It’s not just Google...

More than half the top U.S. tech firms minimise tax bills by using structures that some governments want to change. It won’t be easy.

BY TOM BERGIN
LONDON, JULY 23, 2013
Big business was having none of it. In January 2013, a lobby group which represents the largest corporations in the world wrote a letter to the body that drafts the rules on taxing multinationals. The letter focused on a small change to an obscure document, but one that was significant enough to worry Will Morris, Director of Global Tax Policy at U.S. industrial giant General Electric Co.

The letter, which Morris wrote in his capacity as head of the Business and Industry Advisory Committee lobby, was addressed to Pascal Saint-Amans, head of the Center for Tax Policy at The Organisation for Economic Co-operation and Development (OECD), a group of 34 mainly rich economies including the United States. It expressed concern about the proposed language in an updated tax convention. Morris wrote – 13 times in all – that his group was “concerned” about the proposal, but had been ignored.

Submissions on the OECD’s website show that lobbyists, especially those representing tech firms, had been voicing such fears for more than a year.

With some reason. A Reuters examination of hundreds of corporate filings across a dozen countries shows the proposed changes – now part of an even further-reaching review – threaten tax structures that are used by most of the big tech companies in the United States to shield tens of billions of dollars of income from taxes each year. As Morris wrote then, the proposals could “have the effect of fundamentally changing” the basis on which multinationals are taxed.

The OECD – a forum in which governments work together to agree how to solve economic problems – is grappling with one of the toughest problems in the global economy. National tax rules are out of date and failing to keep up with multinational companies which split their activities across

6.8%

The average 2012 tax charge on non-U.S. earnings published by 37 of the top 50 U.S. tech firms whose PE structures help avoid tax

Source: Reuters
It’s an illusion for some businesses to think that there shouldn’t be an examination of this.

Philip Kermod
Director, Directorate-General for Taxation and Customs Union in the EU
**Big Tech, little tax**

When it comes to taxation, most of the top 50 U.S. software, hardware and internet firms set a tax base outside their major overseas markets. This keeps tax bills down.

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<th>COUNTRY/COMPANIES</th>
<th>TOTAL OVERSEAS INCOME/TOTAL OVERSEAS TAX</th>
<th>TAX RATE</th>
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*Source: Company accounts*

creating uncertainty. It could spark additional disputes with tax authorities. The risk that profits would be taxed more than once would hit trade.

“Moving to a standard under which a PE is created by mere negotiation of a contract would obviously be something that business would be concerned about,” Carol Doran Klein, Tax Counsel at USCIB, told Reuters.

But some European Union and U.S. officials said the Reuters analysis shows why the OECD needs to revisit its guidance on tax residence.

“People should find it surprising,” said Philip Kermode, Director of the European Union’s Directorate-General for Taxation and Customs Union. He said companies’ ability to do business in countries where they are not taxable is the real problem the OECD needs to get to grips with.

“It’s an illusion for some businesses to think that there shouldn’t be an examination of this.”

**BIG TECH**

Much of the attention in the debate about PEs falls on U.S. firms. The United States has tough rules to dissuade companies from using such structures at home, but many tech companies use them abroad, the Reuters analysis found.

The accounts of the 50 biggest U.S. tech companies and their subsidiaries show that only 13 declare the bulk of their income for tax in the main markets where they generate it. The rest use mechanisms to channel some or all of their revenues to a central tax base in a country with a lighter tax regime.

Sixteen of the 20 biggest U.S. software companies by market value, including Microsoft, Adobe and Citrix, do not declare tax residences for their main businesses in their major European markets, their accounts show. Instead, they report software sales in Ireland, Switzerland and the Netherlands, countries which have smaller populations and offer lower corporate tax rates.

Microsoft told Reuters its Irish operation was “established largely in response to customer demand to consolidate shipments” and that it pays all the taxes it should. Adobe said it “pays the lawful amount of tax owed in the countries where we do business.”

Text continues on page 6
PE ratios

Ireland is the top choice of tax base for companies that want to avoid declaring permanent establishments (PEs) or tax residences in their main markets. Apple is the biggest firm to take advantage of Ireland’s approach, rather than allow its income to be taxed in countries where it makes most money. Its pretax non-U.S. earnings of $36.8 billion in 2012 were taxed at just 1.9 percent.

OVERSEAS 2012 TAX RATE

Less than 5% 5-10 10-15 More than 15%

IRELAND

Apple
Pre-tax profit on non-U.S. earnings: $36,800 million
Overseas tax rate: 1.9%

Oracle 6,678 12.5%
Google 5,848 2.6%
Dell 3,875 6.2%

Microsoft 20,667 9.4%

EMC 1,900 7.6%

Synopsys 161 5.7%
Cadence 126 9.0%
Juniper 117 34.6%
SanDisk 108 82.8%
Red Hat 79 24.6%

NETHERLANDS

Seagate 2,745 1.8%
NetApp 630 5.7%

SWITZERLAND

EBay 2,179 3.5%
Citrix 209 14.8%
Yahoo 158 44.8%

TAX BASE UNCLEAR

TAX RESIDENT IN MAJOR MARKETS

IBM 12,234 22.2%
Cisco 6,924 7.0%
Intel 4,831 23.5%
Priceline 1,667 17.3%

W. Digital 1,559 1.9%

Motorola 364 21.2%
Micron 274 1.1%
TripAdvisor 194 19.5%
Intuit 42 23.8%

Reported Loss: LinkedIn, Facebook (Ireland); Applied Materials (Netherlands); Amazon (Luxembourg); Salesforce (Switzerland); Hewlett-Packard (tax resident in major markets)

Source: Company accounts
Citrix said in its 2012 annual report that its effective tax rate was below the headline U.S. federal statutory rate “due primarily to lower tax rates on earnings generated by our foreign operations that are taxed primarily in Switzerland.”

A spokesman said: “Citrix companies fully comply with all tax laws, rules and regulations and we cooperate with the relevant tax authorities to ensure we continue to do so.”

U.S. computer hardware makers and internet firms use similar schemes. At least 13 of the 20 biggest hardware firms, including companies such as Dell, and eight of the 10 biggest internet service companies, including Google, Expedia and Yahoo, reduce their European tax burden by ensuring they do not create PEs in major markets. Companies can create PEs in as many markets as they like.

In Dell’s case, sales and other staff are employed in subsidiaries across Europe but sales are conducted on behalf of an unlimited Irish-registered company. That means it does not have to publish accounts, so it is not possible to see what if any taxes it pays. Dell declined comment.

Google said it chose Ireland as its Europe, Middle East and Africa headquarters for a variety of reasons including good logistics, an educated workforce and low tax. Expedia subsidiaries in countries like Germany supply services to a Swiss affiliate which does business with hotels and others who wish to sell through its websites, company filings and websites show. The company declined to comment.

Some companies that channel cash from their main markets to sales units in Ireland, Luxembourg and the Netherlands then send it untaxed to countries like Bermuda and the Cayman Islands, which do not levy corporate income tax. Microsoft and Google are among them.

Apple Inc uses companies that are registered in Ireland but say they are tax-resident nowhere. This incongruous mechanism was revealed by a U.S. senate panel in May, which called it the “Holy Grail of tax avoidance”. Apple declined comment, but its CEO Tim Cook said in May Apple pays all the taxes it owes and it did not depend on tax gimmicks.

In other cases it is unclear where the money goes, or what, if any, tax is paid on it, because the companies use set-ups that are not required to publish accounts. The unlimited company in Ireland is just one example.

(For a complete list of the companies that Reuters examined, see page 8)
Adobe employs 120 people in Dublin, around one percent of its global workforce; three are engaged in software R&D.

Yet Adobe’s Irish operation generated 80 percent of its non-U.S. income in recent years – more than $500 million annually in 2010 and 2011, the years for which the most recent accounts are available.

Adobe paid only about $3 million a year in Irish income taxes on that profit, because most of it was earned by one of the subsidiaries, Adobe Software Trading Co Ltd - a company that is Irish-registered but which its accounts say is “not subject to Irish corporation tax.”

Adobe declined to answer any detailed questions about its tax affairs but added it “seeks to pay the lowest level of taxes owed under the law.” It said it paid “the lawful amount of tax owed” in the countries where it generates sales, rather than where the contracts are finalised.

Adobe’s units around the world do have a tax residence in each of their markets, but not as sellers of software. Instead they are “service providers” to the second Dublin subsidiary, Adobe Systems Software.

Such an arrangement - where businesses in the main markets only declare profit on a support function - is known as the “Service PE” model. It’s one of several variants which arose in the 1980s but took off in the 1990s with the rise of e-commerce.

Regulatory filings show Adobe has managed an average tax rate on its overseas income of less than 7 percent in the past three years, which is a fraction of the rates in its main markets.

The Irish tax authority declined to comment.

“SYMPATHETIC”

Like Washington’s tax authority, Europe’s tax collectors can disregard PE schemes contrived to avoid tax. But French, Norwegian and Spanish attempts to exercise these rights have failed in court. Experts say civil law codes make judges reluctant to overrule contractual agreements, such as a sales deal.

This is why governments have asked the OECD to change the guidelines which will then form the basis of future tax laws. If the rules are changed, they hope, more companies will be forced to declare a PE in countries where they generate sales, rather than where the contracts are finalised.

A senior U.S. Treasury official involved in the OECD process said Washington understood concerns that these structures may help U.S. firms short-change other governments by not creating PEs in enough countries where they do business. “We are sympathetic to that,” the official told Reuters. “Because maybe ... there ought to be more PEs.”

Back in January, discussion documents said OECD members were split on whether to support a change. Some officials and legal experts aren’t sure it will be possible to come up with a different legally enforceable definition of the moment of sale.

The OECD says it could take another two years before new proposals are drawn up. But the OECD’s Saint-Amans said firms have told him privately they know change is on the way.

He said that when he meets executives in the corridor, they say “We know it’s over, we need to fix it.”

Additional reporting by Himanshu Ojha; Edited by Sara Ledwith and Will Waterman
Companies speak back

Leading countries vowed last week to crack down on tax avoidance by multinationals, asking the Organisation for Economic Co-operation and Development (OECD) to draw up new guidelines.

The OECD, which advises its mainly rich members on economic policy, said one area where companies might most effectively avoid tax is by not declaring a tax residence in countries where they have major sales and operations.

It identified the digital sector as an area where this was a particular risk and said it needed to make a detailed analysis of the business models of technology companies.

A Reuters examination of accounts for hundreds of subsidiaries of the biggest U.S. technology companies shows most do not declare a tax residence for their main business in the biggest European markets.

Historically, tax residence has been determined by where companies make sales. By basing themselves in countries like Ireland, the Netherlands and Switzerland - which offer low tax rates or the ability to send money tax-free to tax havens - these companies legally save tens of billions of dollars in tax each year.

The Irish Connection

Many of the firms examined by Reuters declare Irish subsidiaries as their sole or primary tax bases in Europe, even though they operate others in countries like Britain, France or Germany where most of their sales or marketing staff are based. This helped them to pay an average effective tax rate on overseas income of 5.7 percent, less than half Ireland’s 12.5 percent headline rate of corporate income tax.


Most of those companies contacted by Reuters defended their set up.

Adobe said it “pays the lawful amount of tax owed in the countries where we do business.”

Microsoft said its Irish operation was “established largely in response to customer demand to consolidate shipments” and that it pays all the taxes it should.

Symantec said that its “investment in R&D, M&A and its employee base impacts its pretax profits and tax credits in the countries in which it does business... Symantec works in accordance with tax laws in all markets in which it is present.”

Google said it chose to base itself in Ireland for of a variety of reasons including its educated workforce, good communication and low taxes. It said it followed the tax rules in all the countries where it operates.

A Facebook spokesman said the firm “takes its tax obligations seriously, and works closely with national tax authorities to ensure we comply with the law.”

A LinkedIn spokesman said Dublin was the hub of its European operation, employing around half of its European staff. “LinkedIn abides by all tax laws as determined by the authorities in all the markets in which we operate,” he said.

Apple has said it pays all the taxes it is supposed to.

EMC said that it “complies with the tax laws in the jurisdictions in which we operate. Our profits are taxed in the countries in which they are generated.”

Altera said it “pays all the taxes we are required to pay” and a spokeswoman for Juniper Networks said it “takes compliance matters very seriously. We look to government bodies to set tax policies, and comply with applicable tax laws and regulations.”

Oracle, VMware Red Hat, Synopsys, Cadence, Dell, SanDisk, Analog Devices and Xilinx declined to comment.

Dutch domicile

A range of companies choose to sell equipment, services or online downloads to customers across Europe from the Netherlands, while also often having affiliated companies across the continent that perform sales or marketing roles. This contributed to an average effective tax rate on overseas income of 5.5 percent in 2012. These companies include Activision Blizzard, BMC Software Inc, NetApp Inc, Applied Materials and Seagate Technology. All declined comment.

Alpine base camp

Switzerland is a popular choice for firms looking for a European tax base because effective corporate tax rates can drop as low as zero; companies that do business in countries like France, Germany and the UK can be designated as service providers to the Swiss units.

Companies which supply clients direct from Switzerland include Autodesk, Salesforce.com, CA Inc, Citrix Systems Inc, Yahoo! Inc, eBay Inc, Electronic Arts Inc and Expedia.

An Autodesk spokesman said it “centralises operations where it makes business sense, focusing on locations offering a multi-lingual and well-educated workforce, with Switzerland being one example. Autodesk ... fully complies with the tax laws of the many jurisdictions where we operate around the world.”

Salesforce.com said it “complies with all applicable tax laws in the jurisdictions in
which the company operates.”

A Citrix spokesman said: “Citrix companies fully comply with all tax laws, rules and regulations and we cooperate with the relevant tax authorities to ensure we continue to do so.”

A Yahoo spokeswoman said: “Yahoo! pays all applicable taxes and closely follows the tax laws of every jurisdiction in which we operate.”

eBay said its Bern-based unit eBay International AG was “structured in a manner that best supports our global commerce marketplace business model.”

Expedia, Electronic Arts and CA declined to comment.

The Grand Duchy
A number of well-known companies establish a single tax base for their principal business in Luxembourg and then do most of their selling or other work through service providers to the unit in the Grand Duchy. The enables them to minimise their profit in major markets. Amazon.com Inc is one such a company. It says it obeys the tax rules in every country where it operates.

Uncertain sales base
Reuters was unable to determine the location of the European tax residences - and therefore what if any tax was paid - by a number of companies that do business in countries like France, Germany and the UK. These include Linear Technology Corp, Netsuite, Broadcom Corp and Qualcomm.

A Linear Technology Corp spokesman said: “Many factors influence tax rates, which vary by country and over time,” but declined to answer questions about the company’s structure or tax affairs.

The others declined to comment.

The case of Cisco
Cisco Systems Inc sells to customers across Europe through a UK unit, Cisco International Ltd, while units in France, Germany and Ireland are designated providers of “sales and marketing support” to the UK operation. However, the company’s UK tax residence doesn’t translate into a big tax bill because Cisco International Ltd is designated a “Buy Sell entity”, which effectively acts as an agent for affiliates elsewhere.

A spokeswoman said “Cisco’s operational structure is determined by a variety of factors including the location of sales partners, access to customers, local infrastructure, availability of a skilled workforce, and corporate taxes, among other considerations.”

Selling the old way
Companies that sell in the traditional way and do not use PE structures to shift the bulk of their revenues include: IBM Corp, Cognizant, Teradata, Priceline.com Inc, TripAdvisor Inc, Intel Corp, Hewlett-Packard Co, Texas Instruments Inc, Motorola Solutions Inc, Western Digital Corp, Micron Technology Inc and Intuit Inc. All declined to comment except TripAdvisor, which said it complies with rules within each EU country where it operates.