Forum: General Assembly 6 (Legal)

Issue: Legal measures to reduce tax avoidance by transnational corporations (TNCs)

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Introduction

With the rate of globalization increasing at an exponential rate, many issues have been caused as a result of the world essentially becoming a much ‘smaller’ place. From the threat of insecurity to others, one issue, that has not only been affecting the economic and social well-being of the public, but also the governments of many nations is the issue of transnational corporations (TNCs) avoiding tax. This issue has been in recent news multiple times, from the ethical debate of the nature of tax avoidance to the methods, the general public has been educated more and more about the issue.

The problem with governments losing tax revenue means that nations hosting such large TNCs do not actually benefit fairly due to the complicated methods employed by these large corporations to avoid taxes. However, the issue of tax avoidance is no easy solve. Many factors are critical in actually cracking down on such forms of tax evasion. From the issue of how to tax the corporations in terms of location to what departments of a corporation to tax are just some to mention. This isn’t even considering the multiple loop holes and contradictions that the tax laws hold.

Tax havens complicate the situation even more. With the introduction of these ‘islands’, the nature of reaching a sound solution to decrease tax avoidance has made it even harder and more challenging. These multiple factors have not made the task of solving this issue easy, but multiple efforts have been undertaken, and numerous initiatives have been started. The issue still remains a strong one but effective action will soon come as the problem at hand has caused multiple issues that threaten the economic and social well-being of the world.

Definition of Key Terms

Corporation tax

Corporation tax is a tax imposed on the net income of the company. So instead of taxing each sale that a company makes, which is essentially Value Added Tax (VAT), it taxes the profits the company makes in that region.

Transnational Companies

A commercial enterprise that operates substantial facilities, does business in more than one country and does not consider any particular country its national home. Such examples of TNCs include corporations like Apple, Starbucks, and Amazon.

Background Information

Methods of tax avoidance

There are many methods employed by TNCs to avoid large tax bills which are enforced by nations legally. From royalty agreements to inter-corporation interests, these methods that are used by many large TNCs are completely legal and don't pose any threats to breaking the law. However, many consider these acts as immoral due to the fact that tax avoidance poses implications to a nation's economy. With the TNCs avoiding taxes, this reduces the tax revenue of the nation, which means that the nation has less financial resources to develop and make the social and economic lives of its citizens better.

Inter-corporation interest

For example, when a company establishes a subsidiary group in a tax high nation, such as the UK, there are costs associated with establishing a new brand in a new place. What many corporations do is that they get the head office or the headquarters (HQ) to fund the new operation, in this case the UK operation. However, this money is eventually paid back at an interest which is set by the cooperation itself. This way, the profits that the UK operation makes needs to be paid back at an interest to the HQ which reduces the profits of the UK operation. This way the corporation tax bill which is imposed on the TNCs is reduced as they have made low profits in that nations operation. However, the cooperation itself is not making losses. It is just the UK operation which has made low profits. The other money is just sent to another nation so the money is still there.

Royalty agreement

When one wants to set up a franchise's store in a new nation, they simply cannot establish a store and associate it with a large TNC. What they need to do is they have to sign a license agreement with the franchise allowing them to open stores with specific requirements. In this license agreement, it often states that a percentage of the stores sales go back to office where the license agreement is stated. These license agreement offices are often stationed in tax havens such as Netherlands for example. This way when the store makes profits, part of the profits is directed back to this office due to the license agreement. This in turn reduces the profits in that region allowing for a lower cooperation tax bill. Moreover, the percentage is often set by the TNC itself and is often at a figure where the profits in a reigned are drained by a significant amount. In addition to this, many tax official cannot comment on this percentage rate as the TNCs can argue that this is a special brand and there is impossible to compare with other companies as this corporation is unique.

Past losses

Another trick that many TNCs employ is something called past losses. This is more of a loophole than a trick because it manipulates the tax laws of a nation to reduce taxes. For example, using the UK as a basis, a franchise decides to establish itself in the UK, they spend immense amounts of into aspects associated with establishment such as advertising, equipment and so forth. This often results in losses as a lot of expenditure takes place. So for example the franchise make a loss of three million dollars. Then the next year, business booms and the franchise makes a profit of three million dollars. What the corporation can do it can combine the figures of the two year which would result in zero profits which in turn would be zero corporation tax.

Social and economic implications

The methods by TNCs to avoid taxes are completely legal, they use aggressive tax avoidance methods whereby they utilize the loopholes in the tax laws to benefit. However, the real issue comes is with the implications that tax avoidance has on other factors such as the social and economic wellbeing of the citizens of such nations. For example, the continent of Africa is losing more than $50 billion annually due to such tax avoidance schemes. In a continent where most of the nations are still considered LICs, such reductions in tax revenues can impose serious implications to the development of these nations. This loss in tax revenue translates into less budget for nations to spend on improving infrastructure and create a better quality of life for its citizens. So despite the legality of such schemes and tricks, the real issue with tax avoidance is the implications is poses on the development of nations.

Key Issues

Cutting costs

All companies national or multinational always aim to cut costs in order to increase profits. More frequently than ever, they are under pressure from shareholders to minimize costs as much as they can. However, the large size of TNCs facilitates such cutting costs compared to national companies. Many TNCs outsource departments of their companies to nations where tax is extremely low. The financial advisers of such cooperation try find tax havens such as Ireland to establish subsidiary bodies, minimizing costs on aspects such as production, distribution, and other hubs. This way, when outsourcing aspects of the company that are affected by taxes to other nations with lower tax, they have essentially cut back on costs. A good example is Ireland and how it acts as a major tax haven for many TNCs. Essentially what these companies do is they outsource production and distribution to Ireland and then sell these products to customers in the UK through Ireland as well. This way the UK cannot apply corporation taxes to these TNCs as the products or services are essentially from Ireland and all the profits created are from the Ireland branch. Although this all seems morally wrong, it is in fact all done legally. These TNCs utilize the loopholes created by these tax laws to benefit and essentially cut back on costs.

Race to reduce taxes

Over the past few years, there has been this boom within nations to cut back on the amount of tax they charge due to increasing rate of globalization. Many nations have reduced of made exceptions so that they can attract large businesses to their nation. This ongoing competition has resulted in immense reduction in taxes by many nations to benefit from these large corporation creating tax havens in the world. In addition to this, many established nations like the UK or the USA haven't made much changes to their taxes as these nation already have large sums of financial resources. This trend of many nations not abundant in financial resources cutting back on taxes and established nations not moving at all has provided multinational companies with such opportunities. With such circumstances they are able to outsource subsidiaries as mentioned before to avoid high tax payments.

Selective tax treatment

Many nations which are trying to attract big business and major TNC's occasionally take part in an activity called selective tax treatment. This is when the tax officials of the nation become lenient with taxes and establish special deals with these major TNC's to reduce their tax payments. For example nations like Ireland have managed to get Apple to run its sales operations from Ireland through these special deals. When Apple sells a product in Europe, the customer is contractually purchasing the product from Ireland so all profits are directed to Ireland meaning other nations cannot impose corporate tax. In addition to this, they have secretly created a deal where the majority of the profits are sent to this 'head office' and a little percentage is left in Ireland. However, this 'head office' is only existent in paper and the money actually goes to offshore accounts. This way, Ireland can only tax the small amount profit left in Ireland reducing taxes immensely from Apple. These are some techniques and strategies used by nations to attract these big businesses and many nations are guilty of this including nations like Luxembourg, Belgium and Netherlands.

Major Parties Involved and Their Views

The Organization for Economic Co-operation and Development

The Organization for Economic Co-operation and Development was created with idea of designing, promoting, and improving the financial policies of the world so that the economic and the social well-being of the public would be improved around the world. They collect and analyze data extensively using the collected information as a basis to build upon. With the access to the information of all UN member states the OECD has come up with multiple documents upon this topic which can be used by all governments. They have extensively worked to combat this issue of tax avoidance and have taken a strong stance to combat this issue.

European Commission

The European Commission (EC) is the body of the EU responsible for proposing legislation, implementing decision and also other activities. Recently though, the EC has also taken a stance upon the issue of tax avoidance by TNCs within the EU. They have drawn up action plans, collaborating successfully with the OECD, to effectively combat tax evasion and avoidance. In fact, they have been successful themselves in addressing such issues by launching investigations, most notably been the investigation into the tech giant Apple and its recent calling to pay the one billion dollars of taxes it has evaded. The EC is strongly against tax evasion and avoidance practices and has taken action as well.

Committee of Experts on International Cooperation in Tax Matter

Being a subsidiary body of the Economic and Social Council (ECOSOC), this committee aims to promote increased cooperation between member states to solve issues of tax matter, including the issue of tax avoidance and evasion. They have published two documents that are updated frequently and these documents provide information and guidelines in how to implement tax treaties and also and conventions between Developing and Developed nations. Although their efforts have not been as significant as the action of the OECD or the G20 committee, it nevertheless is making an effort to contribute to the efforts to reduce tax evasion and avoidance.

Group of Twenty

The Group of Twenty (G20) is made up of members whose economies make up almost 80% of the global world trade. This organization has strongly stressed the importance to combat this issue at hand and also has established many initiatives to bring the issue to a halt. One such initiative was in

2009 when they addressed that 'the era of bank secrecy is over'. Despite the initiative having little success, they have continued to discuss the issue over and over again and are still working towards a more effective solution.

Journalists

Just recently, on April 2016, a set of documents cited as the Panama Papers were leaked to the public by journalists showing how a Panamanian law firm Mossak Fonseca helped almost 14000 clients to create offshore entities for multiple reasons including tax avoidance. This incident had shed light on just how massive the problem was. Including this incident, many journalists in the present time have also started to express their view on tax avoidance through leaking documents of such sort. They have in a sense helped with the efforts to combat such issues by providing even more information than that was known before.

Timeline of Relevant Resolutions, Treaties and Events

Date	Description of event
1979	**The Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries** The Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries addresses the transparency is essential in combatting the issue at hand. With transparency in both the HICs and LICs, this allows for the access of information between nations. This way the detection of tax evasion is much easier and committers can be prosecuted.
2003	**Tax Justice Network (TJN) was established** The TJN is an advocacy group consisting of a coalition of researchers and activists that share a concern for tax avoidance, tax competitions and tax havens.
January 2006	**The Exchange of Information on Request** The Exchange of Information on Request (EOIR) was implemented by the OECD, which enables governments to obtain financial information of other governments. If tax evasion is suspected governments can investigate with information from other governments, facilitating the process.

July 2014	**The Standard for Automatic Exchange of Financial Account Information** The Standard for Automatic Exchange of Financial Account Information (AEOI) was published by the OECD and succeeded the EOIR. It contains rules on the exchange of information from government to government encouraging transparency and allowing for the detection of tax noncompliance more easily.
May 9, 2016	**The Panama Papers leaked** The Panama Papers are a group of 11.5 million leaked documents detailing attorney–client information for more than 200,000 offshore entities.
August 30, 2016	**Apple European Union Tax Ruling** The European Commission addressed Apple to pay $14.5 billion dollars in taxes after an investigation discovered that Apple had avoided over a decade years' worth of taxes.

Relevant UN Treaties and Events

- UN Model Double Taxation Convention between Developed and Developing Countries, 2001
- Manual for Negotiation of Bilateral Tax Treaties between Developed and Developing Countries, 1979
- ECOSOC resolution on “Committee of Experts on International Cooperation in Tax Matters”, 11 November 2004 **(E/RES/2004/69)**
- Action Plan on Base Erosion and Profit Sharing, 2013

Evaluation of Previous Attempts to Resolve the Issue

This problem of tax avoidance by these large multinational companies has only taken the spotlight for major economic issues recently. Despite its history, it has become now become the issue that many nations and associations such as the European Union (EU) for example have focused on more thoroughly. These association have recently taken some strict actions and have launched major investigations on TNCs which pay abnormally low taxes compared to their behemoth status and presence. Although these investigations that have been launched are quite long and arduous they have presented some promising results. For example, only recently in August 2016, an EU initiated investigation into Apple and its relationship with Ireland has been exposed conveying how secret deals were made and their strategies. This has resulted in fining Apple to pay almost $15 billion in taxes that it has not paid. This success shows much promise into these investigations that have been launched by many groups and exposure of these activities will further degrade the status of these TNCs. Through this, many of the major corporations would be encouraged to just pay their taxes and become more transparent rather than hide and then be exposed. However, on the other hand, what the TNCs have done isn't illegal. The strategy that they used wasn't wrong or breaking the law. What was the issue was that Ireland engaged in selective treatment which put other business at a disadvantage. So despite the good intentions of these investigations, it doesn't address the main issue which is the loopholes in the tax laws.

Possible Solutions

There are a number of possible solutions that could be initiated to address this issue and bring a stop to this. One for example, is creating awareness among the general public about this whole idea of tax avoidance, its methods, and its consequences. Usually, when tax avoidance does occur, it leaves a nation in a bad position in term of its tax resources as they aren't being payed what they need to be. This would mean that the nation is not getting enough money, which could hinder its efforts to keep a nation in good condition and also improve it. By educating these concepts to the general public, the public would see the wide variety of consequences and possibly start an initiative forcing TNC's to change their methods. Solutions like boycotts of a certain company have worked before, however, something of this sort on a larger scale could result in a greater impact on these TNCs forcing them to change their ways as people would not, for example, buy their products for the boycott which would affect sales. However, all this is just hypothetical and one would need to consider many factors for this to be successful such as the strength of the TNC. Corporations like Amazon and Google have such a large influences that sometimes our daily actions benefit these corporations. However, it is still one solution that could be considered.

Another solution that can be implemented fairly quickly and easily is by imposing a Value Added Tax (VAT) on the goods that are sold in that nation. VAT is just another form consumption tax so this way the nation earns money through each purchase rather than getting a share of the profit. Although, this would result in lower returns as VAT is nowhere nearly as profitable as corporation tax, it would still bring in a lot of money to the nation's government as it earn money on each sale. However, this would not address the issue of tax evasion and avoidance but it does provide the financial resources for nation to develop upon. Because one of the key issues with the whole idea of tax evasion and avoidance is that nations are not benefiting from this activity. Instead it affecting the social and economic wellbeing of the citizens as not enough money is coming in from taxes to properly develop the nation. In the case, VAT seems like a possible solution to combat the consequences of tax evasion. After all, we are trying to stop this issue to improve the well-being of the world, so this way we can indirectly help the nation without taking tough stances on TNCs and imposing tax laws.

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