What are the consequences for companies themselves when taxes are avoided?

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- «Everything we do is strictly legal» is the common phrase when multinational companies and their advisors talk about what they are doing with respect to taxes around the world

- That may be so, but that is because all major tax systems have been designed with the national taxpayer in mind.

- No tax system has been designed with the international market place in mind – ALL major issues in todays 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
  - Non-transactional cash flow across borders or tax systems
  - Assymetrical capital gains and losses across borders or tax systems
- ALL solutions thus needs to stem from cross-border mechanisms

What are the consequences for companies themselves when taxes are avoided?

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- Tax avoidance and tax evasion is not free of cost, but rather creates a huge inefficiency in the companies
    - Facilitator cost
    - Success fees
    - Defence costs
    - Out of court settlement costs
    - Cost of court losses
    - Cost of court wins – the cost of changed regulation
    - Higher taxes than necessary for those parts that ARE taxed
    - Secrecy – has to reduce information down to a few people («partners in crime») – and incriminates these
    - Recruitment base for talents goes down – not all talents want to be part of a tax avoidance/tax evasion scheme – one is left with those that find it acceptable to «cheat to win» - influences the corporate environment and can in certain cases poison this
    - Funds are locked to tax havens – have to borrow money for dividends

What are the consequences for companies themselves when taxes are avoided?

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- Tax avoidance and tax evasion is not free of cost, but rather creates a huge inefficiency in the companies
  - Complicated organizational structure
    - Cost for unnecessary structure – setup-up, reporting, management
    - Additional cost for transactional flow-through (contracts, cash flow, bookkeeping, reporting, management)
  - Complicates
    - transactions and introduces unnecessary steps
    - transactions and introduces additional elements
    - accounting and introduces a huge documentary overload
    - tax compliance and introduces a huge documentary overload
  - Neverending story – tell a lie, and you never get rid of it, and most of the time telling a lie will create a web of new lies – this is costly in itself, as one has to substantiate every lie, repeat it and manage all the lies in order not to get caught

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What are the consequences for companies themselves when taxes are avoided?

- Tax avoidance and tax evasion is not free of cost, but rather creates a huge inefficiency in the companies … and the governments in the countries where they have operations, leading to further costs of doing business
  - Regulatory costs increases and procedural time and cost for companies increases
  - Administrative costs increases and procedural time and cost for companies increases
  - Judicial costs increases and procedural time and cost for companies increases
  - Tax rates are kept higher than necessary
  - Corruption costs increases (people «in the know»)
  - Risk of regulatory backlash increases leading to unknown and undesirable effects
  - Reputational risk increases, leading to cases that damage the stock price of companies and which puts investor trust and personal careers at stake

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What are the consequences for other companies when taxes are avoided?

- Tax avoidance and tax evasion from some companies creates an uneven competition in the market, with huge costs involved
    - Pressure on other companies to do the same to compete
    - Pressure on pricing of products and services from companies that does not do the same, which reduce corporate taxes from these companies
    - The «selfish» decision to reduce taxes, not by using the rules and regulation in-country, but by using cross-border methods, create an enormous downward tax loss from all companies
    - Increases volatility in markets
    - Increases the risk of market crises (like the 2008 financial crisis)
    - Increases the risk of bankruptcy

- Is there then no positives?
    - Yes of course, not the least the free movement of goods, services and capital. However, this could also have been achieved at a much lower cost than today

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What can be done about it?

- ALL major issues in todays 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
  - Non-transactional cash flow across borders or tax systems
  - Assymetrical capital gains and losses across borders or tax systems
- ALL solutions thus needs to stem from cross-border mechanisms

- Are there cross-border mechanisms that can be used? Yes, there are two international systems that can be utilized, only slightly changed:
  - The withholding tax system (where a transaction 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)

What can be done about it?
- the (graded) withholding tax system

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Withholding taxes can fix the non-transactional cash flows (and the sharing economy) and a variant of the international tax credit system can fix the rest:

Withholding Tax Non-transactional cashflows =
General rate + (tax rate in paying country – tax rate in receiving country) / 2 = applicable withholding tax non-transactional cashflows.

Example1: 2 countries with 30% corporate tax (sharing of taxation)

15% + (30% - 30%)/2 = 15%

In example 1 the taxation is shared between countries with taxation.

Example 2: Paying country has 30% tax rate, receiving country has 0% tax rate (receiving country has given away its right to tax, and the paying country retains the right to take back that tax right)

15% + (30% - 0%) / 2 = 30%

In example 2 the taxation is retained by the paying country altogether.

Graded withholding tax

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Graded with-holding tax method (works for non-transactional cashflows)
Based on tax sharing principle in tax treaties

Alt 1: WT-OTH = General withholding tax + (Corporate tax rate – tax rate other jurisdiction)/2 = applicable withholding tax rate

→ withholding tax is minimum 15%

Example low-tax jurisdiction: WT-OTH = 15% + (30%-0%)/2=30%

Example normal tax jurisdiction: WT-OTH = 15% + (30%-30%)/2=15%

Alt 2: WT-OTH = General withholding tax + (Corporate tax rate/2 – tax rate other jurisdiction) = applicable withholding tax rate

→ withholding tax can go down to 0%

Example no-tax jurisdiction: WT-OTH = 15% + (30%/2-0%)=30%

Example low-tax jurisdiction: WT-OTH = 15% + (30%/2-10%)= 20%

Example mid-tax jurisdiction: WT-OTH = 15% + (30%/2-20%)= 10%

Example normal tax jurisdiction: WT-OTH = 15% + (30%/2-30%)=0%

Alternative 1 is for countries where a state always will want to retain at least 50% of the taxation rigths of a transaction.

Alternative 2 is for countries which 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.

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The withholding tax system – the application

- Non-transactional cashflows → royalties, interest, insurance, management fees, technological fees, commercial fees, procurement fees, overhead
- Application is on all non-transactional cashflows 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:
- Example: Average tax rate – assume Google tax rate = 4%

  WT-rate: 15% + (30% - 4%)/2 = 28%
- 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.

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The withholding tax system – the application

- However, a withholding tax system, applied in the modern world can also fix small transations
- Example: Air BnB, Uber and other electronic payment forms cross borders.

  - No payment goes to Air BnB or Uber without a service having been rendered.
  - Payment always goes through a mobile or bank transmission

  It is possible to enter into an agreement with Air BnB and Uber (and other companies) that all transactions flows to Air BnB and Uber is taxed with a graded withholding tax depending on recipient country (if they are organized in a low-tax country then the graded withholding tax will be higher).

  - When a payment is sent to Air BnB and Uber (or others) the electronic payment provider sends the withholding tax (15% or more) to the tax office, while the remaining payment is sent to Air BnB and Uber (or others).
  - Air BnB, Uber and others would calculate in the tax in their prices, and their prices would now be on more competitive terms with other similar services providers (hotels, taxis etc)

What can be done about it?
- the tax credit system

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Reversing the international tax credit system can fix all the issues we have with international transactions today):

A tax credit means that a tax paid in one country becomes deductible in the taxes payable in another country on the same revenue. There is no guarantee that a company gets back all its tax credits, particularly if the tax rate in the deduction country is lower than the tax rate in the country where the tax credit was generated. A tax credit usually stems from a revenue transaction.

A reversed system – a reverse tax credit – can be used on costs that originates (1) cross-border and (2) from an affiliated company of the company to be taxed.

A reverse tax credit system works because all taxation is based on one of three things: resources, activity and people → out of these three things comes all forms of taxation. It is the country with resources, the activity (company operations) or the market (people with purchasing power) that can tax.

What can be done about it?
- the tax credit system

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A reverse tax credit system can work in two ways:
(1) A cost originating cross-border from within the group can have its deductibility limited to the withholding tax rate between the countries (or the largest of the withholding tax rate between the countries and the average tax rate of the company globally). This system works unilaterally.

The difference between the other country's tax system and the allowed tax deduction (the reverse tax credit) can thus be allowed for deduction in the other country. This would be the easiest system to implement unilaterally. If the other country is a tax haven, then there is no further deduction, which matches that there is no further taxation on revenue transactions.

(2) A cost originating cross-border from within the group can have its deductibility limited to the corporate tax rate in the other country and any costs not originating in that second country would be deductible with the average tax rate of the group in the consolidated financial statement for the previous year. This would be the system that gave the most correct result for each corporation.

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Example: distortions of transfer pricing

Replacing a normal-tax country with a tax haven

Company country 1

Cost $100	
	Tax 30% -$30

Company country 2

	Revenue $100
Tax 30% +$30	

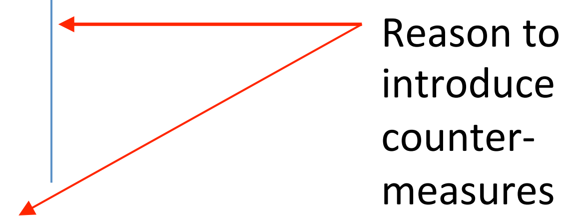
Symmetrical treatment

Company country 1

Cost $100	
	Tax 30% -$30

Tax Haven

	Revenue $100
Tax 0% +$0	



Arbitrage treatment

Distortions of transfer pricing – reverse tax credit

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Reverse tax credit method (works for all costs)

Based on giving deduction rights for taxes in the other state limited to the tax rate in-country.

Cost paid to normal country	$100	Cost paid to tax haven	$100
Tax effect in-country	- $30	Tax effect in-country	- $30
Reverse tax credit	+$30	Reverse tax credit	+$30
Tax effect other country	- $30	Tax effect tax haven	- $ 0
Net tax effect in-country	- $30	Net tax effect in-country	$ 0
Tax effect other country	+$30	Tax effect tax haven	$ 0

The reverse tax credit method, where one replaces the deduction in-country with the tax rate on the transaction in the other country, is a method which works on all costs, and which abides by the internationally developed tax sharing principles in the tax credit system.

Effect of reverse tax credit – restores symmetrical

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Replacing a normal-tax country with a tax haven

Company country 1

Cost $100	
	Tax 30% -$30 Reverse +$30 Other -$30 Net tax $30

Company country 2

	Revenue $100
Tax 30% +$30	

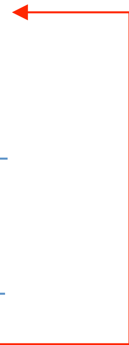
Symmetrical treatment

Company country 1

Cost $100	
	Tax 30% -$30 Reverse +$30 Other -$ 0 Net tax $ 0

Tax Haven

	Revenue $100
Tax 0% +$0	



Symmetrical treatment restored after counter-measures introduced

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Tax treaty anti-abuse rules

- OECD recognizes itself the tax treaty problems of double-nontaxation.

- On March 14, 2014, the OECD preventing double-tax treaty abuse (the so-called Treaty Report). The OECD supplemented this release on March 19 with a discussion draft report on neutralizing the effects of hybrid mismatch arrangements from a double-tax treaty perspective (the so-called Treaty Hybrid Report).1

- These proposals are in connection with the deliverables under the OECD's Action Plan on Base Erosion and Profit Shifting (BEPS).

Tax treaty anti-abuse rules

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- The Hybrid Treaty Report third key area most interesting:
- 3. Interaction between the OECD's domestic law recommendations to neutralize the effects of hybrid mismatch arrangements and the provisions of double-tax treaties. This includes:
- • recognition that, depending on how states decide (if at all) to amend their domestic rules to deal with hybrid mismatches (for example, **denying deductions in the payee state**, forcing inclusion in the recipient state or taxing the recipient in the payee state), states may need to amend their double-tax treaties.

- The reverse tax credit method is a universal method for denying deduction that are possible to implement in each domestic state's regulations and thus can be applied unilaterally.

Effect of reverse tax credit – only positive consequences

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- In addition to that symmetrical treatment is restored between the states, the reverse tax credit method has other positive elements:

- it is applicable to all cost elements that crosses a border
- it is aligned with already internationally accepted tax sharing principles – utilizing the tax credit method
- it allows any country to set its own tax rate – irrespective of other countries – for any resources, activity and markets that are within that country
- it does not affect the taxation of other countries
- it avoids any double-taxation – unless a low- or no-tax jurisdiction is inserted between two countries, and the intention is to take the transaction further into the other countries: hence it does away with companies desire to set up companies in tax havens
- and better: it does not affect the good (or any) companies – these get the tax deduction at the same tax rate as any transaction is taxed at in another country. The only thing that happens is that companies with low- or no-tax jurisdiction companies do not get the tax arbitrage anymore.
- and best of all: it reduces the work of tax administrations to a minimum!

The basis for all taxation

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- The basis for all taxation is however information
- Whatever system of taxation a country or a group of countries enacts, it/they need information about the group of companies being taxed in order to secure that the tax regulation enacted is relevant and neither too burdensome nor too lenient on the companies being taxed.
- An Extended Country-by-Country Reporting that is available to all stakeholders, including investors, at the time of the financial statement reporting is the only instrument that give stakeholders the relevant information to evaluate the company reporting and the governments being reported to.
- Extended CBCR is a prerequisite for correct and transparent taxation of companies and funding of governments. Good governance of taxes is the ultimate goal.