Strategies employed by Multinational Companies to Evade Tax, with a particular emphasis on Tax Havens

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This paper will study some of the strategies used by multinational companies to avoid paying tax. In particular, I intend to focus on the most common way multinational companies dodge paying large taxes; tax havens. Location is key when it comes to avoiding high levels of tax. Large companies, for example, Apple, who locate subsidiaries in a tax haven, such as Ireland, can cut millions of dollars from their tax bill every year by choosing the location of their subsidiary or branch wisely.

In the course of this publication I will highlight the different rates of corporation tax in various countries globally and emphasize the effects that these tax rates have on the economy. I will focus on the taxation of multinational companies as opposed to domestic firms, the key difference being that multinationals tend to fall under the jurisdiction of at least two tax systems (where there is no double taxation relief arrangement in place). I will examine the varied approaches taken by different countries when taxing these multinational companies and I will highlight the reasoning and incentives behind their motives. Finally, I will demonstrate how multinational companies use these tax policies to avoid, and, more crucially, to evade taxes.

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I. Tax Avoidance vs. Tax Evasion vs. Tax Planning

The distinction between tax avoidance and tax evasion is a crucial one. This is essentially where the line is drawn between what is considered to be legal and what is considered to be illegal when it comes to lowering one's tax bill. Tax evasion generally involves fraudulent behaviour whereas tax avoidance is achieved using legal methods. Tax avoidance is essentially the exploitation of legal loopholes which results in less or no tax being paid. The distinction, however, is not always clear and can vary between countries. The two concepts have become somewhat "blurred, at least by the tax authorities, and tax avoidance has been treated with some of the disapproval previously reserved for tax evasion."[1] While neither method is generally viewed as moral, only tax evasion is a criminally punishable offence in most jurisdictions.

Tax planning with the aim of minimizing tax, on the other hand, is considered "a normal and prudent aspect of business and financial dealings."[2] This strategy is free from any moral guilt whatsoever. The distinction between tax planning and tax avoidance can also be unclear, however. Avoidance may involve "an attempt to frustrate the intention of the tax law."[3] Ultimately, in practice, a judge will look to the intention underlying the taxpayer's action to determine whether to punish the taxpayer.[4]

A. The USA

The rate of corporation tax in the USA is relatively (and consistently) high at 40%, which motivates taxpayers to avoid and evade large tax bills. Tax evasion is a crime under US federal law, punishable by imprisonment of up to 5 years, a fine, or both. To be convicted in the

1. Tracey Bowler, 'Countering Tax Avoidance in the UK: Which Way Forward?', *Tax Law Review Committee* The Institute for Fiscal Studies (London: February 2009) at p. 10, online: <www.ifs.org.uk/comms/dp7.pdf>.
2. International Bar Association, *Tax Avoidance, Tax Evasion* (London: Sweet & Maxwell Ltd, 1982) at 91.
3. Frank Alan Cowell, *Cheating the government* (Cambridge: MIT Press, 1990) at 12.
4. *Ibid.* at 11.

US, a person must have wilfully attempted to evade tax and must be liable for additional tax.[5]

B. Canada

Similarly, in Canada tax evasion is illegal while tax avoidance is legal but "inconsistent with the overall spirit of the law",[6] according to the Canada Revenue Agency (CRA). While the rate of corporation tax in Canada (which is currently at 26.5%) is not as high as it is in the US, multinationals still seek to benefit from tax havens. In April of 2016 the government of Canada vowed to improve the CRA's ability to detect, audit and prosecute tax evasion in Canada, as wealthy individuals are making use of tax havens to avoid taxes while most middle-class citizens are paying their fair share.

C. France

The current rate of corporation tax in France is 33.33%. In order to combat tax avoidance, France has a number of anti-avoidance rules in place, for example, "an indirect transfer of profits is presumed where the French tax authorities can prove that a transaction was not conducted at arm's length or under equitable conditions between a taxable French entity or a foreign affiliate".[7] Tax evasion by corporations in France is punishable with fines of 40% in the case of bad faith and 80% in the case of fraud.

D. The UK

The rate of corporation tax in the UK stands at 20%. While this is not a very high rate of corporation tax, it results in the loss of potential multinational companies establishing bases in the UK due to the particularly low rate of corporation tax levied by its neighbour, Ireland, which has a rate of 12.5%. Corporation taxes are evidently a hugely persuasive factor that multinational firms take into consideration

5. *U.S. Code*: Title 26, § 7201.
6. <www.cra-arc.gc.ca/gncy/lrt/vvw-eng.html>.
7. Deloitte, "Taxation and Investments in France 2016" at 16, online: <www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-franceguide-2016.pdf>.

when deciding where to set up subsidiaries. This demonstrates the huge impact corporation taxes have on the economy.

II. Tax Havens

A multinational company generally centres and makes decisions in one country and has subsidiaries in different locations globally, often in tax havens. Tax haven usage by multinational companies has become increasingly popular in recent years, particularly since the second half of the 20th century. Per a short report by Sullivan, in 2002, 18 tax havens accounted for 58% of the profits of subsidiaries of US multinational companies,[8] while in 2007 it was reported that 83 of the largest firms in the US had offshore subsidiaries located in tax havens.[9]

While the term 'tax haven' has negative connotations, it must be remembered that countries who set low rates of corporation tax do so in order to attract multinational firms to set up businesses in their country, thus benefiting their economy in a big way. Therefore, it is often unfair and inaccurate to say that a tax haven is being 'exploited' or 'abused' by these large firms seeking to lower their tax bills. The negative view of tax havens in general comes from the confusion between using tax havens to minimise tax as opposed to using them to evade tax. The distinction between tax evasion and tax avoidance is an extremely relevant one in this case.

A. What Constitutes a Tax Haven

The Organisation for Economic Co-operation and Development (OECD) has identified four key factors that one should consider when determining whether or not a jurisdiction is a tax haven.[10] Firstly, whether it imposes no or only nominal taxes. Secondly, whether

8. M. Sullivan, 'Data Show Dramatic Shift of Profits to Tax Havens', *Tax Notes*, 13 September 2004, Tax Analysts.
9. The United States of America, United States Government Accountability Office, *Large US Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions*, GAO-09-157, December 2008, online: <www.gao.gov/new.items/d09157.pdf>.
10. Organisation for Economic Co-Operation and Development, Harmful Tax competition, An Emerging Global Issue (1998), at 22, online: <www.oecd.org/tax/transparency/44430243.pdf>.

there is a lack of transparency. Thirdly, whether there are laws or administrative practices that prevent the effective exchange of information for tax purposes with other governments on taxpayers benefiting from the low or non-existent taxation. Fourthly, whether there is an absence of a requirement that the activity be substantial.

The Gordon Report included other indicators of a tax haven, for example, good communication facilities, political stability, good location and the provision of offshore banking facilities. Gordon also defined tax havens in a more general sense: “The term “tax haven” may also be more defined by a “smell” or reputation test: a country is a tax haven if it looks like one and if it is considered to be one by those who care.”[11] In other words, if large firms are taking advantage of a country’s beneficial tax regime to minimise tax bills, then it is a tax haven.

III. International Double Taxation

A multinational may also look to set up a subsidiary in a country where it is possible to avoid international double taxation (also known as juridical double taxation). This form of taxation arises when a firm is subject to pay tax on a profit or income to more than one tax authority. This typically arises when a person or an entity in one country has a source of income in a different country and it tends to occur most commonly in three types of situations. Firstly, where a firm resides in two different countries in the absence of international double tax relief. Secondly, if a taxpayer is not resident in the same country as the source of her income. Thirdly, a firm can be doubly taxed if countries have different methods of calculating profit for tax purposes.

However, there are several ways in which countries can avoid being doubly taxed. Two, (or potentially more), can enter a tax treaty granting relief from double tax. If a country adopts unilateral relief they grant relief regardless of whether any other state grants them reciprocal relief. For example, in Ireland where there is no Double Taxation Agreement between Ireland and a particular country, there

11. Richard A. Gordan, *Tax Havens and Their Use by US Taxpayers – An Overview*, (Washington DC: IRS Publication, 1981) at 14, online: <archive.org/stream/taxhavenstheirus01gord#page/14/mode/2up/search/loosely+defined>.

are provisions in the Irish Taxes Consolidation Acts (TCA) 1997 which allow unilateral relief against double taxation in respect of certain types of income.[12]

Unilateral relief can be provided for in one of three ways; exemption, credit or deduction. With an exemption, a company must only pay tax on its profits to one of the tax authorities. Under the credit system "tax paid in one state is allowed as a credit against tax liability in the other state."[13] A key issue with this system is that the taxpayer must pay the higher rate of tax. With deduction, the foreign tax is deducted from the tax liable in the state concerned, instead of as a credit against tax liability like under the credit system.

IV. Ireland as a Tax Haven

Irish tax legislation is very favourable to multinational companies, particularly those involved in research and production. As a result, Ireland has become an increasingly popular location for multinational firms to set up subsidiaries. As mentioned above, the current rate of corporation tax is just 12.5%, which benefits the country hugely as it is a massive incentive for firms to set up in Ireland, as opposed to the UK for example, where the rate of corporation tax is significantly more. The low rate of corporation tax in Ireland is essentially a cornerstone of the country's economic policy and has enticed massive multinationals to the country, including Google, Microsoft, Intel, Amazon, Boston Scientific, Apple, Facebook, Pfizer and PayPal.

Per the American Chamber of Commerce Ireland's 2015 report, in 2013 US foreign investment in Ireland totalled 239.6 billion, "almost $50 billion greater than in Germany and France combined ($196 billion)".[14] According to the US Bureau of Economic Analysis, in 2002 before-tax profits of foreign subsidiaries of US multinationals located in Ireland came to 26,385 million. These figures demonstrate how valuable US multinational firms are to the Irish economy as well as

12. *Irish Taxes Consolidation Acts (TCA) 1997*, online: <www.revenue.ie/en/practitioner/law/acts/taxes-consolidation-act-1997.html>.
13. J.D.R. Adams & J. Whalley, *The International Taxation of Multinational Enterprises in Developed Countries*, (Westport, Connecticut: Greenwood Press, 1977) at 45.
14. <www.amcham.ie/Amcham/media/SiteMedia/Publications/Chamber-Report-2015-(no-listings).pdf?ext=.pdf> at 45.

how reliant the Irish economy is on attracting US firms with a low rate of corporation tax in addition to its favourable tax policy.

V. The Apple Case

One such multinational firm is Apple, which first established a base in Ireland in 1980, and who has received much attention in the past few months due to the taxes it has allegedly neglected to pay to the Irish government. The case of Apple vs. the EU has been described by Times magazine as "the Biggest Tax Battle in History"[15]. This case demonstrates how extremely low rates of corporation tax can create complex tax issues on a global scale. With a view to attracting jobs, the Irish government has offered multinational companies sweetheart tax deals which, according to the European Commission, has allowed Apple to pay just 0.005% tax in 2014.[16] However, the European Commission rejects this and has ordered Ireland to collect $14.5 billion from Apple.

Despite this seemingly attractive proposal, the Irish government fear that if they accept this offer, they will scare multinational firms away. As noted by Miller and Oats "[a] country must weigh up the costs of losing tax revenue" against "the risk of migration"[17] of multinational corporations. Therefore, to protect Irish jobs, they are choosing instead to vindicate their right to offer sweetheart tax arrangements to multinational firms. The EU are saying that Ireland's tax policy is "motivated by employment considerations",[18] and that Ireland are essentially trading tax for employment – an accusation which is hard deny. As one would anticipate, Apple are also appealing the ruling.

However, the issue in this scenario is not Ireland's low rate of corporation tax. In the European Commission's Press Release on the

15. Rana Forhoor, "Apple vs. the E.U. Is the Biggest Tax Battle in History" online: <time.com/4472500/apple-eu-irish-tax-bill/>.
16. European Commission – Press release, "State aid: Ireland gave illegal tax benefits to Apple worth up to €13 billion", online: <europa.eu/rapid/press-release_IP-16-2923_en.htm>.
17. Angharad Miller and Lynne Oats, *Principles of international taxation* (Haywards Heath, West Sussex: Tottel Publishing, 2009) at 23.
18. Julia Fioretti and Tom Bergin, "EU says Ireland swapped Apple tax deal for jobs" online: <www.reuters.com/article/us-apple-ireland-tax-idUSKCN 0HP0QT20140930>.

matter, it identified Ireland's "selective tax treatment" of Apple as illegal because "it gives Apple a significant advantage over other businesses that are subject to the same national taxation rules".[19] The tax arrangement made between Ireland and Apple in 1991, which was replaced by a similar ruling in 2007 allowed Apple to attribute much of its profits to a "head office" which only existed on paper and therefore these profits were not taxed. The result was that Apple paid a very low rate of tax on the profits of Irish-registered Apple subsidiaries, through which approximately 90% of its non-U.S. profits flowed. EU state aid rules do not seek to punish Apple or Ireland, but require Apple to pay back taxes to Ireland to remove the distortion of competition. Should Apple be forced to pay these back taxes the consequences for Ireland would be devastating. It is likely that Apple would look to move their subsidiary elsewhere in Europe and this could potentially trigger other multinationals to do the same.

VI. Other techniques used to Avoid Tax

A. Expansion Abroad

When a company is expanding abroad it must consider whether to set up the new venture as a branch or as a subsidiary. A branch is not a separate legal entity and therefore it is generally subject to tax in the country where the branch is located. In this regard a subsidiary may appear to be more favourable as it is a separate legal entity so it is generally not taxed in the country of the parent company until the profits are remitted. This deferral advantage can potentially reduce a tax bill if the subsidiary is located in a country with a lower tax rate than that of the parent company. Essentially the multinational company can 'park' their earnings from a subsidiary in the country with a lower rate of tax until needed elsewhere.[20]

However, the company will also have to take into account the fact that a parent company can grant relief for a loss to a venture that is set up as a branch as it is part of the same entity, whereas a subsidiary may have to bear the loss itself.[21] Ultimately, these are both factors

19. *Supra*, note 13.
20. *Supra*, note 14 at 256.
21. *Supra*, note 14 at 201.

which the company will consider when deciding in what way to establish a new undertaking.

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Thus, it is apparent that taxation is an area in which multinational companies devote a huge amount of time with a view to minimising tax payable and to increase profits. As outlined above, this can be done legally with the help of several different methods, however, tax havens appear to be the most significant. “Mills, Erikson and Maydew (1998) estimate that large corporations save on average $4 for every $1 spent on tax planning activities. Thus, not only is tax planning a big business, but returns to investment in tax planning can be large”.[22] However, as discussed, the problem arises when multinationals cross the line between tax avoidance and tax evasion.

Regardless of whether or not tax havens are being used for illegal purposes, they continue to receive considerable criticism. The President of Oxfam America, Raymond C. Offenheiser, has held tax havens responsible for much of the widening gap between the rich and poor. In Oxfam’s 2016 annual report on income inequality he stated that “[t]ax havens are at the core of a global system that allows large corporations and wealthy individuals to avoid paying their fair share.”[23]

It remains to be seen whether Apple will be forced to pay billions of dollars of back-taxes to a reluctant Ireland. Should the EU Commission win the case, many multinational companies may become disillusioned with Ireland and may choose to relocate subsidiaries elsewhere, which would have a disastrous effect on the Irish economy. Should Apple win the case, Apple and other multinationals would be encouraged to continue to exploit tax havens. Either way, the result of this case will have a profound impact on both the Irish economy and the ways in which multinationals seek to avoid large tax bills.

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22. M. Scholes, M.A. Wolfsen, M. Erikson, E.L. Maydew, and T. Shevlin, *Taxes and Business Strategy: A Planning Approach*, 2nd ed., (Prentice Hall Inc: 2002) at 8.
23. Patricia Cohen “Wealth inequality rising fast, Oxfam says, faulting tax havens”, Boston Globe (January 19, 2016).