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«Tax optimisation»: the corporate goings-on

Free Riding is unfair

Multinational corporations are turning to offshore centres to make massive tax savings. They are supported in this by consulting firms such as PricewaterhouseCoopers, which offer an aggressive «tax optimisation service». While developing countries are powerless against this practice, the governments of industrialised countries are beginning to fight back.

In early April the General Accounting Office (GOA) – a kind of business inspectorate that works for the US Congress – dropped something of a bombshell when it announced that two-thirds of the companies operating in the USA paid no federal taxes on their profits between 1996 and 2000. For the year 2000, 94 per cent of all US firms paid taxes of less than 5 per cent of their profits.

US firms have long been transferring their profits to nearby Caribbean tax havens. According to US News and World Report, these transfers are now worth more than USD 5 trillion. A 2001 US Senate report put the amount of taxes consequently foregone at USD 45 billion annually. Small wonder then that in the USA the share of corporate profit taxes in overall federal tax revenue has now fallen to 7.4 per cent, the lowest since 1934.

«Tax me if you can»

The US example is impressive, but by no means unique. It merely illustrates the worldwide trend toward shifting the tax burden away from mobile well-to-do individuals and enterprises to less mobile «little people» and firms operating locally. The Bush Administration provided the additional impetus by lowering profit tax rates and riddling tax laws with loopholes. This led Cassandra Q. Butts of the private think tank Center for American Progress to charge the Administration with «furthering the culture of tax avoidance by big corporations and creating a pervasive unfairness in our tax code».

Another Bush critic is David Burnham, a director of the Syracuse University Research Organization, who says that contrary to public statements, the Administration is not actively fighting white-collar crime and tax evasion. There were «fewer audits, fewer penalties, fewer prosecutions». Only three in ten big companies had to undergo any audit at all. That was an open invitation to exploit tax loopholes aggressively.

Lucy Komisar, a freelance journalist in New York and an activist in the Tax Justice Network co-founded by the Swiss Coalition, knows it: «In 1999, Microsoft, owned by the richest man in the world [Bill Gates], reported $12.3 billion US income and paid zero federal taxes». Not only had other well known multinationals paid no taxes, but had even got money back from the US tax authority. The list includes Enron, Goodyear, Colgate-Palmolive and others.

The tax cheats' primer

There are various ways of reducing taxes, including the legal, semi-legal and illegal. Firms lobby for derogations, special agreements or deductions and the authorities willingly oblige. Multinationals open subsidiaries in tax havens such as Bermuda or Jersey and profit from low taxes, loose regulation and lax controls. They attach other subsidiaries to the new «parent company» in the tax haven, thereby taking advantage of further loopholes. They build up a complex internal system of credit support, booking fake interest payments, high management fees, royalties, patent fees, etc.

By over- and under-invoicing, also called *transfer pricing*, they shift their profits about at will, deliberately placing them where taxes are lowest. The more global the corporation, the greater its possibilities. In recent years, the number of subsidiaries has grown exponentially: the UNCTAD 1990 Global Investment Report cited 37,000 corporations with 175,000 foreign subsidiaries, whereas by 2003 that figure was 64,000 corporations with 870,000 subsidiaries. Some 60 per cent of global trade takes place within transnational corporations, which affords ample scope for all manner of manipulations.

Willing helpers

Corporations maintain huge teams devoted to seeking out ways and means of saving on taxes. Countless consulting and accounting firms are at their service. According to the London-based «Economist» magazine, in the past few years the world's four leading consulting and accounting firms alone (PricewaterhouseCoopers, KPMG, Ernst&Young, Deloittes) have tripled their «tax optimisation» personnel. They are aggressively selling their comprehensive tax avoidance programmes designed to minimise the taxes paid by their clients. Democratic US Senator Carl Levin (Michigan) states that KPMG alone is believed to have sold USD 124 million worth of these tax avoidance vehicles in the USA, which meant a tax shortfall of at least ten times as much to the national coffers.

Such practices are also being applied in developing countries, as the Lima economist and financial expert Oscar Ugarteche recently explained on a visit to Switzerland, using the example Peru. In that country, foreign corporations had no need whatsoever to resort to illegal methods such as tax fraud or tax evasion. To attract investments, the Government concludes secret special agreements with them providing for multi-year tax-waivers, investment assistance and free infrastructure services amongst other things. The result is that hardly any foreign firm in Peru pays taxes.

Governments take action

In the industrialised countries – mainly the USA and UK – media reports on scandalous practices have raised public awareness and spurred politicians to action. Presidential candidate John Kerry has often shown himself to be an opponent of aggressive tax optimisation. The initiators of the abovementioned GOA study were two Democratic Senators. At the end of 2002 the US Senate approved a law under which US enterprises would be excluded from defence ministry contracts if they moved their profits to offshore centres. Similar endeavours are afoot in individual US federal states.

In the British Parliament, Labour MP Harry Cohen asked the Chancellor of the Exchequer Gordon Brown whether he knew how much tax revenue Britain was losing on account of transactions in the Channel Islands and other UK dependencies. Brown replied that he had no idea. Essex University Law Professor Prem Sikka then calculated for him that it was at least £25 billion or £425 per inhabitant, but that it could even be three times as much ...

Now Brown too wants to put limits on the tax optimisation industry. In future, consultancy and accounting firms, legal experts and banks that sell tax avoidance programmes will have to register them with the British tax authorities within five days or face a £5000 fine. Those filing late will also pay £600 per day. For enterprises as financially powerful as PricewaterhouseCoopers UK whose profit is £1,505 million, this is of course a manageable contribution.

And what of Switzerland?

On the fringes of the spring meeting of the IMF and World Bank at the end of April, Australia, Canada, the UK and US announced joint action to tackle aggressive international tax evasion. At the same time, tax experts from 27 countries met at the invitation of New Zealand to share their experiences in the fight against cross-border tax avoidance programmes. Naturally, Switzerland was not present.

Box

Pricewaterhouse Switzerland

There are many accounting and tax consultancy firms operating in Switzerland as well. PricewaterhouseCoopers is a big fish. On its website the firm is promoting a brochure on International Transfer Pricing (cost, Frs 230.–), and states that mainly internationally active firms faced the problem of profit distribution within the corporation often not being in line with tax requirements (www.tls.pwc.ch). It also clearly advises in English: «Design your transfer pricing policy to maximise the benefits from differences in corporate tax rates across the world».

Eric Hess from the Swiss Federal tax administration sees this as no problem: tax consultants are part of the free market, and tax avoidance is not illegal. Tax consultants in Switzerland are not subject to any reporting obligation regarding their tax avoidance programmes such as that currently being introduced in the UK (see lead article). In contrast to USA or UK practice, the tax authorities check every corporate tax declaration. Hess is convinced that operations not compliant with the tax laws are not approved. So were the manipulations of the Winterthur coffee trading company Volcafé, which used a letterbox company in Jersey to save millions in taxes in Switzerland and in developing countries[1], just an isolated case?

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[1] Website in English: http://www.evb.ch/index.cfm?page_id=2954