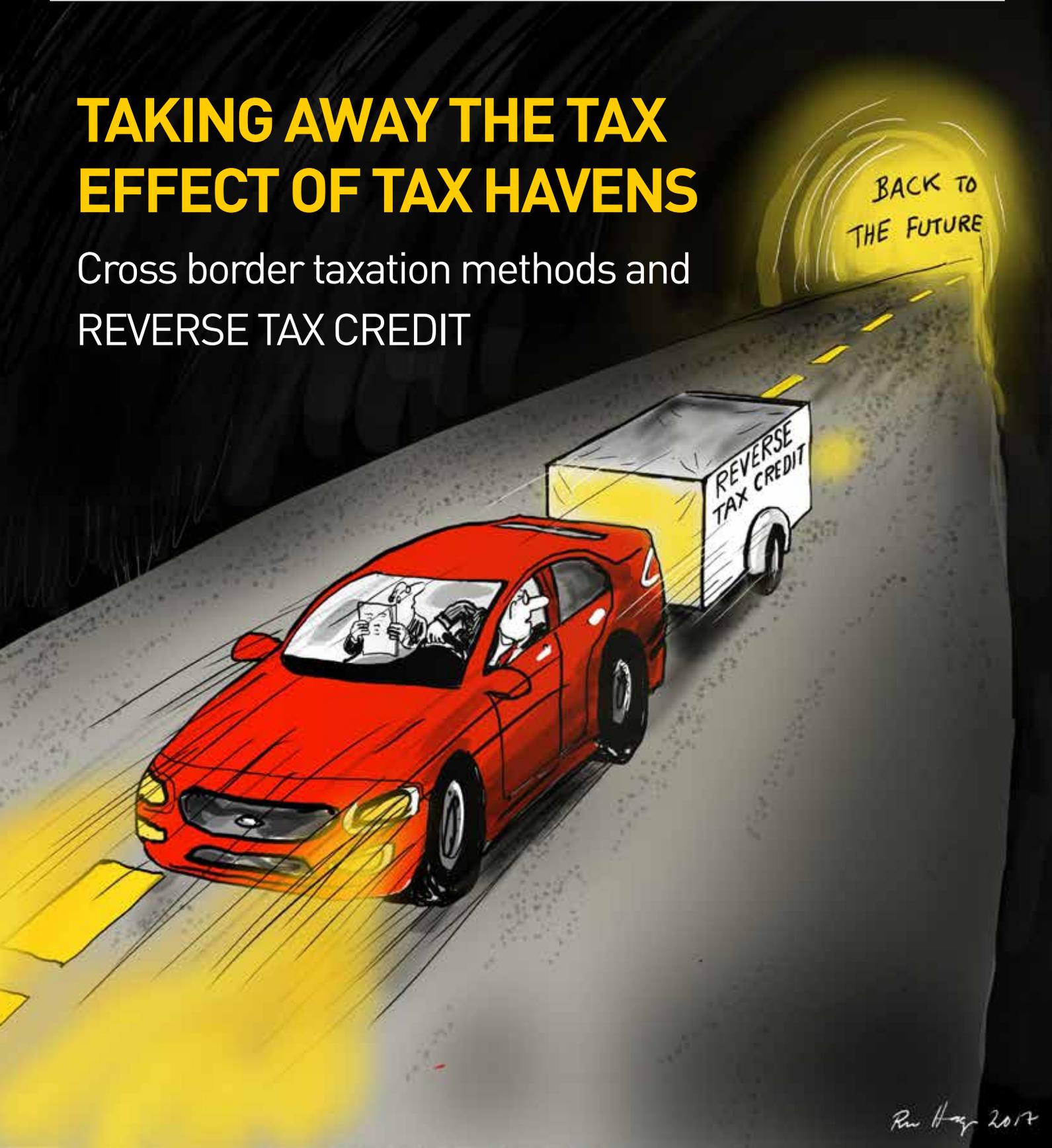




- All the main techniques used for capital flight can be grouped into one area – abuse of cross-border regulation.
- Tax credit is already an approved method for dealing with revenues cross-border together with withholding taxes.
- Reverse Tax Credit can use the tax credit principles to deal with costs cross-border and eliminate the “need” for tax havens.
- Reverse Tax Credit can be enacted unilaterally by any country, and will automatically leverage the playing fields between companies, large or small, multinational or not.

TAKING AWAY THE TAX EFFECT OF TAX HAVENS

Cross border taxation methods and REVERSE TAX CREDIT



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BACK TO
THE FUTURE



Roar Hagen 2017

TAKING AWAY THE TAX EFFECT OF TAX HAVENS

Cross border taxation methods and REVERSE TAX CREDIT

This report introduces the reader to a much-neglected area of international taxation, tax credits, and shows how a more active utilization of tax credits and one of its accompanying features, withholding tax, can fix some of the issues we have with multinational companies not paying taxes. In addition, the report shows how by reversing the principles of tax credits and applying them unilaterally to cross-border transactions on the cost side, one is able to effectively negate the negative effects of multinational companies not paying taxes.

An application of reverse tax credits on cross-border transactions can effectively restore the taxation of multinational companies to where it does not matter whether the companies use low- or no-tax jurisdictions anymore.

This report is thus about increasing the international tax toolbox, and reversing the situation where countries feel they have to participate in the downward spiral of tax competition. It shows that by tweaking international tax mechanisms, it is possible to unilaterally fix the tax situation of many multinational companies.

Reverse Tax Credit is for application with subsidiaries in a country with cross-border cost transactions, while a more active application of withholding tax and tax credits work wonders with cross-border transactions without active representation in the country.

A. Introduction to cross-border taxation methods

International tax mechanisms

ALL major issues in today's taxation stem from cross-border transactions and services:

- Transfer (mis)pricing across borders or tax systems
- Derivative abuse across borders or tax systems
- Mark-to-market abuse across borders or tax systems
- Tax system abuse across borders
- Non-transactional cash flow across borders or tax systems
- Asymmetrical capital gains and losses across borders or tax systems

ALL solutions thus need to stem from cross-border mechanism. In other reports we cover how derivative abuse can be stopped, how mark-to-market abuse can be reduced, how asymmetrical capital gains can be met by changing tax systems. Tax system abuse needs to be tailored towards the specific abuse, and we will not cover that. In this report we will cover what can be done towards transfer mispricing in general, but particularly non-transactional cash flows across borders or tax systems which is a particular variant of transfer mispricing, but one which is not tied to individual transactions. Examples of such non-transactional cash-flows are: interest, insurance, commercial fees, management fees, technology fees,

R&D sharing, royalties, procurement fees, overhead etc. A non-transactional cash-flow is typically a cash-flow which is not tied to a delivery of a clearly defined and individualized goods or service.

Are there cross-border mechanisms that can be used? Yes, there are two international systems that can be utilized, and one of them can be expanded:

- The withholding tax system (where a transaction or a non-transactional cash-flow is taxed at a certain rate, usually 15% unnegotiated)
- The international tax credit system (where the tax paid in one country is deductible from the tax paid in another country)

Withholding taxes and tax credits can fix the revenue side of transactional and non-transactional cash flows (and the sharing economy) and a variant of the international tax credit system, reversing the tax credit system and applying it on cost transactions, can fix the cost side of transactional and non-transactional cash-flows.

Avoiding double taxation

Most of the tax mechanisms we need to fix cross-border transactions already exist, it is mostly a matter of combining them in the right structure and calibrate their level and application correctly. However, through the years since these tax mechanisms were created, it has become popular to concentrate on mainly two tax mechanisms: net profit taxes and value added taxes with all the other tax mechanisms fading into the background or complete disuse. This has happened all the while cross border transactions have increased disproportionately. Since net profit taxes and value added taxes are mainly targeting in-country transactions, we thus have the strange situation that while transactions have become more and more international and cross-border, the tax systems have become more and more national. The outcome has been that taxation has been upheld on national companies, while international companies (multinationals) have enjoyed a continuous reduction in taxes until we in the current situation see companies that essentially can choose which tax to pay. This creates an unjustified tax advantage for the multinational companies.

In this report we will look more closely at the mechanisms that are available if international transactions and non-transactional cash-flows are targeted more specifically, while national tax systems are kept untouched. These mechanisms are mainly created within or in conjunction with the tax treaty system, a system of more than 3000 bilateral income tax agreements¹ between the countries with more than purely superficial economic relations. These tax treaties are mainly based on the United Nations Model Double Taxation Convention between Developed and Developing Countries¹ (United Nations Model Convention) and the Organisation for Economic Co-operation and Development Model Tax Convention on Income and on Capital (OECD Model). In addition we are introducing a reversal of the tax credit mechanism in the tax treaties.

The tax treaties are agreements that essentially tell the companies and the tax authorities which country that has the taxation right of a transaction, a profit or an asset, and how to solve the taxation if both countries have reserved the right to tax a transaction, a profit or an asset. The fundamental basics are that assets are normally taxed in the country where the asset is, transactions are normally taxed in the originating² country but can be taxed in both countries while profits are normally taxed in both countries.

Profits are normally taxed through net profit taxes while transactions and cross-border capital movements used to be taxed through withholding taxes, although this form of taxation is used by less and less countries and is often negotiated to a very low level or zero in bilateral tax treaties.

¹Arnold, B.J. (2015), An introduction to tax treaties, http://www.un.org/esa/ffd/wp-content/uploads/2015/10/IT_Introduction_Eng.pdf

²Originating country is in this report defined as the country where a payment is being done from, while the destination country in this report is the country receiving the payment.

In the case both countries are taxing a profit or a transaction, the mechanism for avoiding such double taxation is the tax credit mechanism. The tax credit mechanism works by transforming the allowed taxes under the agreement in the originating country into a deduction that can be taken directly against the calculated allowed taxes under the agreement in the destination country. The result is that the company pays total taxes on par with the tax level in the country with the highest tax level. The tax credit mechanism is usually applied to income transactions and profits, while there is no similar mechanism for cost transactions and losses.

This report will show that it is possible to reverse the tax credit principle, thus not allowing a higher deduction for a cross-border cost transaction or a loss in the destination country than average tax rate of the company. See section B below for an in-depth discussion of such a reversal of the tax credit principles developed under international law already.

Before we go further into the possibility of reversing the tax credit system and applying it to cost transactions and losses, it is of interest to look more into the taxation possibilities that are within the tax treaties today.

Most people with a minimum understanding of taxes will know about net profit taxes (corporate taxes on business profits being one of them) and value added taxes. Cross-border transactions are normally exempted from value-added taxes, and it is thus normally only corporate taxes that are creating tax credits.

A cross-border transaction or non-transactional cash-flow has however the potential of either reducing the revenues or introducing a cost in the originating country, in both cases reducing the profits to be taxed as payments go out of the country.

The best tax mechanisms are to use net profit taxes on the profit and to use withholding taxes on individual transactions or non-transactional cash-flows as defined in the tax treaty in the originating country, while utilizing tax credits and reverse tax credits to adjust the revenue and cost base respectively in the destination country. Tax credits can then be used to avoid double taxation, allowing the tax credits to be deducted from the calculated taxes in the destination country. Reverse tax credits can similarly be used to avoid double deduction, allowing the reverse tax credit to eliminate the deduction in the destination country and introducing a deduction equal to the average tax rate of the company for cross-border transactions.

Utilizing withholding taxes

Withholding taxes in tax treaties normally start at a level of 15%, in recognition that when withholding taxes and tax credits as mechanisms were created, a "normal" level of taxation of 30% or more was assumed. The "taxation right" was therefore assumed to be distributed half on half on the two countries: the originating country applying maximum 15% and the destination country applying its tax level (assumed to be 30% or above) and deducting the withholding tax in the originating country as tax credits.

With the introduction of tax haven as pass-through countries between the originating country and destination country, a more complex situation has emerged. Revenue transactions are with the introduction of tax havens usually not taxed more than what the originating country taxes, while cost transactions are with the introduction of tax havens fully deductible in the destination country, while in the originating country (the tax haven) there is no corresponding

tax. The original intention of withholding taxes and tax credits have thus been disrupted through the introduction of the tax haven (the low-tax or no-tax jurisdiction). This is the problem that withholding taxes, tax credits and reverse tax credit can fix if countries are willing to see beyond their net profit tax systems and VAT systems.

Example: International app systems like AirBnB and Uber are currently challenging traditional services like hotels and taxis. With withholding taxes and tax credits, this is easy to fix. Any payment to AirBnB or Uber (or other similar service provider) is increased by a withholding tax of the desirable level and while the service itself is paid to AirBnB or Uber, the withholding tax on the payment is paid directly to the tax authorities. The transaction is thus fully paid in-country. If there is a desire to put VAT on the transaction as well to make the transaction more comparable to in-country transactions in hotels and taxis, that is of course fully possible as well. When AirBnB and Uber (or other service provider) pays the service provider in-country, the in-country service provider can be taxed (or not) for his or her profit based on the volume of service (is it only limited or is it a fully professional service on a daily basis).

The same system can be used for software licenses delivered cross-border and other transactional or non-transactional cash-flows. What must be understood is that these tax mechanisms are available both inside and outside corporations in order to make transactions and non-transactional cash-flows and companies operating across borders on the same competitive level as in-country transactions and in-country companies.

What is the benefit? Creating a level playing field between companies, and ensuring that taxes are paid where the market is. When an AirBnB night, an Uber drive, a software license or an advertisement is sold to a person in the country, it is essentially that country that has the taxation right for that transaction. The reason for that is that without that person buying there would have been no transaction. It is the demand (for AirBnB, Uber, software and ads) that creates the revenue that is taxable, not the supply. The supply-side only needs to secure that cost is taken into account if net profit taxes are going to be applied. VAT and withholding taxes are not dependent on knowing the cost, only in what range the cost is so that the level of VAT and withholding tax can be calibrated at the correct level.

Calibrating withholding taxes

This section on calibrating withholding taxes takes as its starting point that the maximum withholding tax is 15% and that this is based on a 50/50 split of a 30% taxation "right" by two countries jointly. A taxation level of 20% would result in a withholding tax of 10% based on a 50/50 split of the 20% tax level. The point is that there is no need for countries that do not want it to go down in taxation level due to international tax competition. Only to the extent that a country desires to offer its citizens and companies lower taxes because the taxes are not needed does the country then need to lower taxes. That is then true and fair tax competition, because it takes its basis in the country's own situation, not the external tax competition from other countries.

A withholding tax is typically 15% or lower, often negotiated down to 0% in tax treaties. This however makes countries negotiate away a tax mechanism that in its principle is easy to apply to transactions and non-transactional cash-flows. The typical application of a withholding tax is a defined level, for example 15%, 10% or 5%.

It is possible to grade the withholding tax based on the tax rate as follows:

$$\begin{aligned} \text{Withholding Tax Non-transactional cash-flows} &= \\ & \text{General rate} + (\text{tax rate in paying country} - \text{tax rate in receiving country}) / 2 \\ & = \text{applicable withholding tax transactions and non-transactional cash-flows.} \end{aligned}$$

Based on tax sharing principle in tax treaties and where a state always will want to retain at least 50% of the taxation right of a transaction or a non-transactional cash-flow:

$$\begin{aligned} \text{Alt 1: WT-OTH} &= \text{General withholding tax} + (\text{Corporate tax rate} - \text{tax rate other} \\ & \text{jurisdiction}) / 2 = \text{applicable withholding tax rate} \\ & (\text{withholding tax is minimum 15\%}) \\ \text{Example low-tax jurisdiction: WT-OTH} &= 15\% + (30\% - 0\%) / 2 = 30\% \\ \text{Example normal tax jurisdiction: WT-OTH} &= 15\% + (30\% - 30\%) / 2 = 15\% \end{aligned}$$

It is also possible to grade the withholding tax based on the tax rate as follows:

$$\begin{aligned} \text{Withholding Tax Non-transactional cash-flows} &= \\ & \text{General rate} + (\text{tax rate in paying country} / 2 - \text{tax rate in receiving country}) = \\ & \text{applicable withholding tax transactions and non-transactional cash-flows.} \end{aligned}$$

Based on tax sharing principle in tax treaties and where a country accepts that the other state has the taxation right (as long as it uses it), but does not accept low- or no-tax jurisdictions and thus increases own taxation in response:

$$\begin{aligned} \text{Alt 2: WT-OTH} &= \text{General withholding tax} + (\text{Corporate tax rate} / 2 - \text{tax rate other} \\ & \text{jurisdiction}) = \text{applicable withholding tax rate} \\ & (\text{withholding tax can go down to 0\%}) \\ \text{Example no-tax jurisdiction: WT-OTH} &= 15\% + (30\% / 2 - 0\%) = 30\% \\ \text{Example low-tax jurisdiction: WT-OTH} &= 15\% + (30\% / 2 - 10\%) = 20\% \\ \text{Example mid-tax jurisdiction: WT-OTH} &= 15\% + (30\% / 2 - 20\%) = 10\% \\ \text{Example normal tax jurisdiction: WT-OTH} &= 15\% + (30\% / 2 - 30\%) = 0\% \end{aligned}$$

Application is on all non-transactional cash-flows and targeted transactions going OUT of a country to (affiliated) companies. Graded withholding tax will work on all of these. If non-transactional cash flows do not end in the recipient country, then the corporate tax rate can be used instead of an individual country tax rate:

$$\begin{aligned} \text{Example: Average tax rate} - \text{assume Google tax rate} &= 4\% \\ \text{WT-rate: } 15\% + (30\% - 4\%) / 2 &= 28\% \end{aligned}$$

This is the closest a country can come to a unitary tax system by unilateral means only.

Utilizing the withholding tax system more intelligently means one uses a tax system that has been agreed between states for decades. It is even possible to introduce thresholds before withholding taxes start to apply so that small cash flows are not hit by this system. As shown in the AirBnB and Uber example above, also small cash flows can utilize these tax mechanisms.

B. Reverse Tax Credit-method

Background for the suggested method

National taxation in combination with tax treaties are to a large extent able to take care of situations which could give rise to double taxation. This is done through allocation of income between the states in accordance with tax treaties (see OECD Model Double Taxation Convention) and the use of tax credits from one jurisdiction as "deduction" against taxation in another jurisdiction in accordance with national tax laws. The use of tax credit as a mechanism against double taxation is well known and an integral part of international taxation. Tax credit is in this connection the tax paid in the one jurisdiction which is used to reduce the tax calculated to get the tax payable in the other jurisdiction. As a general rule, it is not allowed to reduce the tax more than the tax calculated, and the result is thus that the income is taxed at the highest of the two jurisdictions tax rate.

There are two problems with international taxation – "double non-taxation" and the fact that costs are disproportionately distributed when compared to revenues.³ The OECD have worked on curbing "double non-taxation"⁴, and this will not be explored any further, but we will investigate how a method, reverse tax credit, can cut through the disproportionately distributed cost using principles that have a long and good standing.

Problem

The allocation of cost in a multinational company is usually not aligned with the revenue distribution between countries. High-tax countries tend to get a higher-than-average share of cost, while low-tax or no-tax jurisdictions ends up with lower-than-average or close to zero cost while still taking a significant share of revenues in many multinational companies.

The problem is best known through large companies like Apple, Google and Microsoft which recently was shown to have used a tax avoidance technique called a "Double Irish with a Dutch Sandwich".

The double Irish with a Dutch sandwich is a tax avoidance technique employed by certain large corporations, involving the use of a combination of Irish and Dutch subsidiary companies to shift profits to low or no tax jurisdictions. The double Irish with a Dutch sandwich technique involves sending profits first through one Irish company, then to a Dutch company and finally to a second Irish company with its headquarter in a tax haven.

Example of a double Irish with a Dutch Sandwich (Irish authorities have changed the legislation so that this will not be allowed from 2020, but this is still a good example of how multinational companies can reduce their overall corporate tax rate dramatically (many examples of corporations with corporate tax rates below 5%)):

1. An advertiser pays for an ad in a country or for a software license for a downloaded software
2. The money goes to a subsidiary in Ireland, which holds the intellectual property (IP).
3. Tax payable in Ireland was at the time 12.5 percent (low-tax jurisdiction), but the Irish company pays a royalty to a Dutch subsidiary, for which it gets an Irish tax deduction, reducing the profits to a minimum.
4. The Dutch company pays the money to yet another subsidiary in Ireland, with no withholding tax on inter-EU transactions.
5. The last subsidiary, although it is in Ireland, pays no tax because it is controlled from outside Ireland, almost always a tax haven (no-tax jurisdiction).

³Aarsnes, M.F. (2011), Protection Against Derivative Abuse, PWYP Norway

⁴See the OECD BEPS (Base Erosion and Profit Shifting)

By doing it this way, it is possible to have full deduction for the cost of the companies marketing organizations in the countries where the ads or the software is sold (enough revenues are left in the countries to cover their cost and usually a small profit in order to not get into problems with the countries tax authorities). At the same time profits are moved along a chain of subsidiaries until they reside in a low-tax or no-tax jurisdiction.

Extracting companies are using similar techniques to move untaxed funds from high-tax countries to low-tax or no-tax countries. As one will see, most tax issues arising from tax avoidance and tax evasion, stem from cross-border transactions⁵, utilizing tax systems that was not built to handle these situations:

- Capital gains abuse⁶ – almost always between states or utilization of weak tax system
- Tax regulation abuse⁷ – almost always between states and/or tax treaties
- Mark-to-market abuse⁸ – almost always between states, usually including a tax haven
- Non-transactional cash flows⁹ – almost always between states to avoid discovery
- Transfer pricing¹⁰ – most mispricing is between states to avoid discovery
- Derivative abuse¹¹ – almost always between states, decoupling the transactions from each other
- Fake invoices (criminal activity) – can be from anywhere, but often between states to avoid discovery

As all the main techniques used for major tax avoidance¹², tax evasion¹³ and capital flight¹⁴ can be grouped into one area – abuse of cross-border regulations - the problem is obviously routed in international transactions. The solution should likewise be sought in international tax principles. One of these is the mechanism of tax credits, but adapted to fit the cost side, not the revenue side.

Tax credit is already an approved method for dealing with revenues cross-border together with withholding taxes. We will here demonstrate that reversing the tax credit principles can give a mechanism – reverse tax credit – that can deal with disproportionate costs cross-border in a neutral way.

⁵ The major classes of capital flight mechanisms utilized by extractive industry companies have been described in this report from Publish What You Pay Norway: 'An Extended Country-By-Country Reporting – a policy proposal to the EU, Vol 2', Chapter 2.2: Multinationals and the Use of Transfer Instruments.

⁶ A capital gain can occur on any asset or security (like a share) that is sold for a price higher than the purchase price that was paid for it. Realized capital gains and losses occur when an asset is sold and triggers a taxable event. A capital gain abuse is when a company utilizes a combination of jurisdictions to avoid taxation with the help of low-tax or no-tax jurisdictions.

⁷ Tax regulation abuse is when multinational companies combine tax regulation in different jurisdictions to create situations that lowers or nullifies taxes on profits. A 'Double Irish with a Dutch Sandwich' would fall into this category. Each tax regulation may have well-intended purposes by itself, but taken in combination, the result is outside of what the lawmaker of any individual tax regulation intended.

⁸ Mark-to-market is the accounting or sales practice of linking an asset to a known market, allowing the asset value to be adjusted to an observed market level, resulting in a gain or a loss. A mark-to-market abuse is when multinational companies use contracts to link a cost in one country with a revenue in another country and allow these to fluctuate with the intention of minimizing the profits in a high-tax country and transferring the profit to a low-tax or a no-tax jurisdiction.

⁹ Non-transactional cash flows are all cash flows which only has a contractual background – no further goods or services are transferred but those originating in the original contract. Examples would be interest, insurance, IP royalties, marketing fees, technical fees, fees for use of procurement network, transportation network etc. Abuse of non-transactional cash flows are when the revenues are disproportionate when compared to the cost.

¹⁰ Transfer pricing is the pricing of goods and services from one corporate entity to another. Transfer mispricing is when the price are disproportionately in favor of one jurisdiction, usually a lower-tax, or no-tax jurisdiction.

¹¹ Derivatives are financial instruments used for securing a desirable position for a company. Derivative abuse is when derivatives are used in order to move untaxed funds across border for the purpose of lowering taxes.

¹² Tax avoidance is the reduction of taxes through supposedly "legal" means. However, the legality of tax avoidance is often not sorted out before a tax avoidance scheme has been tried in the court system in a country, and even then it is dependent on many things. Many tax avoidance schemes are never tried before any court, although they are borderline on tax evasion.

¹³ Tax evasion is the reduction of taxes through which results in the illegal non-payment or underpayment of taxes.

¹⁴ Capital flight, in this setting, is when assets or money rapidly flow out of a country, from a subsidiary of a multinational company inside the country to associated companies outside of the country. Capital flight is usually seen as an undesired outcome as it disrupts normal economic processes, one of them taxation by the correct subject.

The motivation for taxation

The undisputed places of taxation are usually (1) where a resource is grown or extracted or a physical asset is owned (geography), (2) where resources are transformed into saleable goods (geography and demography) and (3) where goods or services are sold to the final consumer (demand and demography).

Geography is WHERE production of resources and goods happen and demography is WHOM produces the resources or goods and to WHOM goods and services are sold (demand in the market). The tax havens that are introduced by many multinational companies in the value chain do neither have the geography (resources are not grown or extracted there, there are seldom physical assets of significance there and they do not have the industries to produce the goods) nor the demography (people to produce resources or goods or markets where goods and services can be sold). Jurisdictions outside of 1, 2 and 3 is therefore inserted by the multinational company, and must be scrutinized thoroughly in order to see whether they are delivering additional value in the value chain¹⁵ outside of 1, 2 and 3 above.

The introduction of additional jurisdictions is normally done contractually, and it is only because these contracts are honored by countries, tax administrations and courts, that are presented with these contracts that these additional jurisdictions are allowed part of the profit in the value chain. The multinational companies presenting these contracts are however not honoring these contract themselves, as one will find that these additional jurisdictions are supported only with the weakest defenses in the form of substantial presence and documentation. The cost of their existence in an efficient value chain can only be defended internally in the multinational company through the taxes these additional chains in the value chain are saving the multinational company.

Only through secrecy are these defenses possible to withstand scrutiny as transparency would have demonstrated very clearly that there are no substantial contribution to the value chain from these jurisdictions. It is therefore reason to treat with skepticism jurisdictions that are outside of 1, 2 and 3 above. Unfortunately, these jurisdictions are receiving a disproportionately large part of revenues and only a small or no part of costs.

The only jurisdiction outside of 1, 2 and 3 above that could have meaningful costs that should be taken into account is (4) the home jurisdiction of the multinational company or a part thereof that performs actual services to the value chain. However, these services are usually less than 1%-2% of the total value of the good or the service sold in the market, since if they had been larger it would have been more efficient to establish these services directly in jurisdictions 1, 2 or 3 as most services are relevant at the geographical location of receipt of service, not production of service. A service is not rendered until it has been consumed. Production of a service without consumption is not a taxable event. If a newspaper is produced in Sweden (jurisdiction 2) but sold in Norway (jurisdiction 3), it is the sale (and consumption) of the newspaper in Norway (jurisdiction 3) that is the taxable event. The service (producing the newspaper in jurisdiction 2, Sweden) is only about how much cost should be allocated to jurisdiction 3, Norway, in order to calculate the tax base in Norway to apply the correct tax rate. In Sweden, one would then calculate the taxes based on the total revenue less total cost, but allowing for the tax paid in Norway as a tax credit in order to avoid double taxation. It is this principle that can be used in its reverse form if multinational companies are presenting revenues and costs disproportionately to the jurisdictions 1, 2 and 3.

¹⁵ A value chain is the transformation of grown or extracted resources into saleable goods.

Geography and demography in this meaning are the jurisdictions where economic activity takes place and capital is viewed as a virtual resource that can come from any jurisdiction, but which must be applied in jurisdictions 1, 2 or 3 in order to be relevant in the value chain. Capital is in this model satisfactorily served by interest and dividends (dealt with in tax-treaties). It's the addition of demand in the equation that results in taxable revenues, and thus the taxation cannot be delinked from that demand. The only question is how the profits that the demand creates for the company offering the goods and services demanded are going to be distributed along the value chain:

- Marketing and outlets: Taxation based on profits created by market based revenues less cost
- Production countries: Taxation based on cost plus
- Resource countries: Taxation based on resource markets
- Other countries: No taxation

Alternative ways to tax

There are different alternatives to tax multinational companies.

	Revenues	Cost	Profit
In-country mechanisms	1. Adjust revenues up difficult to estimate	2. Adjust cost down difficult to estimate	
Multilateral mechanisms			3. Global taxation of multinational profits
Tax Credit/ Reverse Tax Credit	4. Tax based on global income, allow for global costs and allow tax credit for taxes paid in other countries (works for companies with home base in country)	5. Tax based on local income, allow for local cost and allow for reverse tax credits for taxes paid globally (works for companies with only subsidiary in country)	
End-user mechanisms	6. VAT and sales/ consumer taxes (destination taxes)		

- (1) The best mechanism is to ensure that revenues reflect the actual economic activity in a country. No tax system beats that, and this is thus the preferable taxation. All purchases in-country by consumers in that country should lead to the revenues being taxable in that country. This also applies to electronic deliveries cross-border, as there would not have been a sale if it were not for the consumer in the country, i.e. the economic activity is the sale & delivery to the market in the relevant country. The revenues may be difficult to estimate, unless banks and credit card companies become required to report the payments made to international companies by individual card holders on an aggregated basis to the tax authorities. This would then be used to compare with the tax return information from the company. In order for this to work, the institute of permanent establishment would have to be expanded to include a permanent market presence.
- (2) Adjusting down the cost may be difficult, and would anyway only apply to costs invoiced from associated companies in other countries. This would thus not be a recommended method to arrive at a correct tax base for a company in a country.

- (3) Global taxation of multinational profits is dependent on multinational agreement on taxation of multinational companies. This does not seem feasible in the near-future, and this method can thus not be relied upon to be available for countries in the short- to medium-term.
- (4) Tax Credit-method is already available to countries and is widely used on the companies that are home-based in the relevant country. This method is however only applicable to home-based companies, and not to subsidiaries of foreign-based companies.
- (5) The Reverse Tax Credit-method could be enacted unilaterally in a country's tax system the same way as the Tax Credit-method is enacted in a country's tax system or agreed in a tax treaty. The Reverse Tax Credit-method is a method that unilaterally takes care of adjusting the effects of a cost-base that is disproportionate to the revenue-base in a country. This method will be discussed further in this paper. The Reverse Tax Credit-method is an alternative to method (1) which was to adjust the revenue up to match actual sales to the market in-country. Today the tax authorities have very little information about what goes on in the various parts of the multinational companies. Most of the information that the tax authorities collect or which are given through automatic information exchange agreements are about individual citizens, not about multinational companies. The reverse tax credit method allow the tax authorities to perform a theoretically correct taxation of a multinational company/subsidiary without having to speculate on what is happening in low-tax or no-tax jurisdictions. The multinational company/subsidiary is given the benefit of the average tax rate that they have. A company that thus is more aggressive in their approach to reduce taxes, are then simultaneously and automatically reducing the tax rate applied to cross-border transactions and non-transactional cash flows. The Reverse Tax Credit principle utilizes an auditor-approved globally consolidated financial statement, but in case of lack of such it is possible to set the tax as low as zero until the corporation provides such documents.
- (6) VAT is an end-user consumer tax and should be applied to all categories of goods and services in order not to favor some goods and services above others unless there are good reasons to differentiate. One example may be reduction of VAT on healthy food to increase consumption (reduction of VAT compensated by reduction in health-care expenditures). Another example may be consumer taxes on gasoline to reduce consumption (increase in taxes compensates increased pollution for every unit gasoline used). When it comes to goods and services delivered cross-border, there is no reasons to have less VAT (or other end-user taxes) than on goods and services delivered in-country.

Tax Credit and Reverse Tax Credit

A tax credit is based upon the taxes paid in the countries which have taxed the same profit as the current tax country (usually the home-country). Profit is revenues less cost, and the principle of tax credit is thus applicable to both the revenue side and the cost side of the profit, but when applied to the cost-side one has to reverse the tax credit principle. The reason for this is that tax credits are applicable to positive net revenues, i.e. when revenues are higher than costs, or said in another way, when costs have already been covered.

The corporate tax rate of a multinational company reflects the average tax rate that the company has paid overall on profits (revenues less costs). This then actually reflects the tax rate that the multinational company has strived to achieve. If it is not possible to use method 1 above and adjust the revenues upwards to get the correct tax base, the next best thing would be to use method 5 (reverse tax credit) to give the multinational company the

tax rate for its cost that it has strived to get for its profits. It is therefore fully acceptable to base the Reverse Tax Credit principle on the achieved corporate tax rate as demonstrated in the financial statement of the parent company. This Reverse Tax Credit would be applicable to all costs originating from associated companies outside of the country and in some cases to the entire tax base. This would mean applying a symmetry-principle on the multinational companies: the more the company has strived to reduce its corporate tax rate, the more cross-border costs are cut. This would help level the playing field amongst multinational companies. The most tax aggressive companies would have the largest Reverse Tax Credit, while the least tax aggressive companies would experience the least Reverse Tax Credit.

Applying the Reverse Tax Credit-method to costs originating from associated companies outside of the country is applicable to companies who demonstrates that they are running all their revenue through the subsidiary or permanent establishment (including permanent marketing presence) in a country.

Applying the Reverse Tax Credit-method to the entire tax base would be applicable to companies that only upholds a marketing and support organization in a country, but which makes all the sales to the country from other countries, evading both taxes and sometimes VAT. The taxation of the subsidiary would under this method be the revenues less the cost plus the difference between the country's tax rate and the corporate tax rate applied to the cost base.

Example of the application of Reverse Tax Credit

Tax rules in various countries are notoriously detailed and cumbersome. Below is a simplified example that illustrates three different situations (1) ownership of subsidiary directly from the US to Norway, (2) ownership of subsidiary in Norway via UK and (3) ownership of subsidiary in Norway via the Tax Haven.

The example illustrates how a Reverse Tax Credit method allows total taxes worldwide and profit after taxes worldwide to become the same whether or not a low-tax or no-tax jurisdiction is introduced in the value chain. The underlying assumption is that the US treats UK and the Tax Haven the same and that the cost in the Tax Haven is the same as in the UK. This is not an obvious assumption generally, but is applicable under the "all other equal" condition (example only differs in taxation, nothing else).

The example illustrates how a company can reduce its overall taxation utilizing low-tax or no-tax jurisdictions (first three columns, in the last column the tax is reduced from \$262,50 to \$245,00). The example illustrates further how a country by utilizing reverse tax credit (in this case Norway, but it could just as well have been the US) can effectively negate the effect of the low-tax or no-tax jurisdiction (last three columns, in the last column the tax is unchanged from the previous two columns).

Disclaimer: The example is prepared based on how taxes and tax credits are applied in principle, and is not intended to replicate specific tax regulations in the US, in Norway or in tax havens. Any names used are for illustration purposes only. The application of Reverse Tax Credit is based on a theoretical application and can deviate from how any individual country would apply the Reverse Tax Credit principle. The example is purely created to show that utilizing a principle like the Reverse Tax Credit it is possible to negate the harmful tax effects of tax havens in a country's individual taxes and in a company's total taxes.

	CURRENT METHOD			REVERSE TAX CREDIT-METHOD		
	US - Norway	US- UK- Norway	US- Tax haven- Norway	US- Norway	US- UK- Norway	US- Tax Haven- Norway
Parent in US:						
Income in US	\$1000	\$1000	\$1000	\$1000	\$1000	\$1000
Cost in US	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500
Cost related to Norway	\$100	\$100	\$100	\$100	\$100	\$100
Income related to cost in Norway	\$150	\$ 100	\$ 100	\$150	\$100	\$100
Profits pretax Norway	\$200	\$200	\$200	\$200	\$200	\$200
Profits third country		\$50			\$50	\$50
Profit before tax US	\$750	\$750	\$700	\$750	\$750	\$750
Tax 35%	-\$262,5	-\$262,5	-\$245	-\$262,5	-\$262,5	-\$262,5
Tax credits	+\$54	+\$69	+\$54	+\$54	+\$69	+\$67,5
Profits after tax	\$541,5	\$556,5	\$325	\$541,5	\$556,5	\$555
Middle country:						
Income related to cost in Norway		\$150	\$150		\$150	\$150
Cost related to Norway		\$100	\$100		\$100	\$100
Profits before tax		\$50	\$50		\$50	\$50
Tax 30% / 0%		\$15	\$0		\$15	\$0
Profit after tax		\$35	\$50		\$35	\$50
Norway:						
Income	\$500	\$500	\$500	\$500	\$500	\$500
Cost Norway	\$150	\$150	\$150	\$150	\$150	\$150
Cost from others	\$150	\$150	\$150	\$150	\$150	\$150
Profits before tax	\$200	\$200	\$200	\$200	\$200	\$200
Tax 27%	-\$54	-\$54	-\$54	-\$54	-\$54	-\$54
Reverse tax on Norway cost from others (\$150*27%)				-\$40,50	-\$40,50	-\$40,50
Reverse tax credit				+\$40,50	+\$40,50	+\$27,00
Profit after tax	\$146	\$146	\$146	\$146	\$146	\$132,50
Overview of total taxes:						
US taxes after tax credits	\$208,5	\$193,5	\$191,0	\$208,5	\$193,5	\$195,0
Middle country taxes	N/A	\$15,0	\$0,0	N/A	\$15,0	\$0,0
Norway	\$54,0	\$54,0	\$54,0	\$54,0	\$54,0	\$67,5
TOTAL TAXES	-\$262,5	-\$262,50	\$245,0	-\$262,5	-\$262,50	-\$262,50
Profit before taxes:						
US	\$550	\$500	\$500	\$550	\$500	\$500
Middle country		\$50	\$50		\$50	\$50
Norway	\$200	\$200	\$200	\$200	\$200	\$200
Total taxes	-\$262,50	-\$262,50	-\$245	-\$262,50	-\$262,50	-\$262,50
Profit after taxes	\$487,50	\$487,50	\$505	\$487,50	\$487,50	\$487,50

DEFINITIONS IN THE EXAMPLE

Explanation Tax Haven-example:

1. The example is based on that a \$750 global profit is taxed in the US at 35% tax rate. This is an oversimplification, as there would be many conditions entering the example in the real world, as the US tax system has very comprehensive regulations and exemptions. It is for example not so that there would be an income in the US negating the cost related to Norway in the Tax Haven-example. There is not a flow-through of profits from third country in the Tax Haven-example either, although the US has a general global profit taxation. The simplification has been done to show how, all other conditions equal, a reverse credit method would get everything back to as if the tax haven was treated like any other country.
2. In Norway there are "Costs from others" of \$150. These are costs from associated companies outside Norway, in the example either UK or the Tax Haven. In the tax calculation in Norway, the FULL tax effect of the \$150 is reversed so that there before the Reverse Tax Credit is NO deductions in Norway connected to this cost. The tax effect is calculated as $\$150 * \text{tax rate } 27\% \text{ in Norway} = \$40,5$.
3. The Reverse Tax Credit is meant to be calculated as the difference between the Norwegian tax rate 27% and the corporate tax rate. Here, there is no corporate tax rate calculated, and hence we have used a proxy: the cost related to Norway that has affected the US taxes multiplied with the lowest of the US (35%) and the Norway (27%) tax rate. This creates the tax credit in the US from Norway of \$67,5. That means that the overall taxation globally (bottom of the example) equals the US tax on the global income of \$262,50 also in the Tax Haven-example, and the profit after taxes globally is the same as in the direct ownership from the US and via a UK-company in the example.
4. A more realistic example given the current rules would have been that:
 - a. The US global income would have not included the Tax Haven income of \$150, resulting in a US tax of \$210 instead of \$262,50. If also the US applied the Reverse Tax Credit principle, they would calculate an additional tax on the Tax Haven revenue.
 - b. This would in the proxy calculated here for Norway give a Reverse Tax Credit of \$0 as there would be no reverse tax credit from the Tax Haven connected to the cost deduction in Norway of \$150. This would have meant that the tax to Norway effectively would have increased with \$40,50 ($\$150 * 27\%$).
 - c. With both Norway and US applying the Reverse Tax Credit, the example would thus have been:

Global tax in the US	\$ 210
Tax credit from Norway	- \$ 54
Normal tax in Norway	+ \$ 54
Additional tax in the US	+ \$ 52,5 (if US applied Reverse Tax Credit)
Tax credit from Norway	- \$ 40,5 (if US applied Reverse Tax Credit)
Additional tax in Norway	+ \$ 40,5
Total global taxes	= \$ 262,5 (if US applied Reverse Tax Credit)

One will see that whatever tax rate is applied between the tax rates of the US and Norway and the corporate global rate (or the tax haven rate as applied here in the example), the total taxes globally always become the same as if the ownership was done directly from the home country (in this case US). The only thing that matters is which country actually benefits from the Reverse Tax Credit.

In this example it is the country which gets a cost, but which does not get the associated revenues, that benefits (in this case Norway). The US company can avoid having Norway benefit by not using a tax haven (or any middle company), and invest directly from the US to Norway. The Reverse Tax Credit method is thus not only a method that nullifies investments through tax havens, but it is also a method that promotes home-country multinational companies to NOT investment through tax havens to promote optimal taxation in the home-country.

The best part of the Reverse Tax Credit method is that it levels the playing field among multinational companies at all levels:

- If only the subsidiary country, in this case Norway, or the home-country, in this case the US, legislates the Reverse Tax Credit method, Norway or the US will benefit through additional taxation that the multinational company tried to reduce its overall taxation with in the first place.
- If both the subsidiary country and the parent company country, legislates the Reverse Tax Credit method, both countries will benefit through additional taxation, and adjustments to the tax treaty between the two countries can ensure that, once both countries have enacted Reverse Tax Credit, that the benefits goes to both countries under an agreed distribution formula.
- If the multinational company sees its and its home-country's best interests, it reverts to investing in subsidiary countries directly from the home-country, simplifying the corporate structure tremendously and thus reducing the cost of doing operations worldwide.
- Other companies will benefit because they will now compete on an equal footing with other companies around the world, and it does not matter anymore where a company has its home-country. The Reverse Tax Credit method puts all companies on an equal footing, and raises taxation in subsidiary countries UNLESS the home-country has the same method OR the multinational companies in those countries do not use tax havens.
- An additional benefit would be that funds will no longer be locked into tax havens, but can be freely distributed to the investors in the company, and investors in the company need no longer to be concerned about whether multinational companies are invested in tax havens or not with respect to evaluating whether they will get their full dividends or not.

The conclusion is that the Reverse Tax Credit method is a universal method that can be used unilaterally by any country, but which will benefit the world better the more countries that implement it. The method will not only put national companies in the same competitive position as multinational companies, but will also eliminate the differences between highly aggressive multinational companies and less aggressive multinational companies. The method also eliminates the need for detailed tax information from tax havens but is benefitting from the extended country-by-country reporting promoted by Publish What You Pay Norway. Last but not least it simplifies taxation and eliminates tax competition between countries. This is of particular importance for developing countries who still need tax revenues to build their countries.

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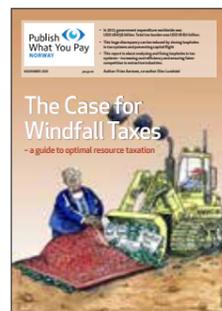
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An extended country-by-country reporting standard. A policy proposal to the EU. Volume 2



- Natural resources have the largest value creation potential to mobilize tax revenue, but profit often ends up elsewhere.
- Today, the Extractive Industries can transfer significant profits out of the source country before it get taxed.
- One simple policy proposal, aligned with US and EU regulation, will give investors and constituents the instrument to follow their money.
- The proposal links taxpayments to the audited financial statements through 8 simple accounting numbers.

The Case for Windfall Taxes – a guide to optimal resource taxation



- In 2012, government expenditure worldwide was USD 28 656 billion. Total tax burden was USD 18 821 billion.
- This huge discrepancy can be reduced by closing loopholes in tax systems and preventing capital flight
- This report is about analyzing and fixing loopholes in tax systems – increasing cost-efficiency and ensuring fairer competition in extractive industries.

Protection from derivative abuse



- Extractive industries are big users of a financial instrument called derivatives, which can be abused to transfer revenues out of host countries before it is taxed.
- The value behind all derivatives is 10 times the world GDP.
- One simple policy proposal can be enacted upon unilaterally to stop abuse, while protecting proper use of these instruments.

Lost Billions. Transfer Pricing in the Extractive Industries



- Over 110 billion USD has disappeared through mispricing of crude oil in the US and the EU between 2000 and 2010.
- Profits have been moved from the source country to the extractive industry companies.
- In December 2000, the Netherlands imported crude oil for the price of 1,69 Euro per bbl. while the spot market prices were no lower than 26 Euro, resulting in an underevaluation of around 40 million Euro to the source country.

Silence is Golden



- Lawyers have a duty of confidentiality. The confidentiality springs from “the best interest of society” and lawyers shall safeguard rule of law in the society. However, confidentiality also has a different and unintended effect that it is necessary to shed light on.
- Companies can claim client confidentiality to protect themselves against government insight into activities and transactions, transaction routes and company structures. The lawyers can also claim client confidentiality to prevent insight into to what they have participated in.
- These days, important questions regarding the extent of lawyers’ privilege of confidentiality in the tax area are being asked. PWYP Norway presents a small selection of short articles that highlight various aspects of this issue.

Piping Profits



- In this report, PWYP Norway has attempted to unravel the labyrinthine corporate structures created by some of the world’s biggest energy and mining companies.
- Few details are known about the murky and expansive networks of extractive companies and their subsidiaries.
- PWYP Norway seeks to clarify this picture by finding out how many subsidiaries companies have and where these are located, also establishing through this process how many are located in secrecy jurisdictions.

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