

Construct a Legitimate Tax Plan that Minimizes a Multinational Technology Company's Taxes

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Abstract

As businesses have become global, the Information and Communication Technology (ICT) has spread in private business sectors. This has led to the development of digital markets, the regional and organizational decentralization¹ of the internal organization as well as the more frequent occurrence of hybrid forms of corporations. In contrast to the local independent and international activities of enterprises, generally accepted tax principles² are used to evaluate current tax regulations as well as to recommend possible reform approaches based on physical and legal aspects, which serve as taxable entities and tax attributes. This paper proposes a valid tax plan that minimizes a multinational technology company's taxes.

¹Defined as the process of transferring and decision making authority to lower levels of the organization i.e. divisions, branches, departments, and subsidiaries (12 Manage, n.d.).

²A part of GAAP or Generally Accepted Accounting Principles is a guide to record and report the financial information and developed by Securities and Exchange Commission (Cliff Notes, n.d.).

Keywords: Information and communication technology; Digital markets; Tax; Multinational technology

Introduction

According to Hines [1-3], "tax differentials among countries and the interaction between the home and the host countries' tax systems not only influence the location and the amount of capital invested abroad, but also the financing of investment, the repatriation of dividends, and the transactions between related parties located in different jurisdictions". Azemar [4] says "once the investment is done, multinational firms have at their disposal various possibilities to reduce their overall tax liabilities. They can shift income from an affiliate located in a high tax country to an affiliate located in low tax country and preserve these tax-saving benefits by deferring the repatriation of their profits, as long as they can find active use of their earnings." Gravelle [5] says that multinational firms move about profits from high tax jurisdictions to low tax. He suggests that an effective way by which multinational technology companies can avoid high taxes is by shifting debt to high tax jurisdictions. This decreases profit margins and tax liabilities. This is achieved by transferring Intellectual Property³ to subsidiaries in low tax jurisdictions to shift income and pay lower taxes. Wells suggest that US multinationals are at a competitive disadvantage because they have to employ a mass of tax minimization strategies outside the country [6]. Multinational technology firms, in the words of Markle and Robinson [7] have the discretion as to where to locate their geographically mobile operations, which increases their ability to defer or avoid taxes. Gumbel [8] stated that there is no fraud involved in such practice. He says, "The key here is what's known as transfer pricing, who is determining which revenues and profits should be recognized in which parts of a multinational company with affiliates in numerous countries. For example, Google has a very strong case to make that its intellectual property is something for which its subsidiaries worldwide should be paying for- thereby transferring a portion of their revenue back to Google elsewhere".

Salifu [9] agrees with Prebble's idea that "creating a tax plan is a very complicated process as incompatibilities between tax laws and the specifics that tax laws relate to;-create administrative inefficiencies, giving rise to unethical actions resulting in incomprehensible as well

as unnecessary expense". Salifu justifies this thought through these words, "very large multinational enterprises operate through a complex hierarchy of various legal entities that carry on business through operating, holding and financing entities in order to realize their shareholder's objectives of profit maximization". Salifu states the example of Hewlett-Packard corporation (HP), "market its products and services globally and is subject to income tax in approximately eight (80) foreign countries (Hewlett-Packard Corporation). In addition to HP's United States headquarters, it also has geographic headquarters in Switzerland, Singapore and Japan. HP also carry out product development and manufacturing across several European countries including Ireland, as well as countries such as China, India, Japan and Singapore to mention but a few. Furthermore, HP laboratories are located in India, China, UK, Singapore, Israel, the United States and Russia".

Other tax reduction methods include: Corporate debt-equity, Payments for intangibles, Shell holding companies, Hybrid entities, Conduit, and Company-specific tax rulings [10].

History

In 1853, the Irish corporate tax system as shown in Figure 1 evolved gradually from the income tax system through the Act of the British Parliament-An Act for Granting to Her Majesty Duties on Profits Arising from Property, Professions, Trades and Offices [11]. The relatively lower rate of 12.5% evolved as a response to the need to attract inward investment and the later impact of EU rules against preferential tax rates. In 1910-the marginal rate of income tax was 8.33%. The entire UK tax system was adopted by the Irish state in 1922 after independence. Ireland started a tax policy in the 1950s to attract foreign direct investment [12]. In 1956, Export Profits Tax Relief

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³An asset that includes Patents, Trade Secrets, Copyrights and Trademarks (Nguyen, 2005). When a multinational company forms an IP Holding subsidiary, it transfers its IP assets to the Holding company (Nguyen, 2005)

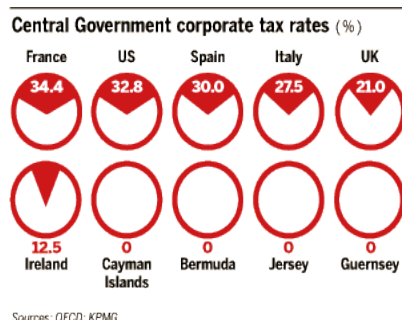


Figure 1: Comparison of Corporate Tax Rates among various Countries from Financial Times.

introduced a 0% tax on income from export sales of manufacturing goods [13]. It took until 1960 for export sales relief (ESR) to apply to all exports and to fully relieve them from tax. This applied to goods manufactured in Ireland. It is worth noting that dividends from ESR profits were also exempt from income tax in the hands of individual shareholders. In 1973, Ireland joins the European Union and agrees to phase out the zero rates. In 1980, 10% tax was introduced in manufacturing, and later changed to 12.5%. This incentive, together with the flexibility of the tax regime, helped attract many pharmaceutical companies. Nine of the top 10 global pharmaceutical companies now have operations in Ireland as well as leading technology companies. The importance of these special low corporate tax rates in a global environment was critical for Ireland as the regular corporate tax rate was very high for example, it hit 50% in the years from 1982 to 1988 [14]. In 1987, 10% tax on international financial services was introduced with EU State Aid Approval. Ireland appeals as a center for pharmaceutical and technology companies to US as their peers are present and legal infrastructure is similar. The 10% effective tax rate then fell afoul of EU rules in 1998. In 1999 imputation was removed and the Irish tax system became a classical system for the first time. Between 1996-2003, a phased reduction in the general rate of corporation tax to apply equally to all corporate taxpayers-12.5% on trading income and 25% rate on non-trading income. However, transfer pricing policies have "resulted in loss of taxable revenue to national governments around the world", says Salifu. The example he provided is as follows: "The Guardian reported that, the European Union (EU) lost some £191 billion in tax revenue between 2005 and 2007;-due to transfer price manipulations carried out by MNEs that took advantage of their presence in non-EU and developing countries cited in.

Current issues

Multinational tech companies have long complained about the restrictive policies in foreign countries that limit market access. They face challenges setting up shop in foreign countries due to the protectionist policies that information technology and innovation foundation (ITIF) identify, but also because of real privacy concerns in those markets that data stored by companies such as Microsoft and Google could be subject to government surveillance. The concerns raised in the tech sector are about the harmful impact of certain US policies on overseas trade [15]. The common consolidated corporate tax base (CCCTB) in the European Union models corporate taxes to assess the impact of modification of investment flows, employment, GDP and economic welfare [16]. In recent times, tax havens face political pressure to cooperate with high tax countries to reduce tax evasion and avoidance. The OECD⁴

⁴The Organization for Economic Co-operation and Development and its mission is promote policies that will improve the economic and social well-being of people (OECD, n.d.).

has created the Global Forum on Transparency and Exchange of Information [17] for Tax Purposes⁵. As per OECD principles, countries are expected to sign tax information exchange agreements (TIEAs) with other countries⁶. The British government detailed plans for a new 25% tax on profits of multinational technology companies⁷, as shown in Figure 2. Big US technology companies have come under fire from British lawmakers for the small corporate tax they pay in Britain in relation to their business activities in the country (Winnings, 2014). The tax will only relate to companies with UK revenues of more than £10 million (\$15.7 million) per year⁸. The government estimates the tax will raise £1.4 billion over the following 5 years and will have no economic impact. To reduce worldwide tax burden, "Google sells almost all ads in Europe through its Irish subsidiary, leaving little tax revenue in other countries, but more in where customers reside. This subsidiary in turn pays royalties to a second Irish subsidiary based in Bermuda [18]. Google transferred nearly \$12 billion to Bermuda reducing, by more than \$2 billion".

Environmental statement

In 2010, Ireland introduced mandatory disclosure rules to: obtain early information about certain tax schemes and how they work; obtain information about who has availed of them; and close down by legislative action, or use of anti-avoidance provisions, any such schemes that are viewed as aggressive. A General Anti-Avoidance Rule (GAAR) has been in place since 1989 and Irish transfer pricing rules are based

⁵A framework for international cooperation in exchange of tax information (Bilicka and Fuest, 2013).

⁶TIEAs are important in cases where no double taxation agreements exists as double taxation agreements include arrangements for information exchange (Bilicka and Fuest, 2013).

⁷The draft legislation said the tax would be levied on companies that operate in the U.K. but are avoiding having a permanent set up in the country to lower their tax bill, and companies that use offshore entities (Winnings, 2014).

⁸If the tax official decides the diverted profits tax apply, the company will be issued a notice explaining the charge and how it has been calculated. The company shall have 30 days to respond, after which the tax official will have 30 days to either issue the original charge or a revised charge or confirm that no charge need be paid. Once the charge is confirmed by the company, it will have 30 days to pay, or face penalty for late payment (Winnings, 2014).

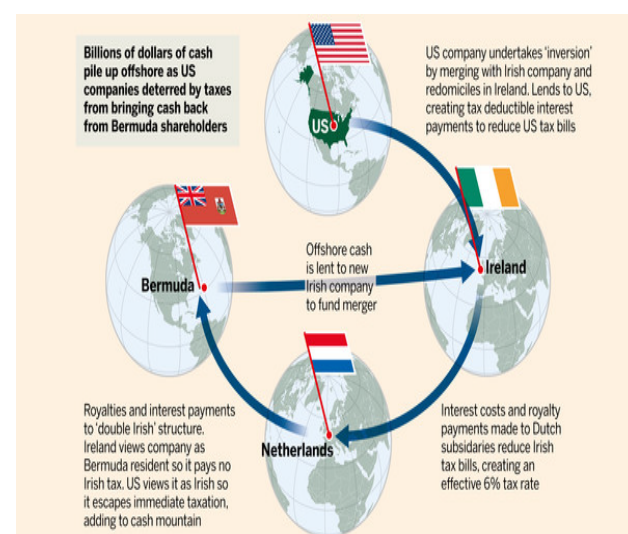


Figure 2: Offshore structure among various countries from financial times.

on the OECD arm's length standard. Ireland only engages in fair tax competition and complies with all relevant international rules, but some company structures have been criticized for aggressive tax planning. Tax planning by companies relies largely on mismatches between the domestic rules of different countries.

Dumistru [19] said many companies express their "ethical and responsible conduct with respect to the social environment." However, many cases indicated that "the business practices were clearly not aligned with the declared corporate behavior". The multinational firms have expanded their activities via technology all over the world, that is also related to the notion of corporate social responsibility (CSR), which suggests that social issues, such as overcoming poverty, enhancing employees "well-being and improving the welfare of society should be addressed [20]. "For instance, when information technology multinational firm sell their Intellectual Property (IP) to a tax haven resident, Controlled Foreign Holding Company (CFH), the result is serious economic impairment" [21]. This situation is even more striking for developing countries because of the need to mobilize revenue in order to provide social amenities for the people.

Discussion of Facts and Issues

Ireland's 12.5% corporation tax rate (rate, reputation, and regime) on trading income is a key factor to attract foreign direct investment, which in turn generates employment [22]. The country has been active in its participation in efforts at OECD level, in developing a response to aggressive tax planning, i.e. The Base Erosion and Profit Shifting project carried out by the OECD⁹; The EU Code of Conduct Group¹⁰; and Global automatic exchange of tax information between countries. To avoid high taxes, global reach and vicious incentives of the system, many US multinationals move their base outside the country. Yet inversions¹¹ are increasingly controversial, when governments intend on cracking down tax avoidance. Multinational technology firms can tactically patent Intellectual Capital to efficiently protect their valuable technological assets (Wiederhold, 2011). The finance ministry of Ireland fight that the factors driving the trend of inversions are of push rather than pull nature¹². The "Double Irish" structure as shown in Figure 3 exploits different meaning of residence in the US and Irish tax to move profits from Ireland to Bermuda¹³. Conversely, Ireland is starting to surrender to shut corporate tax loopholes¹⁴ as it does not want to be identified as a tax haven. After the ban on Double Irish structure, Irish subsidiaries of US companies using the "check the box" rule¹⁵, can maintain their minimum taxes as shown in Figure 4 by

⁹The aim is to better align the right to tax with real economic activity (HLB Ryan, n.d.).

¹⁰Examines harmful tax practices in the EU (HLB Ryan, n.d.).

¹¹Provide "a real boost" to earnings per share, retained earnings and cash flow. That has a big bearing on acquisition premiums. "It is bridging valuation gaps for sellers and sometimes exceeding sellers' expectations," says Cian McCourt, a partner and head of the New York office of A and L Goodbody, an Irish law firm

¹²The high tax rate of USA makes Ireland an attractive option.

¹³This structure allows royalties paid by the Irish manufacturing subsidiary to end up in a company that is not taxable under either Irish or US rules. This offers additional advantages by making it easier for companies to escape US tax on their offshore intellectual property, cutting US tax bills by loading their domestic businesses with debt, and making low foreign tax rates permanent. They halt the build-up of offshore cash (Houlder, Boland, and Politi, 2014).

¹⁴The government ensures that companies incorporated in Ireland must have a tax residency in another jurisdiction or become obligated for the Irish 12.5% rate (Houlder, Boland, and Politi, 2014).

¹⁵Result of both US tax code and Ireland and Malta's tax treaties (McCabe, 2014).

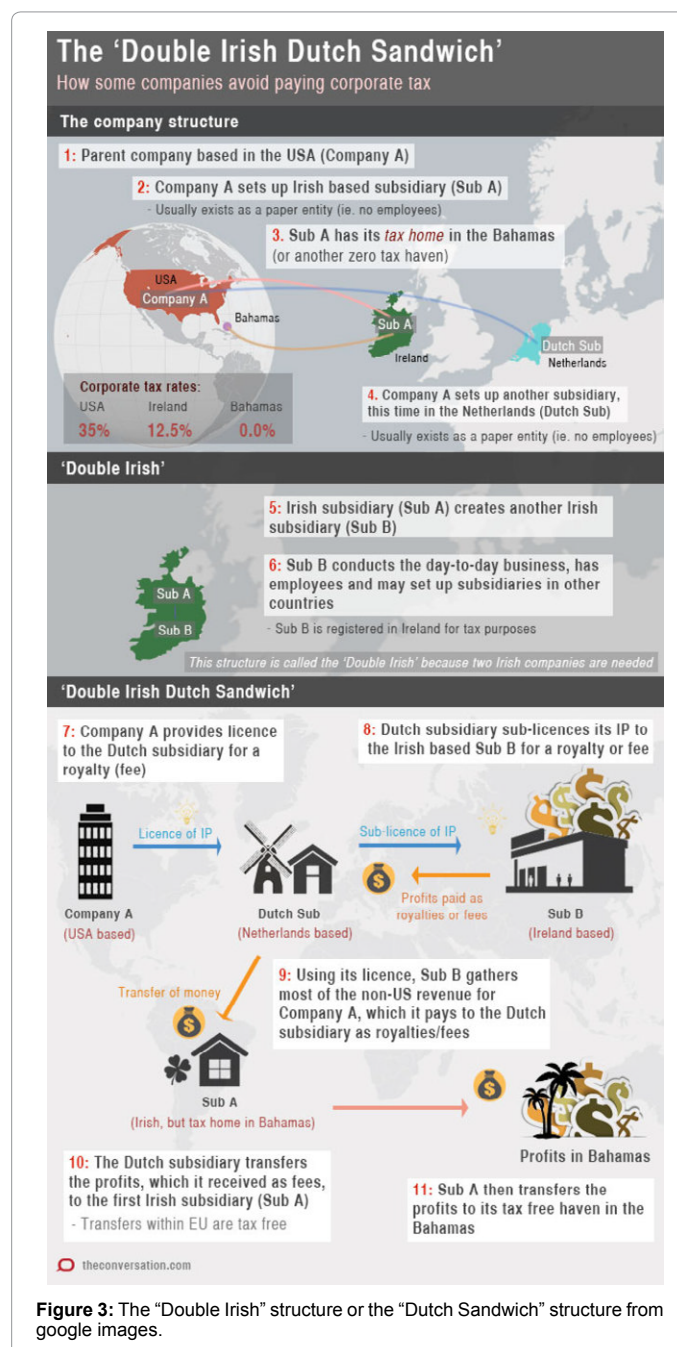


Figure 3: The "Double Irish" structure or the "Dutch Sandwich" structure from google images.

moving their holding company from non-EU tax havens like Bermuda to EU tax haven Malta [23]. These firms can direct royalties through this Maltese company and enjoy its low tax rate. The IBM Multinational Corporation's subsidiary is established in Dublin. It paid a 28.2% tax in 2014, 16.6% in 2013 and 24.6% in 2012. Applying the "check the box" rule on the income statement for the year 2014, the assumptions will be 35% corporate tax and 30% refund on trading structure. Using the financial data from Yahoo Finance, the results would be as follows (\$) as shown in Tables 1 and 2.

Financial Data from Yahoo Finance When compared to the original data, the difference between the net income is \$15,257,700-\$12,022,000=\$3,235,700 or 21.2% increase. This shows that the "check the box" rule is beneficial.

X

LOW TAX: NEW ROLE IN DOUBLE IRISH STRUCTURES

- Irish law amendment gives Malta new role;
- New law - offshore management & control (M&C) no longer possible;
- Exception - *Ireland-Malta Tax Treaty*:
 - M&C of Irish-Co can be moved to Malta >
 - Branch deemed Malta tax resident;
 - Branch can operate tax refund mechanism (i.e. 5% effective tax);
 - Maltese branch will be registered to give maximum tax residence certainty;

Result : Double Irish structures can continue via Malta!

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graph TD
    US-Co[US-Co] --> Irish-Co-1[Irish Co 1]
    Irish-Co-1 --> Irish-Co-2[Irish Co 2]
    Irish-Co-1 --> Malta-M&C[Malta M&C]
                    
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Figure 4: New “Check the Box” rule from slide share.

Period Ending		31/12/2014	31/12/2013	31/12/2012
Total Revenue		92,793,000	98,367,000	102,874,000
Cost of Revenue		46,386,000	49,683,000	52,513,000
Gross Profit		46,407,000	48,684,000	50,361,000
Research & Development		5,437,000	5,743,000	5,816,000
Selling General & Administrative		22,438,000	22,629,000	22,389,000
Operating Income or Loss		18,532,000	20,312,000	22,156,000
Total Other Income/ Expenses Net		1,938,000	333,000	843,000
Earnings Before Interest and Taxes		20,470,000	20,645,000	22,999,000
Interest Expense		484,000	402,000	459,000
Income Before Tax		19,986,000	20,243,000	22,540,000
Income Tax Expense (35%)	0.35	(6,995,100)	(7,085,050)	(7,889,000)
Refund (30%)	0.3	5,995,800	6,072,900	6,762,000
Net Income from Continuing Operations		18,986,700	19,230,850	21,413,000
Discontinued Operations		(3,729,000)	(398,000)	(395,000)
Net Income		15,257,700	18,832,850	21,018,000

Table 1: Financial data from yahoo finance.

Period Ending	Dec 31,2014
Total Revenue	9,27,93,000
Cost of Revenue	4,63,86,000
Gross Profit	4,64,07,000
Operating Expenses	
Research Development	54,37,000
Selling General Administrative	2,24,38,000
Non Recurring	
Others	
Total Operating Expenses	
Operating Income or Loss	1,85,32,000
Income from Continuing Operations	
Total other Income/Expenses Net	19,38,000
Earnings Before Interest and Taxes	2,04,70,000
Interest Expense	4,84,000
Income Before Tax	1,99,86,000
Income Tax Expense	42,34,000
Minority Interest	
Net Income from Continuing Ops	1,57,51,000
Non-recurring events	
Discontinued Operations	-37,29,000
Extraordinary Items	
Effect of Accounting Changes	
Other Items	
Net Income	1,20,22,000

Table 2: Period ending revenue and net income.

Analysis of Facts and Issues

The objective of this paper is to provide a genuine tax plan for a multinational technology company. Tax is a crucial part of business. In order to drive your business forward, it is critical that the company's tax strategy is aligned with business goals and objectives [24]. The assumptions of the tax plan have taken into consideration the geographical common corporate practices (Ireland-USA-Malta Tax haven) as well as the basic functions of a Multinational Corporation Technology company. Only 5% tax is applied to the income before tax (35%-30%). 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 the firm.

Conclusions and Recommendations

According to Salifu, Information technology multinational firms “are among the wealthiest company's worldwide and should go beyond the confines of legal and regulatory requirements in order to make appropriate tax contributions to their resident countries for the provision of relevant infrastructure for national development.” Davidson [25] stated that “the corporate income tax system is not broken. It is true that some multinational corporations do not pay as much tax in their host economies as their consumers and voters in those economies might expect. Yet this does not necessarily imply any wrongdoing on the part of those corporations. As Kleinbard makes clear, multinational corporations are fully compliant with the law of the land in those economies where they operate and the governments of those economies have been unwilling to change the international income tax norms and tax architecture.” Profit shifting and tax planning (both aggressive), are not violations of the law. Multinational investors benefit from unintended gaps/loopholes in the tax laws. The international tax system should avoid double taxation and non-taxation of corporate profits. Measures directed against profit shifting which the European Commission currently discusses and the OECD can be summarized under the following four headings: “(1) Extension of residence taxation-by tightening CFC rules. Can be effective but has the disadvantage that some countries benefit from certain forms of profit shifting and may not be willing to extend their own residence based taxation. In addition, from the perspective of an individual country extending residence based taxation addresses tax avoidance related to foreign subsidiaries of domestic multinationals but not tax avoidance by domestic subsidiaries of foreign parent companies; (2) Extension of source taxation-can be achieved through unilateral measures or through measures requiring international coordination. The first approach includes, for instance, targeted measures like thin-capitalization rules. An example for the

second approach is the extension of withholding taxes on border crossing interest or royalty payments. This will typically involve changes of existing double taxation agreements and EU Directives, so that multilateral coordination is required here. Unilateral measures have the attractive feature that no international coordination is required. The drawback is that this will ably lead to double taxation and undermine the consistency of the national as well as the international tax system. If restricted to multilateral measures, this would be an effective way of pushing back tax avoidance;

(3) Fundamental reforms of corporate income taxation-This includes reform concepts like the introduction of worldwide formula apportionment or destination-based corporate taxation. A fundamental reform of international corporate taxation, is desirable but clearly a long term project; and

(4) Stricter reporting and transparency requirements-obligation for tax advisers to report tax avoidance schemes or country-by-country reporting of multinational investors. May help but raises a number of complicated issues" (Fuest, et. al. 2013). The elements to resolve in business taxes structure are: "1) conflicts of interest between big and small countries; many countries design their tax systems to attract inward investment. This is a non-holistic approach, normally contrary to the achievement of a coherent international system; 3) developed countries have higher overseas income from intangibles compared to emerging economies; and 4) business groups, including the main US group on international tax (US Council for International Business), say revising PE rules risks creating uncertainty" (Needham, 2013). Enforcement of residence taxation is a difficult task because some countries are reluctant to move into this direction and unilateral action can only address certain forms of income shifting. The extension of taxation seems more promising. Impose new or extend existing withholding taxes on interest and royalty payments for short-term basis¹⁶. Since the redistribution of tax revenues like "check the box" rule between countries will be affected by imposing withholding taxes, it is not clear whether this is desirable and whether countries are willing to crowd back tax avoidance. For long-term basis, investigate the most fundamental approaches such as the destination-based cash flow tax. Whether stricter reporting and transparency requirements for multinational companies are a promising way forward is still vague [26-30]. Davidson also stated that "multinational corporations add value to both their home economies and their host economies. Tax havens add value by allowing multinationals to reduce their tax liabilities while increasing their investments in high-tax economies. An increase in their tax burdens would reduce those levels of investment, leading to reduced employment opportunities, reduced consumption and reduced innovation."

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¹⁶This measure effectively handles currently used tax planning structures and does not mislead investment decisions as long as withholding taxes are credited in the residence country (Fuest, et al., 2013).