's offshore affiliates and pay little to no tax on these. In fact, they would seem to exist primarily for this purpose. Apple Operations International receives dividends from most of Apple's offshore affiliates but has no employees and no physical presence. Apple Sales International contracts manufacturers in China to make Apple products which it then sells to Apple Distribution International which pays as little as 2 percent tax on its profits having negotiated this 'special' rate with the Irish government.

- Apple does not just pay less tax in the US, but also in other states in which it conducts business. This is because Irish tax law asserts jurisdiction only over companies managed and controlled in Ireland, but as Apple is managed and controlled from its US headquarters this arrangement allows Apple to escape both US and Irish taxation.

- In exploiting the gap between US and Irish tax jurisdictions Apple was able to pay no tax on income totalling US$30 billion over 2009-2012 through Apple Operations International, and enjoyed a tax rate of 0.05 percent on income of US$74 billion over the same period through Apple Sales International.

- In 2016 the European Commission ruled that Apple must repay €13 billion in back taxes to the Irish Government. Apple has appealed this decision. So has the Irish government, concerned that it may damage its competitiveness as a low tax jurisdiction.

Google:

- Google is also a US-based firm. It has a market capitalisation of US$530.70 billion. In 2014 it recorded global revenues of US$66 billion and net profit of US$14 billion.

- Like Apple, to reduce the company's taxable income Google has relied on profit shifting. In 2011, the company moved 80 percent of its pre-tax profits from international subsidiaries to Bermuda where a corporate tax rate of zero applies to the company.

- Google's profit shifting, and its use of complex tax manoeuvres through Ireland and the Netherlands as tax centres due to their low tax rates, as well as routing sales through them to the low tax jurisdiction of Bermuda, mean that the company pays as little as 2.4 percent tax on its non-US revenues.

Part IV: Responses to Public Enquiries

The dissatisfaction of the citizens of states in which Google and Apple operate but pay little or no tax has led to governments undertaking a series of inquiries, and in the UK and Australia embarking on unilateral attempts to tax 'diverted profits'.

Apple:

- In May 2013 the United States Senate Committee on Homeland Security and Governmental Affairs held a public inquiry into Apple's compliance with US tax laws to 'spotlight Apple's extensive tax-avoidance strategies' after finding evidence of tax avoidance and an 'unusual tax scheme' whereby its three Irish subsidiaries paid no tax in either Ireland or the US. In addition to a written submission, Apple sent its Chief Executive Officer, Tim Cook, and Chief Financial Officer, Peter Oppenheimer, to represent the company at the inquiry's hearing.
    - In his opening statement, Cook highlighted the company's decision to keep its product design and development staff (approximately 50,000 employees) in the US and the jobs created by companies in Apple's US supply chain, and pointed out that Apple is the largest corporate tax payer in the US.
    - Senator John McCain noted that this rendered revenue the firm had moved offshore to be effectively outside the reach of any tax authorities. Even so, Cook stressed Apple pays all the taxes it owes, complies with the relevant laws but also the spirit of the laws, and does not 'stash money on some Caribbean island'.
    - Cook concluded: 'Apple has always believed in the simple, not the complex. You can see it in our products and the way we conduct ourselves. It is in this spirit that we recommend a dramatic simplification of the corporate tax code. This reform should be revenue neutral, eliminate all corporate tax expenditures, lower corporate income tax rates and implement a reasonable tax on foreign earnings that allows the free flow of capital back to the U.S. We make this recommendation with our eyes wide open, realising this would likely increase Apple's U.S. taxes. But we strongly believe such comprehensive reform would be fair to all taxpayers, would keep America globally competitive and would promote U.S. economic growth'.
- In April 2015 the Australian Senate also held an inquiry into Corporate Tax Avoidance at which senior Google and Apple representatives appeared.
    - At this inquiry Tony King, Apple's Australia and New Zealand Managing Director, stated in a similar vein that his company 'pays all the taxes it owes in accordance with Australian law' and claimed that its effective tax rate in Australia was above 30 percent.
    - When asked about the company's seemingly low gross profit and its use of tax minimisation strategies, he reiterated that Apple 'pays tax in accordance with Australian tax law'.

- When it was put to King that of the A$600 retail price of an iPad in Australia, A$550 is shifted to Ireland of which approximately A$220 is never taxed anywhere in the world, and that while this may be lawful it nevertheless constitutes avoiding tax, he replied: 'we do not avoid tax, we pay all of our taxes that are due in the Australian market in accordance with the law'.

- Apple stresses its lawful behaviour, while blaming the states in which it is based and operates for the laws to which it adheres, rather than accepting responsibility for the results produced.

Google:

- Inquiries into Google's taxation strategies were held in the UK in 2012 and 2013. The terms of the 2013 inquiry undertaken by the House of Commons Public Accounts Committee noted that, in order to avoid corporate tax, 'Google relies on the deeply unconvincing argument that its sales to UK clients take place in Ireland, despite clear evidence that the vast majority of sales activity takes place in the UK'.
    - At both inquiries Google was represented by its Vice President for Sales and Operations, Matt Brittin. When questioned about the company's claim that Google conducts the bulk of its European business from its low-tax jurisdiction Dublin offices, Brittin noted that 'any advertiser in the UK, Germany, France or any European country contracts with Google in Ireland, because that is where they have the rights to sell Google advertising'.
    - The Parliamentary Committee repeatedly presented evidence including sales jobs advertisements for positions located in London, as well as that provided by whistle-blowers suggesting a significant portion of Google's sales activities take place in the UK where the company paid just £10 million in tax on 2006-2011 revenues of £11.5 billion. Despite the evidence, Google's official position was that 99 percent of its European sales take place in Ireland: hence the legitimacy of the company's tax structure.
    - At the Parliamentary inquiry Brittin remained committed to this business model as an accurate depiction of Google's European operations, but also claimed to have no detailed knowledge of them, declaring 'I am not a tax or a legal expert'. When pressed on the specific actions of Google, he declined to elaborate, further stating that, 'obviously, what I cannot do is talk specifically about Google's affairs', though eventually acknowledging that 'the lower tax regime was one factor in establishing us in Ireland'.
- A similar position was taken by Google Australia, also present at the Australian Senate inquiry into corporate taxation, represented by Managing Director Maile Carnegie.
    - She agreed with her Apple counterpart that global taxation requires overhauling, saying 'Google believes international cooperation at the OECD level is essential'.

    - Carnegie went on to respond to questions about profit shifting from Google Australia to the low-tax jurisdiction of Singapore, saying 'the products and services we sell to Australian customers are sold by our Singapore group' leading to the following breakdown in profits from sales in Australia: '$2 billion in software products and services revenue booked in Singapore and a little over $100 million of consulting services booked in Australia'.

- Carnegie's and Brittin's positions were consistent with public statements made by Google's Chairman, Eric Schmidt, who has declared that 'we pay lots of taxes; we pay them in the legally prescribed ways', and that he is 'very proud of the structure that we set up. We did it based on the incentives that the governments offered us to operate.'
- As with Apple, the clear implication is that the fault again lies with governments if they engage in tax competition and choose not to close opportunities for tax minimisation. Far from shying away from what others may regard as corporate obligations, Schmidt proudly stated: 'it's called capitalism…we are proudly capitalistic…I'm not confused about this'.

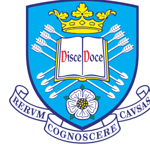
Conclusion

- Regardless of the potential for self-regulation to enhance corporate reputation, what appears to matter most to corporate leaders are traditional financial and market performance metrics. These, much more than community responsibility, are what confer reputation. Therefore, it is unsurprising that the comments of corporate leaders amount to a disregard for tax minimisation concerns. Instead, they stress their firms' lawful behaviour.
- They have a point. They are not breaking any laws and they are not evading tax. They are minimising it. If the public believes them to be acting legitimately and for the outcomes produced to be desirable, then they remain in a politically powerful position to arrange their tax affairs as they see fit, with the help of the states that allow them to do so.
- The problem for them is that, increasingly, this seems no longer the case. Part of the reason for this is their responses to the criticisms they have faced, abrogating responsibility for the outcomes as they explain their strategies with reference to national laws, and even declaring their pride with the way in which they have structured their tax affairs.
- Through both their actions and the explanations offered for them they are now undermining their legitimacy in the eyes of the public. This is also rebounding on the states that are at the forefront of offering them opportunities for tax minimisation, like Ireland.
- Therefore, the public pronouncements of MNCs like Apple and Google are not just revealing of their perspectives, but strategically cavalier. In claiming their positions as legitimate, and in the process shifting blame to governments for the opportunities afforded them, they are inviting and politically enabling the response they least desire: global regulation.

- They have also strengthened the arm of states that wish to put in place greater tax demands while working towards the necessary global reforms to undermine the strategies of tax havens like Ireland.
- They have also demonstrated that global corporate tax avoidance is not caused by market forces, nor capitalism, nor globalisation, but by tax competition between states. The solution to the problem therefore cannot reside with the MNCs that have benefited from the opportunities states have afforded them. It must lie with the states in which they are headquartered, principally the US, and must involve action against those states wherein they are avoiding their tax obligations.

Reference

Davis, A.K., Guenther, D.A., Krull, L.K. and Williams, B.M. (2016) 'Do Socially Responsible Firms Pay More Taxes?', *The Accounting Review*, 91(1), pp 47-68.



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