CLOUDS IN MY COFFEE

Corporation tax

This is a story about Internet companies and coffee shops. I should point out immediately that I am writing this column from my temporary home in Amsterdam, where I have been seconded for a short period. "Coffee shops" mean something quite different here so, to avoid any confusion, I am referring to a large multinational chain where coffee just means, well, coffee – even when it is called a pistachio and rose mocha. And the Internet company I am thinking of? Google it.

> *What is wrong with companies seeking to minimise their taxes?*

Alert readers may have a sense of where I am going with this. One cannot these days read a newspaper or watch a news programme without at least one reference to large, multinational companies – the above mentioned being just two examples – that are being pilloried for "playing" the international tax framework to minimise their tax liabilities.

As a taxpayer, I don't want to pay any more tax than is legally due. I'm sure I'm not alone in this. What then is wrong with companies seeking to minimise their taxes? A tax bill is, after all, a negative cost to a business alongside other costs like premises, raw materials, transport, manpower and energy. No one should fault a financial director for seeking to control or reduce these costs – that is, after all, their job – provided, of course, that the methods employed are legal.

Genuine tax planning is not only perfectly legal but, in the context of company finance directors, it is an essential part of their remit. For example, all global brands – from soap powder to digital technology – will arrange some form of international royalty structure to ensure that their "intellectual property" – trademarks, copyrights, patents, industrial design rights – is not only protected but structured in the most tax efficient manner.

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What these companies have been doing – and the large multinationals with the household names are probably just the tip of the iceberg – is legal. They have simply been utilising the tax rules as laid down by a variety of different governments worldwide. If the net effect is "generous", and allows companies to avoid tax, then the onus is on governments worldwide to rectify the situation. It is not realistic to expect companies to pay more tax than is due.

No doubt there has been some less than legal stuff going on as well – there always has been and always will be. But, as we always say at Sovereign, any tax planning that is not fully compliant or that simply relies on not making required disclosure to the relevant authorities is not tax planning at all. It is evasion – or to use another

word, fraud. Being clear about this difference is important; as former UK Chancellor the late Lord (Denis) Healey so succinctly put it, "the difference between tax avoidance and tax evasion is the thickness of a prison wall."

So, why all this fuss over multinational corporations now? After all, there was precious little outrage prior to the global financial crisis in 2008. Well, every country running significant budget deficits – as nearly all were in the aftermath of the financial crisis – was deemed at imminent risk of becoming another Greece unless it immediately began cutting spending and raising taxes. Fiscal probity, we were assured, was the way out of the mess.

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So, in this context of national belt tightening, people were shocked to learn that some of the world's biggest companies were paying virtually little or no tax in countries where they doing a lot of business. There was also the perception that multinationals were enjoying an unfair tax advantage over their domestic competitors because their international operations allowed for substantial tax management to minimise the corporate tax burden at group level.

It is often said that there is no such thing as bad publicity. I can't help thinking that the finance directors of some of these firms who have had to defend their practices might disagree. They are only doing their job and are only working within the parameters laid down by governments around the world.

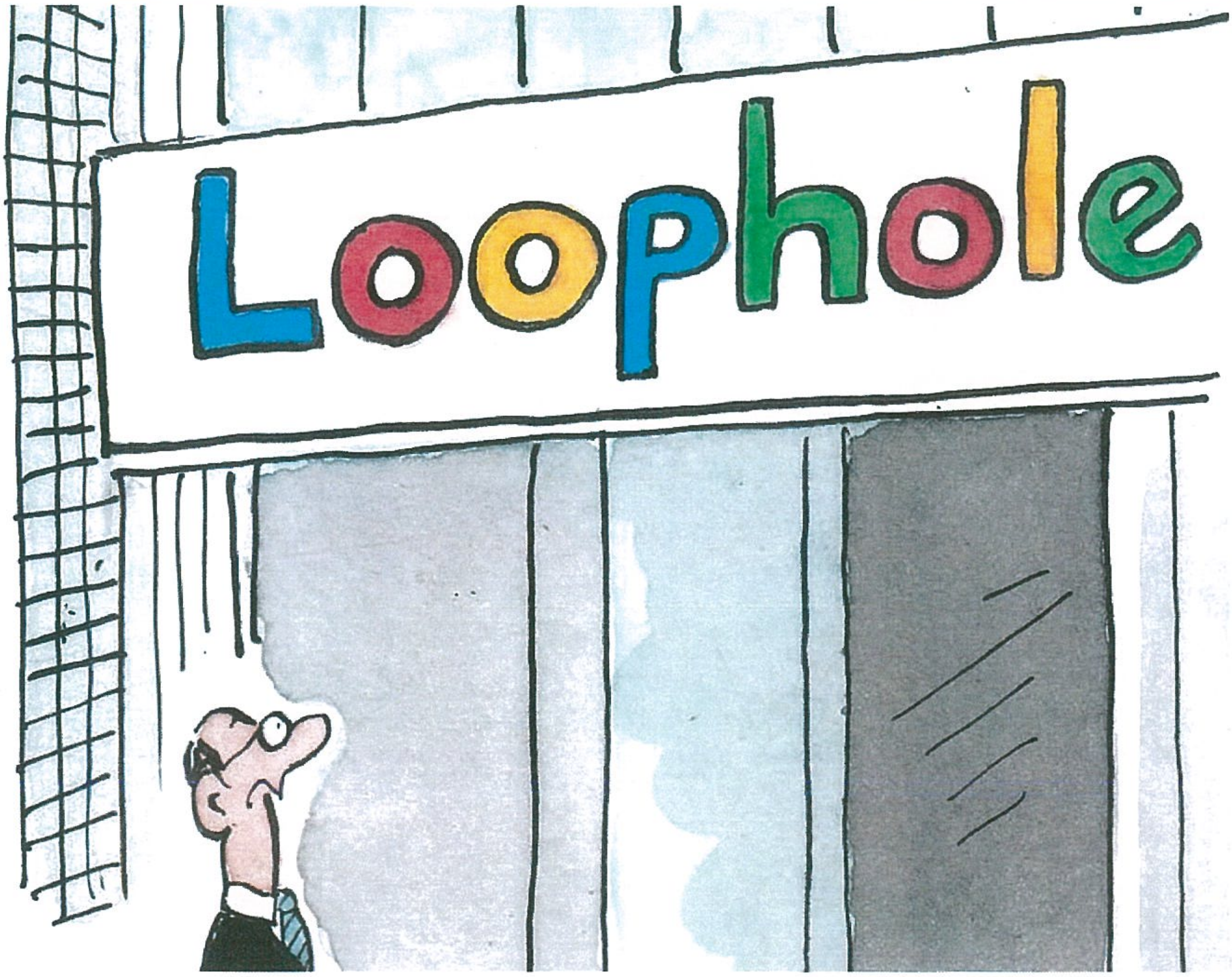
There are a number of valid reasons for the differences between tax obligations and tax payments...

The reporting of these cases has often verged on the irresponsible. Joe Public has been whipped up into a frenzy of indignation against multinationals and their advisors – and, indeed, offshore financial centres. All this indignation should more properly be directed against the various onshore governments that created the environment, through legislation and secret tax rulings, whereby multinationals could pick and choose the most amenable base for their international operations.

The UK, meanwhile, has been roundly criticised for its unilateral £130 million tax settlement with Google on back taxes. Business Secretary Sajid Javid conceded that it was "not a glorious moment" for the government. He said that the agreement has fuelled a "sense of injustice" that big businesses receive preferential treatment.

To me, there is another side to the argument. First, the critics generally cite the "statutory" rates of tax – for example 35% in the US or 20% in the UK. However, the statutory rate does not reflect the tax expenditures that reduce the "effective rate" on corporate profits – that is, what corporations actually pay in taxes as a share of their profits. Secondly, one of the largest corporate tax expenditures is "deferral of income from controlled foreign corporations", which allows multinationals to delay paying tax on their foreign profits. Companies get a credit against their home taxes for the taxes they pay to other countries, and they pay no home taxes on the profits they earn in other countries unless they "repatriate" them.

In other words, there are a number of valid reasons for the differences between tax obligations and tax payments and those who point to the gaps between statutory rates and effective rates are uninformed or disingenuous. These companies are following accounting rules. They are not doing anything illegal.



World governments are currently attempting to bring the international tax framework up to speed with the modern, digital business world. The OECD's base erosion and profit shifting – "BEPS" for short – initiative is designed to combat tax-planning strategies that exploit gaps and mismatches in tax rules to make profits disappear for tax purposes or to shift profits to low-tax locations. It aims to give countries the tools they need to ensure that profits are taxed where the economic activities that generate those profits are performed, not least through a proposal to introduce country-by-country profits reporting. The BEPS initiative will require close international cooperation, transparency, data and reporting requirements from all countries and multinationals.

Maybe it is time for corporation tax to be seriously overhauled...

There is however a more radical solution. Maybe it is time for corporation tax to be seriously overhauled – or perhaps even scrapped altogether in its current form? I am not alone in this view. Former UK Chancellor, Lord (Nigel) Lawson, joined the debate by suggesting that corporation tax has "had its day". He argues that it would be better to levy a tax on corporate sales, stating that "while multinationals can artificially shift profits to whatever tax jurisdictions they choose, sales are where they are, and can't be shifted."

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I expect to see continued fallout from these stories although it worries me that the result will be yet more regulation and complexity and that will affect business, individuals and their advisors. The important point, as always, is to keep a close eye on these developments, particularly those of us whose job it is to advise clients on such matters.

Jurisdictions such as Gibraltar, where so much of our financial sector – and the employment and revenue that goes with it – is dependent on our role in the legitimate structuring of international investments, need to watch any ill-advised comments and respond to them when we can and as robustly as possible. We should not be reticent or defensive but instead must play a full and active part in the global corporate tax debate.

Ian Le Breton
is Managing Director of Sovereign Trust (Gibraltar) Limited

Tel: +350 200 76173
Email: ilebreton@SovereignGroup.com