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How to Reduce the Tax Bill of a Multinational Technology Company?

Dimitrios V. Siskos
Embry-Riddle Aeronautical University, siskosd@erau.edu

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Dimitrios V. Siskos[1]

Adjunct Assistant Professor

Worldwide College of Business, Embry Riddle Aeronautical University

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Abstract

It is said that nothing in this world is certain except for death and taxes. For those with clever accountants, however, the latter can be kept to a minimum. Particularly, companies seek to minimize their tax liability through "tax planning", adopting deductions, rebates, exemptions and other "legal" tools that the domestic tax system provides to them. However, while tax planning is considered to be quite logical in the terms of making profit, there is a grey area between this and "tax avoidance". This paper suggests a legitimate tax plan for a multinational technology company that minimizes its tax obligations[1], without being inconsistent with the policies of Corporate Social Responsibility[1] (CSR) and the desire for profit maximization by the shareholders. As such, it is proposed that a multinational company should exploit tax havens' opportunity to relocate the Intellectual Property (IP) ownership but ensuring, in the same time, that it shares its gross profit between the tax haven and the source country paying 13% of the gross profit to the relevant resident.

Keywords: Tax Plan, Tax Haven, Offshore, Intellectual Property, Corporate Social Responsibility.

[1] Dimitrios V. Siskos has almost 15 years of financial experience in the industry sector in Greece and over 10 years of teaching and research experience in Greek, European and US Universities (on-campus and online modalities). He focuses on continuous improvement, loves precise and accurate data and is willing to add value to the organization for which he works. He is the owner and the administrator of the website: http://www.thinkingfinance.info, where you can find stuff from his Research, Projects, and Writings.

Introduction

The most visible effect of globalization is the increasing number of companies that develop international activities. To access foreign markets, firms face several dilemmas, as whether to relocate production abroad, which are basically influenced by tax factors (Barrios, et al., 2008). Therefore, multinational technology companies have to construct a legitimate tax plan, embedded with the latest updates, to minimize the tax obligations. The general perception is that taxation is purely a national affair, but in reality there is a longstanding tradition of international tax cooperation, which has become firmly institutionalized over time and has gained some degree of autonomy, influencing over national tax policies (Rixen, 2010, pp.1).

The creation of a tax plan for a multinational technology company is not a simple process as long as it requires compatibility between the national tax systems of the countries the company operates. Otherwise, the consequences are serious enough to create administrative inefficiencies, extra costs as well as to become a basis for unethical actions (Prebble, 1997). The position is a lot of exigent when it comes in respect of business profits due to complex set of jurisdictions interacting with one another. However, unlike the "soft law" mode of governance, the international tax system has a significant impact on binding national tax rules and bilateral double tax treaties (Rixen, 2009).

The international tax governance faces a lot of challenges, mainly by the fact that countries prefer to defend their domestic tax systems over the international ones in the bilateral and multilateral agreements. This comes as a consequence of the irrational political desire to avoid double taxation[1] situations while, in the same time, to gain taxable revenues. Indeed, national tax autonomy causes harmful tax competition[2] and a "race to the bottom" (Baskaran and Lopes, 2013). As result, the international multilevel governance tax system serves as the final recipient of all the cases which require tax arbitration or derive from harmful tax competition (Rixen, 2009).

As such, technology companies have to exploit any tax opportunities to minimize taxes, as the one referred by Warpole (2001), who presented a special treatment of intangible assets by relocating them to tax havens.

[1] Double taxation represents taxing the same taxable matter, for the same period of time, by two different fiscal authorities, belonging either to the same state or to different ones (Dudas, 2011).

[2] Harmful effects may occur when one country's tax policies influence either the policy decisions of another country or the location decisions of financial services and other highly mobile activities (Weiner and Ault, 1998).

The aim of this paper is to introduce a legitimate and ethical tax plan focused on Multinational Technology companies, which will minimize tax obligations.

History

When the transfer pricing[3] regulations were introduced in 2001, this subject was completely unknown. During the next decade, the transfer pricing has become an important international taxation issue for both tax administrations and taxpayers (Gupta, 2009). Many companies have benefited by transferring prices between different countries.

According to the Telegraph, Starbucks' US operation charged high prices to its UK operation for various services, such as royalties for the use of branding or for management services, or lent money to its UK operation at high interest rates (Ebrahimi, 2012). Consequently, Starbucks' profits rose in the USA and fell in the UK; as illustrated in Appendix 1.

Current state

From Antigua in the Caribbean to Nauru in the South Pacific, offshore[4] tax havens leach billions of dollars every year in tax revenues from countries around the world (N.Y., 2001). As the US Internal Revenue Service reported, the Caribbean tax havens alone drain away at least $70 billion a year in personal income tax revenue.

According to Bloomberg, multinational technology companies as Google and Amazon have received strict criticism for their strategy to send billions of dollars of profits abroad. For example, Google sells almost all ads in Europe through its Irish subsidiary, leaving little tax revenue in other countries, but in which customers' reside. The Irish subsidiary in turn pays royalties to a second Irish subsidiary, but which is based in Bermuda. Last year, Google sent nearly $12 billion in Bermuda reducing by more than $2 billion global tax burden borne. At the same time, Google's subsidiary in Italy income tax paid just $1.8 million. However, many governments all over the world make efforts to eliminate the tax breaks that lure foreign capital. Recently, as Reuters referred, the Italian parliament introduced the "Google tax" which refers on the

[3] Transfer pricing is an important instrument for managing the global tax liability of multinationals (Durr and Gox, 2013).

[4] Work done for a company by people in another country that it typically done at a much cheaper cost.

internet advertising and will start on July 2014 (Mackenzie, 2013). Under the new measure, the Italian multinationals companies are obliged to buy their ads on Internet only by companies which have their headquarters in Italy and not, as happened till now, by partnerships located in "tax havens" such as Ireland, Luxembourg and Bermuda.

Environmental statement

Nowadays, the multinational companies have expanded their activities, via technology, in every place of the world. However, that extension of corporate areas is also related to the notion of Corporate Social Responsibility (CSR), which suggests that multinational corporations should address social issues, such as overcoming poverty, enhancing employees' well-being, and improving the welfare of society (Kim and Choi, 2012).

Even though many companies have expressed their ethical and responsible conduct in respect of the social environment, there were many cases when the business practices were not aligned with the declared corporate behavior (Dumitru, 2012). For example, important companies from Romania that have a clear CSR policy have decided to apply Tax Avoidance Practices[5] (TAP), in order to avoid some of the domestic taxes (Dumitru, 2012, pp. 1085). Consequently, CSR hypocrisy is very common through profit motivated companies since, even in companies' reports, they avoid to admit that operating abroad may result in less tax to be paid in the domestic countries (Obiri, 2011).

Discussion of the facts and issues

The Intellectual Property (IP)

For most economists, the intellectual capital is considered as one of the main competitive advantages. The reasons of such tendency are related to the fact that intellectual capital is a major factor, mostly in the growth of the multinational companies fear value, which does not appear in the accounting system (Derun, 2013). Multinational technology firms can strategically patent Intellectual Capital to effectively protect

[5] Tax avoidance is a practice of using legal means to pay the least amount of tax possible.

valuable technological assets. The patented Intellectual Capital is known as Intellectual Property[6] (IP) (Wiederhold, 2011).

However, recent challenges and attention to IP tax planning has prompted governments around the world to consider new tax measures that affect all phases of IP development and business (Sang et al., 2013). Consequently, this results in IP migrating from one tax jurisdiction to another lower tax jurisdiction to realize maximum corporate profits.

Assumptions

It is required to make some assumptions in order to provide a legitimate tax plan. As such, the technology company is a large Multinational Corporation that was incorporated in Greece in 2007; it has a presence in UK and has global customers. Additionally, the company has a patented IP –created and registered in Greece- that generates an annual turnover of EUR €22 billion and a gross profit of EUR €2.4 b. Additionally, the technology company paid 26% tax at the end of the previous year -which ended in December 31, 2013- and this left a net profit of EUR €1.78 Billion. Although, the Greek Corporation tax has remained 20% for 2011 and 2012, the ministry has already decided to raise tax in 26% for 2013 and 2014. Obviously, this has increased the technology company's tax and, thus, the company should apply some legitimate methods that could significantly reduce its tax obligations.

The Tax Plan

The tax plan, that this paper suggests, is based on the geographical financial conditions as well as on the other big multinational companies' tax reduction models (Google, Facebook). Firstly, the technology company must relocate its Greek headquarters to Cyprus (very common in Greece); in order to take advantage of the 12.5% basic income tax rate (see Appendix 3). Furthermore, the company's IP ownership should be relocated to Bermuda[7] due to its zero tax income rates (see Appendix 3).

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[6] When Pfizer acquired Pharmacia for $60 billion in 2003, the company booked $31 billion in acquired intellectual property (IP) rights (Fischer and Gee, 2013).

[7] Bermuda is a British Colony comprising a string of small islands no more than 15 miles long and 21 square miles in area.

Since the patent will be developed in Bermuda and will be used in Cyprus, the taxable income will be divided between the two countries using the residual profit-split method[8], which is often the most appropriate transfer pricing method when income is generated from the use of intangible assets (Markham 2004). As such, the amount charged for using the IP by its Bermuda Controlled Foreign Holding Company (CFH) must be half of its gross profits, which means €1.2 billion.

Tax Plan Outcomes

According to the method chosen, the technology company's tax will be reduced from EUR €0.62 billion (Greek tax) to EUR €0.15 billion (Cyprus tax) on the €1.2 billion, plus zero tax (Bermuda) on the other €1.2 billion. Similarly, the net profit will be increased from EUR €1.78 billion to EUR €2.25 billion.

This method provides the resident country with a tax revenue of EUR €150 Million (Table 1) which –at 13% of the technology company's gross profit- is a fair amount and also provides the technology company's shareholder's with a reasonable return on their investment.

Countries	**Profit**	**Tax**	**Tax Amount**	**Net profit**
Greece	€2.40 b	26%	€0.62 b	€1.78 b
Cyprus	€1.20 b	12,5%	€0.15 b	€1.05 b
Bermuda	€1.20 b	0%	€0.00 b	€1.20 b
Total			**€0.15 b**	**€2.25 b**

Table 1. The Tax plan outcomes

Analysis of the facts and issues

Legitimate Tax Plan

The objective of this paper is to provide a profitable, legitimate and ethical tax plan. Generally, it is globally accepted that the companies' major concern is to touch the highest level of profitability in order to be

[8] The profit split method is used to evaluate controlled transactions to determine if the allocation of profits and losses between the related parties were conducted at arm's length based on the relative value of their contributions to the profit or loss.

economically powerful. However, alongside this effort, the organization must be compliant with all legal rules and regulations; in every community where it has an active business presence (Waller et al, 2011). Furthermore, following the CSR policy as described above in this paper, the organization should take initiative for welfare of the society and should perform its activities within the frame work of environmental norms.

Assumptions

The assumptions of the tax plan have taken into consideration the geographical common corporate practices (Greece-Cyprus-Tax haven) as well as the basic functions of a Multinational Corporation Technology company.

The Tax Plan

Investors and shareholders have become some of the most important allies of the CSR movement over the years. While investors are influenced by an organization's level of participation in CSR (Obiri, 2011), the shareholders are considering social issues to ensure a morally appropriate use of their money (Glac, 2010). Considering the fact that according to the proposed tax plan, the Multinational Corporation pays 13% of its operating profit to its resident country (Cyprus), it is a positive CSR driven effect that investors may appreciate. Thus, the tax plan fulfills all the requirements made by the stakeholders (shareholders, investors, society) as the company reduces its tax obligations while considering the environment and, finally, increases the added value of firm.

Conclusions

Companies look for ways to maximize shareholder value and as such, multinational companies are in particular well-placed to exploit tax havens and 'hide' true profits thereby avoiding tax. However, most multinational companies relocate only the IP ownership to tax havens such as Bermuda, Bahamas, Bahrain, etc., and not the work that generates the business revenue, which remain in countries that are not tax havens. As such, the paper propose a "fair" tax plan, where the multinational company relocates the IP ownership in order to split the tax payable and to maximize profit, while in the same time it follows CSR policies.

Consequently, as Waegenaere et al. (2010) found, the present value of income taxes collected by the domestic government is weakly negative when production takes place in the foreign country.

Recommendations

There are two different views in how do people perceive the fact that multinational technology companies avoid taxes using the tax havens opportunities. The 'business' people accept such practices as they can easily understand the need of having a profitable company for the shareholders. Moreover, no one could blame them that this practice is illegal as most of them are based on the existing laws. According to Forbes, these companies aren't doing anything illegal, but rather "gaming" the tax code system (Guglielmo, 2013). On the other hand, the 'simple' people who pay all of their taxes perceive such practices as unethical. According to the Guardian, tax avoidance has been branded by some as an immoral and unethical practice that undermines the very integrity of the tax system (Foster, 2013).

A time has come to re-examine the provisions and settle these controversies so that there is more certainty and fairness in the manner in which the law will be applied (Gupta, 2009). As such, the governments should provide some clarity around what is tax avoidance, what is acceptable and what is not, so as to prevent tax conflicts and define what is morally wrong.

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Appendices

Appendix 1[9] - Foreign investments of the main capitalist countries in millions of pounds sterling

Segment Results

The tables below present reportable segment results net of intersegment eliminations *(in millions):*

Americas	January 1, 2012	January 2, 2011	% Change	January 1, 2012	January 2, 2011
				As a % of Americas	
Quarter Ended				total net revenues	
Net revenues:					
Company-operated stores	$ 2,356.2	$ 2,148.0	9.7 %	91.4 %	92.3 %
Licensed stores	216.4	173.8	24.5	8.4	7.5
Foodservice and other	6.0	6.1	(1.6)	0.2	0.3
Total net revenues	**2,578.6**	**2,327.9**	10.8	**100.0**	**100.0**
Cost of sales including occupancy costs	1,006.7	875.9	14.9	39.0	37.6
Store operating expenses	874.8	795.6	10.0	33.9	34.2
Other operating expenses	20.5	17.9	14.5	0.8	0.8
Depreciation and amortization expenses	97.1	98.2	(1.1)	3.8	4.2
General and administrative expenses	16.3	13.3	22.6	0.6	0.6
Total operating expenses	2,015.4	1,800.9	11.9	78.2	77.4
Operating income	**$ 563.2**	**$ 527.0**	6.9 %	**21.8 %**	**22.6 %**
Supplemental Ratios:					
Store operating expenses as a percentage of company-operated stores revenue				37.1 %	37.0 %

EMEA	January 1, 2012	January 2, 2011	% Change	January 1, 2012	January 2, 2011
				As a % of EMEA	
Quarter Ended				total net revenues	
Net revenues:					
Company-operated stores	$ 264.3	$ 225.2	17.4 %	87.2 %	86.9 %
Licensed stores	31.2	26.5	17.7	10.3	10.2
Foodservice	7.5	7.4	1.4	2.5	2.9
Total net revenues	**303.0**	**259.1**	16.9	**100.0**	**100.0**
Cost of sales including occupancy costs	150.4	122.7	22.6	49.6	47.4
Store operating expenses	93.8	76.8	22.1	31.0	29.6
Other operating expenses	8.6	8.1	6.2	2.8	3.1
Depreciation and amortization expenses	14.2	12.2	16.4	4.7	4.7
General and administrative expenses	16.5	16.4	0.6	5.4	6.3
Total operating expenses	283.5	236.2	20.0	93.6	91.2

[9] Source: (Emmanuel, 1972)

Income from equity investees	0.3	2.3	(87.0)	0.1	0.9
Operating income	**$ 19.8**	**$ 25.2**	(21.4) %	**6.5 %**	**9.7 %**

Supplemental Ratios:

Store operating expenses as a percentage of company-operated stores revenue	35.5 %	34.1 %

Appendix 2[10] – Share of Projected World Estimates of GDP

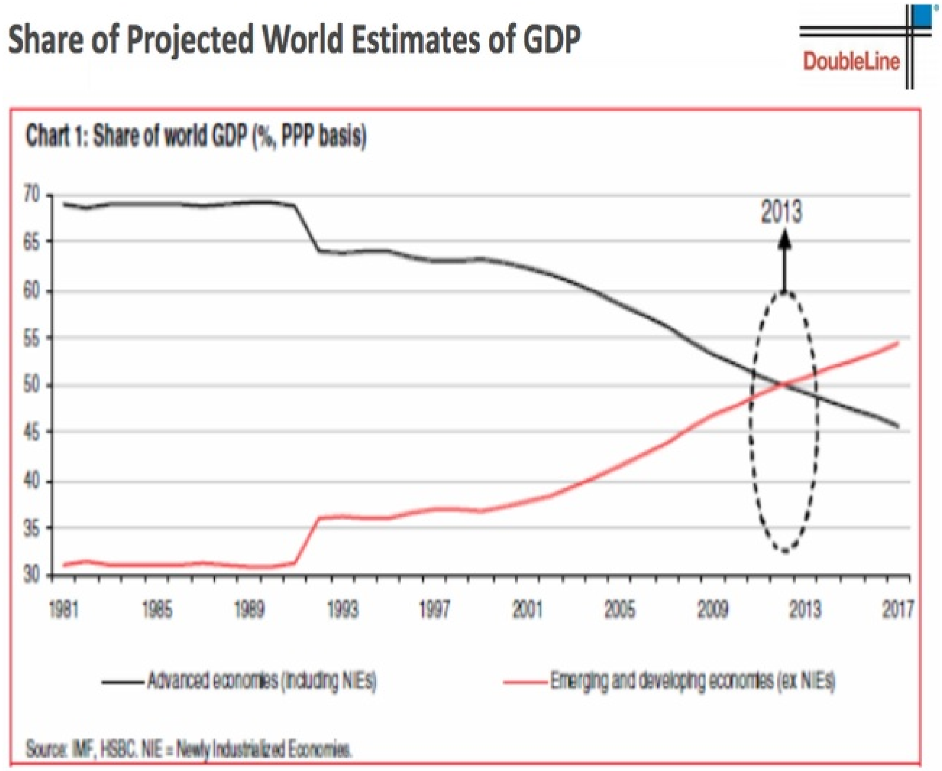

Figure 1. Share of Projected Estimates of GDP

[10] Source: IMF, results reflect current/nominal values of Investment

Appendix 3[11] – Share of Projected World Estimates of GDP

Corporate tax rates table

This table provides a view of global corporate tax rates between 2006 and 2013.
Use our interactive Tax rates tool to compare tax rates by country or region.

Location	2006	2007	2008	2009	2010	2011	2012	2013	Footnotes
Afghanistan	0	20	20	20	20	20	20	20	+ Show
Albania	20	20	10	10	10	10	10	10	+ Show
Angola	35	35	35	35	35	35	35	35	+ Show
Argentina	35	35	35	35	35	35	35	35	+ Show
Armenia	20	20	20	20	20	20	20	20	+ Show
Aruba	35	28	28	28	28	28	28	28	+ Show
Australia	30	30	30	30	30	30	30	30	+ Show
Austria	25	25	25	25	25	25	25	25	+ Show
Bahamas	0	0	0	0	0	0	0	0	+ Show
Bahrain	0	0	0	0	0	0	0	0	+ Show
Bangladesh	30	30	30	27.5	27.5	27.5	27.5	27.5	+ Show
Barbados	25	25	25	25	25	25	25	25	+ Show
Belarus	24	24	24	24	24	24	18	18	+ Show
Belgium	33.99	33.99	33.99	33.99	33.99	33.99	33.99	33.99	+ Show
Bermuda	0	0	0	0	0	0	0	0	+ Show
Bolivia					25		25	25	+ Show
Bonaire							0	0	+ Show
Bosnia and Herzegovina	10	10	10	10	10	10	10	10	+ Show
Botswana	25	25	25	25	25	22	22	22	+ Show
Brazil	34	34	34	34	34	34	34	34	+ Show
Bulgaria	15	10	10	10	10	10	10	10	+ Show
Cambodia					20	20	20	20	+ Show
Canada	36.1	36.1	33.5	33	31	28	26	26	+ Show
Cayman Islands	0	0	0	0	0	0	0	0	+ Show
Chile	17	17	17	17	17	20	18.5	20	+ Show
China	33	33	25	25	25	25	25	25	+ Show
Colombia	35	34	33	33	33	33	33	25	+ Show
Costa Rica	30	30	30	30	30	30	30	30	+ Show
Croatia	20	20	20	20	20	20	20	20	+ Show
Curacao						34.5	27.5	27.5	+ Show
Cyprus	10	10	10	10	10	10	10	12.5	+ Show
Czech Republic	24	24	21	20	19	19	19	19	+ Show
Denmark	28	25	25	25	25	25	25	25	+ Show
Dominican Republic	30	25	25	25	25	29	29	29	+ Show
Ecuador	25	25	25	25	25	24	23	22	+ Show

Figure 2. Corporate tax rates table

[11] Source: KPMG, Corporate tax rates table.