Organizing Tax Avoidance in Large Corporations

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Definition

• Tax avoidance (Stiglitz, 1985): Explicit reduction of tax liabilities

• Tax evasion: Illegal practice to avoid paying tax liabilities
What would happen if people like you / me violate the tax law in Sweden?

→ Tax offender (Criminal)
→ Skatteverket / Polisen

What would happen if IKEA / Starbucks / Google violates the tax law in Sweden?

→ Tax planning / Tax avoidance
→ Investigation ???

→ Tax avoidance is a Legal practice to avoid paying tax liabilities
A problem for whom?

Oxfam

Christian Aid

ActionAid

#occupiedwallstreet movement, 2011
Crimes of globalization

“Crimes of globalization are those demonstrably harmful policies and practices of institutions and entities that are specifically a product of the forces of globalization, and that by their very nature occur within a global context”.

(Rothe and Friedrichs 2015, p. 26)
Increasing attention to tax avoidance

PWC: 548 tax rulings in favour of 340 MNC

HSBC: 106,000 clients, 203 countries +$100 billion

Liechtenstein Leaks: 170 countries, 120,000 offshore companies + individuals

“But Nobody Pays That,”
David Kocieniewski,

Methods of tax avoidance - Basic schema

**Country 1**
Parent Corporation A
Shareholder/investor

**Country 2**
Subsidiary B
Wholly-owned by A

**Country 3**
Wholly-owned by B/
Second-tier subsidiary A

Diagram:
- A (Parent Corporation A) transfers R&D to B (Subsidiary B)
- B receives R&D services from A
- B licenses C (Second-tier subsidiary A) with Transfer rights
- C pays Royalties to B
- B pays Buy-in payment and R&D Services to A
Methods of tax avoidance

- Profit shifting: Operational activities (higher-tax state) move to a subsidiary (lower-tax state)
  - **Ireland →** Corporate income tax rate: 12.5%
  - **Switzerland →** Corporate income: 0% non-residents
  - **Bermuda →** 0% (total exemption), Government fee
- Payment for intangibles: Include royalties for the use of licences, brands, patents
  - **Netherlands →** Innovation Box regime: 5% corp income
- Transfer pricing: Payments for goods (and loans) between a parent company and subsidiary
The Starbucks case

Starbucks Manufacturing EMEA BV (Netherlands)

Starbucks Mfg (Netherlands)

Starbucks Coffee Trading Sarl (Switzerland)

Rain City CV, Emerald City CV (Netherlands)
Starbucks Coffee International Inc. USA

The Google case

Google Incorporated
USA
Tax paid: 0
No double taxation

Google Algorithms
Bermuda
Tax paid: 0
No double taxation

Google Ireland Limited
Ireland
Tax paid: £6m
12% rate (0.6% profits)

Royalties: 99.4% profits
Sales locally, invoices Ireland

No double taxation
No double taxation
No double taxation
Methods of tax avoidance (Cont…)

- Conduit: A corporation channels money through a country with low corporate tax rate
  - Mauritius → India; BVI → China; Cyprus → Russia
- Hybird entities: Obtain a deduction for the same cost in two different countries
  - Switzerland: Capital income for non-residents 0%; Witholding tax for royalties: 0%
  - Belgium: 95% Dividends are exempt
  - Luxembourg: Treaty with Belgium → no taxed
Offshore territories

Cayman Islands (June, 2015):

- 58,238 inhabitants
- Second Financial Center (Portfolio invest. asset)
- 96,554 companies
- 196 banks
- 11,061 mutual funds
- 752 insurance companies
- 144 trust companies
→ Ugland House: 18,000 companies

IMF: 46 territories
OECD: 70 territories
TJN: 82 territories

Source: http://visual.ly/locations-offshore-tax-jurisdictions
Inward direct investment of top ten economies

Offshore countries: China, P.R.: Hong Kong, Netherlands, Luxembourg, Japan, Switzerland, Virgin Islands, British
Non-offshore countries: Brazil, Canada, China, P.R.: Mainland, France, Germany, Spain, United States, United Kingdom

Source: Coordinated Direct Investment Survey (CDIS) by the IMF
Available at: http://data.imf.org/?sk=40313609-F037-48C1-84B1-E1F1CE54D658&sd=141046933565&ss=1390030109571
Top ten Swedish investment countries include:
Offshore Countries: China, P.R.: Hong Kong, Luxembourg, Netherlands, Singapore, Switzerland
Non-offshore Countries: China, P.R.: Mainland, France, Germany, United States, United Kingdom

Source: Coordinated Direct Investment Survey (CDIS) by the IMF
Available at: http://data.imf.org/?sk=40313609-F037-48C1-84B1-E1F1CE54D6D5
Total inward direct investment – Sweden Vs. Top 10 economies (%)

Top ten Swedish investment countries include:
Offshore Countries: China, P.R.: Hong Kong, Luxembourg, Netherlands, Singapore, Switzerland
Non-offshore Countries: China, P.R.: Mainland, France, Germany, United States, United Kingdom

Source: Coordinated Direct Investment Survey (CDIS) by the IMF
Available at: http://data.imf.org/?sk=40313609-F037-48C1-84B1-E1F1CE54D6D5&sd=1410469433565&ss=1390030109517
## Top 10 direct investment countries in Sweden (2013, US$, Millions)

<table>
<thead>
<tr>
<th>Country</th>
<th>Investment (US$ Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Netherlands</td>
<td>4342358</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>3251506</td>
</tr>
<tr>
<td>United States</td>
<td>2763956</td>
</tr>
<tr>
<td>China, P.R.: Mainland</td>
<td>2331238</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1607970</td>
</tr>
<tr>
<td>China, P.R.: Hong Kong</td>
<td>1195301</td>
</tr>
<tr>
<td>Germany</td>
<td>926532</td>
</tr>
<tr>
<td>France</td>
<td>783712</td>
</tr>
<tr>
<td>Switzerland</td>
<td>770327</td>
</tr>
<tr>
<td>Singapore</td>
<td>750078</td>
</tr>
</tbody>
</table>

Source: Coordinated Direct Investment Survey (CDIS) by the IMF
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What do we know about tax avoidance...

- Who uses it?
  Multinational companies (Halmon, 2010)

- Who decides?
  CEOs (Dyreng, Hanlon and Maydew, 2010)

- When to use it?
  High quality governance (Desai, 2009)
  Non-family firms (Chen, 2010)
  Risk-takers [fine/scandal] (Hanlon, 2009)
  Spend on auditing firms (Dyreng, 2010)
Is the top leadership of the organizations promoting tax avoidance?

- Cross-national analysis
- Sample size: 22 countries (including Sweden)
  - High-income: 15; Medium-income: 6; Low-income: 1
- Data:
  - Global Competitiveness Report 2012-2013 (Reports 99 indicators base on surveys with 100 CEOs in 144 countries)
Hypotheses tested

• H1: CEOs who report that their firms have a strong ethical behaviour are less likely to adopt tax avoidance mechanisms.

• H2: Corporate boards and investors who demand that management be highly accountable tend to reduce the use of tax avoidance mechanisms in their corporations.

• H3: In countries with strong auditing standards, corporations are less likely to adopt tax avoidance strategies.
## Results of OLS regression on the nature of tax avoidance

<table>
<thead>
<tr>
<th>Hypothesis</th>
<th>Predicted</th>
<th>Final Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>EthicBehav</td>
<td>H1</td>
<td>Negative</td>
</tr>
<tr>
<td>EfficCorpBoard</td>
<td>H2</td>
<td>Negative</td>
</tr>
<tr>
<td>StregthAudit</td>
<td>H3</td>
<td>Negative</td>
</tr>
</tbody>
</table>

### Control variables

- **Constant**: 3.813 (0.493) **
- Adjusted $R^2$: 0.940
- Observations: 22
- $F$: 18.366*

* * * indicate significance at 10%, 5%, and 1%, respectively.

Dependent variable: Tax Avoidance (ETR)

**H1: Accepted** CEOs can contribute to reduce tax avoidance

**H2: Accepted** Boards can help to reduce tax avoidance

**H3: Rejected** Strong auditing increasing tax avoidance
How does tax avoidance work?
Mr. Ingvar Kamprad

Fourth-wealthiest individual in the world (2013, Forbes)

Personal Fortune $ 57 billion

Personal Fortune in Sweden (2013) $ 88 million

Tax Sweden $1.3 million

http://www.svd.se/sa-mycket-kommer-kamprad-att-skatta
IKEA

- Created 1958
- "Småland legacy"
- 361 stores in 49 countries (Franchise)

### High income countries
- Australia, Austria, Belgium, Canada, Croatia, Cyprus, Czech Republic, Denmark, Finland, France, Germany, Greece, Hong Kong, Hungary, Iceland, Ireland, Israel, Italy, Japan, Kuwait, Lithuania, Netherlands, Norway, Poland, Portugal, Puerto Rico, Qatar, Russia, Saudi Arabia, Singapore, Slovakia, Spain, Sweden, Switzerland, Taiwan, United Arab Emirates, United Kingdom, United States

### Upper middle income countries
- Bulgaria, China, Dominican Republic, Malaysia, Jordan, Romania, Thailand, Turkey

### Lower middle income countries
- Egypt, Indonesia

### Lower income country
- South Korea

- 1982 → Residence in Leiden, Netherlands
- Charity foundation
IKEA became a charity

“Ingvar Kamprad spends a lot of time thinking about how to secure longevity and independence for his business and concept. He seeks for an ownership structure [...] that would be sustainable over many generations. The answer was to separate the ownership of the retail operation from the ownership of the concept and the IKEA brand. Ingvar Kamprad therefore donated a large number of the operating companies to a Dutch Foundation – the INGKA Foundation - which today owns a large number of the IKEA franchisees”.

(IKEA Foundation 2015)
IKEA taxes and donations

• In 2014 the Stichting INGKA Foundation informed that:
  – IKEA Group reported sales for €28.7 billion
  – Paid taxes for €801 million
  – Corporate income tax rate 19.3%

• In 2014 Stichting INKEA Foundation informed that:
  – Gave donations for €104 million
  – Reached 170 million children around the world through 40 partner organizations (i.e. UNICEF, UNDP, Save the Children)
  – Received the 2015 THANKYOU award from the World Childhood Foundation
IKEA’s tax approach

“The operations comply with all relevant laws and regulations and thus pay taxes accordingly. However, we have always viewed taxes as a cost, equal to any other cost of doing business. An optimized tax structure allows us the flexibility to use funds, that have already been taxed in one market, in new markets for further business development without the additional burden of double taxation”. (Kamprad 2011)
IKEA tax avoidance strategies

- Payment for intangibles
- Profit shifting
- Use double treaty (Luxembourg-Belgium)
- Use exemptions (Netherlands)
- Use exemptions + Avoid double treaty (BVI)

Charity: “[T]o support individual IKEA retailers experiencing financial difficulties”. (Kamprad 2011)
Conclusion

- IKEA’s tax avoidance structure harms society in the 49 countries they operate.
- IKEA uses tax avoidance to expand their global operation.
- IKEA is involved in crimes of globalization.

Cont....
Conclusion

Understanding IKEA’s crimes of globalization:

1. Rational choice theory: Profit, opportunity
2. Neutralization techniques: Stick to regulations
3. Learning theories: MNC
4. Anomie theory: Goals, egoism
5. Organizational theory: Structure, differential association
6. System criminality theory: global "experts"
7. Regimes of truth: Legislation in offshore territories
8. Political economy theories: Interaction politics & economics