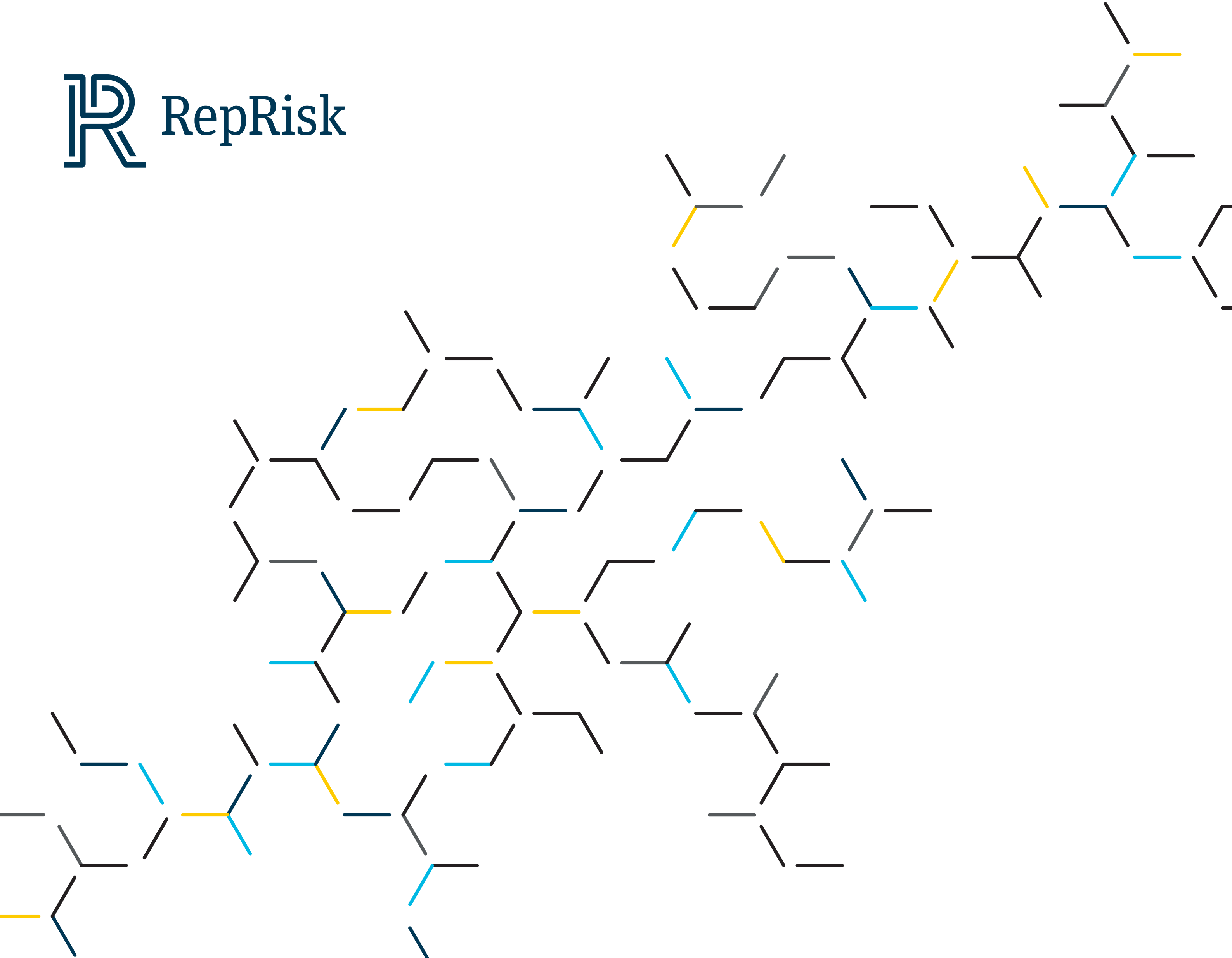

RepRisk Special Report

Tax Optimization

June 2016

About RepRisk

RepRisk is a leading business intelligence provider, specializing in environmental, social, and governance (ESG) risk analytics and metrics.

Harnessing a proprietary, systematic framework that leverages cutting-edge technology and hands-on human intelligence in 15 languages, RepRisk curates and delivers dynamic risk information for an unlimited universe of companies.

Since 2006, RepRisk has built and continues to grow the most comprehensive ESG risk database that serves as a due diligence, research, and monitoring tool in risk management, compliance, investment management, corporate benchmarking, and supplier risk. The database currently includes risk profiles for over 65,000 listed and non-listed companies, 17,000 projects, as well as for every sector and country in the world.

Headquartered in Zurich, Switzerland, RepRisk serves clients worldwide, including global banks, insurance providers, investment managers, and corporates, helping them to manage ESG and reputational risks in day-to-day business.

RepRisk provides the transparency needed to enable better, more informed decisions.

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Foreword RepRisk

I am pleased to announce the release of our Special Report on Tax Optimization, a practice that although not illegal, is deemed unethical, as paying taxes in the countries where a company operates is seen as the socially responsible thing to do. Companies that use legal loopholes and overseas tax havens to avoid paying corporate tax can face reputational risks, as they are perceived to be denying governments and the societies in which they operate the necessary funds to provide education, healthcare, and infrastructure.

The case studies in the report highlight incidents of tax avoidance in the Technology, Retail, and Support Services (consulting) sectors, and show that large multinationals are continuing to practice tax avoidance. It is interesting to note that the two countries most closely associated with tax avoidance are the United Kingdom and the United States.

The aim of the report is to provide transparency and to highlight those companies that may face reputational risk as a result of their tax policies.

Philipp Aeby CEO, RepRisk AG

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Introduction

Taxes usually rank as one of the most significant expenses that a company or organization faces. Particularly in the case of globally active companies, strategic boardroom decisions can and do mean substantial cost differences that can number in the USD millions, or – in the case of the major players – billions.

With so much at stake, companies can face immense pressure to optimize their tax structure and reduce their tax liability as much as possible. However, the decisions taken in this regard are often the difference between compliance and non-compliance, as well as between the perhaps ethically questionable practice of tax optimization, and outright tax evasion.

The term “tax avoidance” (tax optimization) is defined by the Financial Times (FT) as: “… using the tax law to obtain a tax advantage that the government never intended. It frequently involves contrived, artificial transactions that serve no purpose other than to reduce tax liability.” The FT defines “tax evasion” as the “practice of using illegal methods to avoid paying tax.”

ActionAid has claimed that developing countries lose around USD 138 billion in revenues each year due to tax optimization schemes practiced by multinational companies. These revenues are often needed to provide education, healthcare, and infrastructure.

Since 2014, RepRisk has identified the most severe incidents of Tax Optimization in three main sectors: Technology, Retail, and Support Services (Consultancy), with a number of multinational tech companies leading the way.

Introduction

The tables below outline data (2014 to the present) related to tax optimization from the Reprisk ESG Risk Platform, the most comprehensive database on ESG risks.

Top 5 companies: Tax optimization

1. Apple Inc
2. Google Inc
3. Amazon.com Inc
4. Alphabet Inc
5. Starbucks Corp

Top 5 sectors: Tax optimization

1. Banks
2. Retail
3. Software and Computer Services
4. Technology Hardware and Equipment
5. Travel and Leisure

Top 5 countries: Tax optimization

1. United Kingdom
2. United States of America
3. Luxembourg
4. Ireland
5. Switzerland

Top 5 NGOs: Tax optimization

1. Americans for Tax Fairness
2. Citizens for Tax Justice
3. International Consortium of Investigative Journalists
4. Organization United for Respect at Walmart
5. US Public Interest Research Groups

Case study on Google

Google, and its parent company Alphabet Inc., have been repeatedly accused of using “tricks” to avoid paying international corporate taxes. The UK, Italian, and French governments have criticized the company for routing profits to Google’s European headquarters in Ireland, where the corporate tax is only 12.5 percent, compared to 33 percent in France and nearly 40 percent in the US. The company allegedly transfers the funds from Europe to Bermuda and other tax havens, thus avoiding US taxes as well.

Google’s tax avoidance headlines have not been limited to Europe alone. The US-based nonprofit organization Truthout alleged in July 2015 that the company paid just 1.4% of its profits in state taxes – less than one-sixth of the required California rate. The company has also faced questions about its tax arrangements from a parliamentary committee in Australia.

In January 2016, following a six-year inquiry by the UK tax authorities, Google announced an agreement to pay GBP 130 million (USD 187.5 million) in back taxes for its UK sales between 2005 and 2015. The UK Public Accounts Committee however described the amount as “disproportionately small.” The company faced further criticism when it was alleged that its chief executive, Sundar Pichai, had been awarded a shares-based pay package that was worth GBP 12 million (USD 17 million) more than the tax deal agreed with the UK tax authorities.

The European Commission has also begun to scrutinize Google’s tax arrangements. The investigation is part of a wide-ranging probe on similar tax arrangements in the European Union that have allowed multinational companies to avoid USD billions in tax annually.

In February 2016, the French authorities ordered Google to pay EUR 1.6 billion (USD 1.7 billion) in unpaid taxes and stated that they would not negotiate a deal with the company. It was claimed that by channeling its profits through Ireland, the company had paid only EUR 5 million (USD 5.5 million) in corporate taxes in France in 2014, even though its revenues had amounted to EUR 225.4 million (USD 252 million). On May 24, 2016, the French authorities raided Google’s Paris office as part of the tax fraud investigation, amid claims that the company may have breached its fiscal obligations to France if it had failed to declare activities carried out in the country.

Technology sector

Case study on Amazon

The largest internet-based retailer in the US, Amazon, that posted revenues of USD 107 billion in 2015, has also been criticized in recent years for avoiding its tax obligations. The International Consortium of Investigative Journalists, the Wall Street Journal, and mainstream newspapers in Australia and Switzerland reported probes concerning Amazon's tax deals with Luxembourg.

In May 2014, Amazon was one of several multinationals criticized by the government in the German state of Baden-Wurttemberg. The company was accused of exploiting legal loopholes by processing most of its revenues through companies in Luxembourg, where tax rates are lower than in Germany. Such practices allegedly cause German tax authorities to suffer losses of up to EUR 160 billion (USD 179 billion) annually.

The European Commission has also investigated Amazon and other multinationals over suspicions that their tax arrangements constituted an illegal aid from governments and represented an illegal advantage over competitors. The EU's antitrust authority expressed concerns about the so-called "cosmetic" tax arrangements Amazon had reached with Luxembourg in 2003, and for which the company could face EUR hundreds of millions in back tax penalties.

As a result of the EU probe, Amazon revised its European tax practices in May 2015 and began posting sales in Britain, Germany, Italy, and Spain instead of channeling all sales through Luxembourg. The move meant that the company would face higher tax bills in the countries where it was doing business.

A final EU ruling on Amazon's tax deal with Luxembourg is expected in July 2016. It has been estimated that EU state regulators could order Luxembourg's tax authorities to recover about EUR 400 million (USD 447 million) in back taxes from the company.

The company was accused of exploiting legal loopholes by processing most of its revenues through companies in Luxembourg.

Case study on Apple

Apple's tax arrangements have also faced scrutiny. In March 2014, the company was accused of diverting profits worth AUD 8.9 billion (USD 6.4 billion) in Australia to a holding company in Ireland in order to avoid paying the correct amount of Australian tax. According to an Australian Financial Review investigation, the practice had been going on since 2004. Later that year, the European Commission determined that Ireland's tax treatment of Apple amounted to an illegal corporate subsidy.

In September 2015, Apple came under severe criticism when it was reported that the company had under-reported CNY 8.8 billion (USD 1.3 billion) in revenues in China, and had underpaid CNY 452 million (USD 68 million) in taxes due at the end of 2013.

That same month, a report by Al Jazeera America claimed that 72 percent of the largest 500 US firms had been using tax havens at the end of 2014 and collectively had held more than USD 2.1 trillion in offshore cash. According to the report, Apple held USD 181.1 billion in tax havens, the largest share of offshore money not subject to US taxes.

At the end of 2015, the Italian tax authority reached a EUR 318 million (USD 355.6 million) settlement with Apple after accusing the company of failing to pay taxes worth EUR 900 million (USD 1 billion). Italian prosecutors claimed that from 2008 to 2013, the company had channeled revenues made in Italy to its Irish-based unit. The settlement was reportedly one of the biggest in the country.

According to the report, Apple held USD 181.1 billion in tax havens, the largest share of offshore money not subject to US taxes.

Retail sector

Case study on McDonald's

Since 2014, fast food giant McDonald's has suffered some of the most widespread and severe criticism for its tax optimization tactics, prompting investigations by tax authorities in Europe, South America, and the United States.

In February 2015, a report entitled "Unhappy Meal" compiled by a coalition of European and American trade unions, and the NGO, War on Want, called on governments around the world to investigate corporate tax avoidance at McDonald's. The report claimed that the company avoided USD billions in corporate taxes from its European operations by funneling nearly EUR 4 billion (USD 4.47 billion) of revenues into a Luxembourg subsidiary staffed by 13 people, and alleged that the company's tax optimization practices could have cost EU governments over EUR 1 billion (USD 1.1 billion) in tax revenues from 2009 to 2013.

Following the report, the European Commission asked the government of Luxembourg to give details of its tax arrangements with McDonald's.

In October 2015, the Italian consumer association Codacons, also asked Italian prosecutors to investigate McDonald's for tax evasion, claiming that the company may have avoided payments of EUR 224 million (USD 250 million) to the Italian tax authorities.

In December 2015, the EU Commission launched an official investigation into McDonald's over the tax avoidance claims.

In April 2016, the French authorities ordered McDonald's France to pay EUR 300 million (USD 335 million) to cover unpaid taxes, after claiming that the company had funneled profits worth EUR 2.2 billion (USD 2.4 billion) from France to lower-tax jurisdictions such as Luxemburg and Switzerland. On May 18, 2016, the French police raided the headquarters of McDonald's Corp near Paris and seized documents and computers.

On June 7, 2016, the European Commission publicly disclosed secret exchanges between Luxembourg and McDonald's that show that Luxembourg allowed the company to pay no corporate tax on the income of McDonald's Europe Franchising SARL (MEF), a company headquartered in Luxembourg that received royalty payments from restaurants in Europe and Russia. In 2009, Luxembourg allegedly granted McDonald's tax exemption on royalties earned by MEF, provided that the profits had been declared and taxed in the US. However, McDonald's claimed that a tax treaty signed by the US and Luxembourg exempted the other contracting country from taxing the royalty income. A final ruling by the EU is still pending, but the EU Competition Commissioner has the power to force Luxembourg to recover the unpaid taxes.

Case study on Starbucks

Starbucks consistently underscores its desire to demonstrate ethical practices and good corporate social responsibility, yet the company has been in negative headlines several times over its tax optimization arrangements.

Particularly in Europe, and especially in the UK, Starbucks has been accused of dodging its tax responsibilities. In 2012, the company even faced a boycott in the UK when it was revealed that the company had made use of legal loopholes to reduce its UK taxes to a minimum. In April 2014, the coffee chain was again strongly criticized following allegations that it had only paid a total of GBP 8.6 million (USD 11.5 million) in UK corporate taxes since 1998.

Following severe public criticism, the company relocated its European headquarters – and thus its tax base – from the Netherlands to London. However, tax experts claimed that this would have little impact on its tax bill in the UK: by charging its sister companies high royalties fees, Starbucks had been posting a loss in its Netherland's headquarters since 2010.

The EU opened a formal investigation into Starbucks, as the company had paid less than 1 percent in corporate tax in the Netherlands in 2014 and had reported losses in European markets despite supposed annual sales of USD hundreds of millions. A preliminary decision in November 2014 accused the Dutch authorities of allowing the company to use unfair methods to reduce its tax bill. In particular, the EU criticized Starbuck's arrangement of paying royalties of USD tens of millions to a company in Britain for a coffee-roasting recipe, which they claimed was a tax avoidance scheme.

At the end of 2015, the EU Commission ordered Starbucks to pay back approximately EUR 30 million (USD 33.5 million) in taxes after claiming that the "sweetheart deal" that the company had arranged with the Netherlands had artificially reduced the firm's tax burden.

Particularly in Europe, and especially in the UK, Starbucks has been accused of dodging its tax responsibilities.

Retail sector

Case study on Walmart

American-based retailer Walmart – that has been repeatedly criticized for its low wages, paltry benefits, and oppressive working conditions – has also been severely criticized for allegedly shirking its tax responsibilities.

Both the NGO Americans for Tax Fairness (ATF) and the United Food and Commercial Workers (UFCW) union have accused Walmart of employing a variety of tactics to avoid paying USD billions in taxes owed in the US.

According to an ATF report in November 2014, the retailer exploited tax loopholes, including accelerated depreciation, to cut its tax bill by USD 5.1 billion for the four-year period from 2008 to 2012. The report, "How Walmart Is Dodging Billions in Taxes and Scheming to Avoid Billions More," claimed that Walmart avoids paying US taxes by keeping its profits offshore. It also stated that the company has engaged almost 75 lobbyists to promote a tax system that would eliminate all federal taxes on profits earned offshore, and a US law that would see the corporate income tax rate fall from 35 percent to 25 percent.

In June 2015, ATF further reported that Walmart had established a complex and opaque web of 78 subsidiaries in 15 different tax havens to allegedly pursue international tax optimization strategies. The union claimed that Walmart had placed around USD 76 billion of assets in tax havens such as the British Virgin Islands, the Netherlands, Luxembourg, Barbados, and Gibraltar, even though the company had no retail stores in these locations.

In the same month, an UFCW study reported that Walmart's tax haven subsidiaries depended on hybrid financial instruments and complex inter-company debt arrangements to reduce the company's tax bill. The study accused Walmart of failing to list any of these subsidiaries in its annual report with the US Securities and Exchange Commission.

At the end of 2015, Walmart was again cited in a report by the European Network on Debt and Development entitled, "Fifty Shades of Tax Dodging."

The retailer allegedly exploited tax loopholes, including accelerated depreciation, to cut its tax bill by USD 5.1 billion for the four-year period.

Support Services (Consultancy) sector

Financial advisory companies have repeatedly been criticized for creating complicated tax optimization schemes. In 2013, a professor at the University of Essex in the UK branded Deloitte, Ernst & Young, KPMG, and PriceWaterhouseCoopers Luxembourg as the “modern-day mafia” for providing companies with advice on how to avoid taxation, which he claimed led to serious social consequences. He criticized the consultancy companies for advising their clients on how to place money in tax havens or avoid taxes by making profits disappear through complicated transactions.

Case study on PricewaterhouseCoopers Luxembourg

In particular, the management consultancy firm PricewaterHouseCoopers Luxembourg (PwC) faced serious criticism throughout 2014. The company, along with large banks and a number of accountancy firms, was criticized for assisting China’s elite to use offshore companies to conceal their wealth and thus avoid taxes. Although not illegal, such action is often linked to conflict of interest and corruption. According to the International Consortium of Investigative Journalists (ICIJ), most of these offshore companies are registered in known tax havens, such as Samoa and the British Virgin Islands. The ICIJ claimed that PwC had assisted in establishing at least 400 such companies in these locations.

In March 2014, PwC came under harsh criticism when a US Senate report accused the heavy equipment manufacturer Caterpillar of avoiding USD 2.4 billion in US income taxes by moving the overwhelming majority of its profits to a Swiss affiliate. According to the report, the move was part of a strategy developed by PwC.

However, PwC faced a major reputational crisis in November 2014, when a former employee leaked documents showing that the company had been complicit in assisting a list of companies including IKEA, EQT Private Equity, Pepsi, and AIG, among others, to reduce their taxes by using tax havens such as Luxembourg and the Netherlands. The documents, known as “Lux Leaks,” were analyzed by the ICIJ, who claimed that between 2002 and 2010, the company had helped more than 340 clients avoid EUR billions in taxes by advising them to channel their profits through Luxembourg, where corporate tax rates can sometimes be less than one percent, and had used different tax planning schemes to optimize their clients’ tax costs.

In February 2015, UK Public Accounts Committee recalled the PwC’s top tax partner to a second hearing to give evidence on the company’s tax schemes. In 2013, he had assured the UK authorities that the firm did not “mass market tax products or promote tax products.” However, the Committee claimed that the evidence from the Lux Leaks had under-

Support Services (Consultancy) sector

mined his assurances, and accused the company of promoting tax avoidance “on an industrial scale.”

PwC has filed criminal charges for theft and violating business secrecy against two former members of its staff, claiming that they had stolen the documents leaked to the ICIJ. A third person, a journalist for France 2, was accused of complicity. The trial against the three men began in Luxembourg in April 2016. If found guilty, the whistleblowers could face up to five years in prison. PwC has also launched civil proceedings against the three men.

Between 2002 and 2010, the company had allegedly helped more than 340 clients avoid EUR billions in taxes by advising them to channel their profits through Luxembourg.

Case study on Mossack Fonseca

The Panama-based law firm Mossack Fonseca hit the headlines on May 9, 2016 when the International Consortium of Investigative Journalists published a searchable database of almost 214,000 offshore companies, allegedly set up by Mossack Fonseca to allow high-profile clients to conceal important financial information. The 2.6 terabytes of data, the largest ever release of information on offshore companies, was originally leaked to the Sueddeutsche Zeitung by a whistleblower, who asked to remain anonymous.

The data, which became known as the “Panama Papers,” provided an insight into how Mossack Fonseca’s activities had enabled twelve current and former heads of state, more than 128 international politicians, business tycoons, international banks, and corporations, as well as criminals, and members of Mafia groups, to launder money and optimize their tax obligations or avoid them completely. Allegedly, Mossack Fonseca had set up the secret offshore entities for over 360,000 clients in tax havens around the world, sometimes providing a sham director in order to conceal the name of the true shareholder.

On April 12 and April 22, 2016, Panamanian prosecutors raided the head office of Mossack Fonseca in Panama, seizing bags of shredded documents. The investigations into the company are still ongoing.

Methodology

RepRisk Special Reports are compiled using information from the RepRisk database, which monitors environmental, social and governance (ESG) risks or companies, projects, sectors and countries. The RepRisk database currently contains risk incidents on over 65,000 listed and non-listed companies, as well as over 17,000 projects. RepRisk analysts monitor the issues related to ESG risk across a broad shareholder and other stakeholder audience of NGOs, ac demics, media, politicians, regulators and communities. Once the risk incident has been identified with advanced search algorithms and analyzed for its novelty, relevance and severity, risk analysts enter an original summary into the database and link it to the companies and projects in question. No article is entered twice unless it has been escalated to a more influential source, contains a significant development, or has not appeared for the past 6 weeks.

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