A Fair International Tax

A proposal by Richard Murphy of Tax Research LLP

The issue

There is now widespread recognition that tax is:

- an issue of social justice;
- a corporate responsibility issue;
- a contributor to the poverty gap;
- a significant cause of international disquiet;
- a development issue.

The Tax Justice Network, of which the author of this report is a senior adviser, has been successful since its launch in March 2003 in, amongst many other things, showing that international tax avoidance and evasion reduces the tax yields in both developed and developing countries. That issue has become more serious since financial crisis engulfed the world in 2008. Tax is now the commodity in shortest supply in many economies around the world.

That crisis has been exacerbated by a new issue. There is now very clear evidence of massive tax avoidance by many of the world's largest corporations. From Apple, to Google, to Amazon and many more besides, it appears tax is not being paid in the right place at the right time in the amount that can reasonable be expected. This paper looks at an alternative, and new way, of tackling this problem.

A solution

The purpose of this proposal is to suggest a solution to the problem of international tax whilst at the same time creating an entirely valid campaign 'ask' which takes forward the issue of tax justice in a meaningful way. It does this by suggesting that there is a need for a fair international tax.

Background to a tax for a fair international tax

Some of the specific tax problems this suggestion recognises are:

1. a downward trend in the rates of corporation tax that countries are seeking to levy;
2. a downward trend in the rate of corporation tax paid by companies even when the rate of corporation tax to which they are subject is constant (as was the case in the UK for quite a number of years);

3. increasing use of tax avoidance schemes by companies despite the efforts of individual countries to curtail this activity;
4. the promotion of tax competition as something of benefit by tax haven states and some other countries committed to their use for their own purposes e.g. by Ireland;
5. the difficulty in achieving international corporation on these issues;
6. the continuing ability of companies to hide both in the secret spaces that tax havens offer and in the similar secret spaces that there own subsidiaries create.

In summary, these describe a conflict between national taxation systems and global companies that those companies are only too willing to exploit to obtain steadily falling tax rates. The winners are:

1. multinational companies and those who advise them;
2. small, low tax territories;
3. the well-off who own such companies or who live in such places.

The losers are:

1. countries with large populations and significant social obligations;
2. the less well off in those countries, whether they are developed or not;
3. small, local businesses;
4. the taxation systems of the world that lose credibility in the face of such an onslaught.

It is this range of issues, with these winners and losers that this proposal seeks to address.

How a fair international tax

A fair international tax would work as follows:

1. The tax authority in any country in which a multinational group traded would have the right to look at its consolidated group accounts to determine if the fair international tax was payable;
2. The tax charge would be based upon the declared profit of the group and not upon any individual company within it;
3. The profit used for these purposes would be the net profit before tax but with depreciation charges and any amortisation or equivalent charges on goodwill and intangible assets added back. This is because the tax

provides for separate allowances to be given in place of these charges;

4. The part of the group profit attributable to the state considering using a fair international tax would be calculated on a formula basis. That formula would consider only the sales and employee details of the group, again because the fair international tax will allow for separate allowances to be made for capital spending.
5. The ratio of group profit attributable to a state would be calculated by a formula:
    a. 25% would be attributed on the basis of where third party sales originated (anti-avoidance mechanisms would challenge their relocation to tax havens; all those attributable to such places being ignored for these purposes) (origination is where sales are from; destination is where sales are to);
    b. 25% would be calculated on the basis of the destination of third party sales (again with anti-avoidance measures in place);
    c. 25% would be calculated on the basis of payroll cost in a jurisdiction;
    d. 25% would be calculated on the basis of payroll headcount in a jurisdiction.

    So, for example, if profit before depreciation and amortisation was £10 million, sales originating in a location were 30% of turnover and destination sales were 20% of turnover with 60% of payroll cost and 40% of payroll head count then attributable fair international tax attributable to the jurisdiction would be:
    a. 25% x £10,000,000 x 30% = £750,000
    b. 25% x £10,000,000 x 20% = £500,000
    c. 25% x £10,000,000 x 60% = £1,500,000
    d. 25% x £10,000,000 x 40% = £1,000,000

    This would result in profit of £3.75 million out of the total of £10 million being attributable to the jurisdiction.
6. The fair international tax would be payable if the resulting net profit attributed less any allowances for capital spending due when multiplied by the jurisdictions tax rate was greater than the current tax charge declared within the accounts of group companies located in the jurisdiction.

Is there any tax quite like fair International Tax in existence?

Internationally there is at present no tax quite like this fair international tax.

The nearest equivalent is in the USA where individuals are subject to Alternative Minimum Tax. That applies if their overall tax rate after deducting all allowable reliefs and allowances is lower than an acceptable tax rate. This logic is not quite the same as fair international tax as it relates to reliefs and allowances not to income, but the objective is similar, albeit for individuals and not companies.

Is it legal?

Since this is a basis for calculating profits subject to tax within a state without ever creating a ring fence to benefit non-residents or to bring controlled foreign companies within a tax net there appears to be no reason why it is not legal.

Is it acceptable to the EU?

For the reasons noted in the previous paragraph a fair international tax is likely to be legal in the EU.

Could one country go alone?

A move to charge this tax in any one country would be unpopular, but there would be on reason why it could not be done. It is little different from suggesting that the country in question believes that all existing transfer pricing regulations fail to deliver a fair result and therefore an alternative has to be imposed: that is legal and up to any country to decide. It may however give rise to some requirement on a country's part to renegotiate double tax treaties.

Why would a country want to do this?

Faire international tax should be attractive to any tax administration in a developed country. The reasons are:

1. it effectively sets a minimum rate of tax for companies incorporated within their territory. This immediately reduces the incentive to:
    a. shift profits offshore through transfer pricing;
    b. tax plan aggressively;
    c. accept tax driven investment incentives.

   Fair international tax is, as such, a powerful tool in the fight against tax avoidance.
2. fair international tax provides a means of tackling tax avoidance in a very simple fashion when more complex investigations of tax abuse might not be cost-effective or might yield limited results;
3. in cooperation with other countries fair international tax might effectively mark an end to the 'race to the bottom' in tax.

What would stop a country doing this?

A country may not wish to introduce fair international tax because:

1. it feared international business might flee from its shores;
2. in consequence it believed it would harm its economy;
3. in countries with highly developed financial services sectors

it might fear a loss of business for that sector;
4. it might fear an international backlash as a consequence of the tax as, for example, California did when it tried to introduce unitary taxation in the 1980s.

Why these fears with are unfounded

These fears are unfounded because:

1. Most multinational businesses could only flee the shores of a developed country by refusing to trade there. It is exceptionally unlikely that they would wish to avoid trading in major developed countries as that is where customers are. Setting up complex sales commission arrangements would be subject to anti-avoidance rules;
2. It is inevitable that some groups of companies who wished to avoid the tax charge would seek to do so by artificially splitting their groups into apparently independent entities. This would, however, only be effective if they were willing to declare some of their profits (those on which they did not wish to pay tax) outside the group accounts and this would have significant harmful effect upon their company's value. Most executives are rewarded by share options that require them to enhance the overall value of their companies, and so it is unlikely that most large quoted companies would wish to do this and they are the main target of this tax.
3. There would, undoubtedly, be some international backlash, particularly from low tax territories. However, such territories are already used to being subject to controlled foreign company legislation. This issue is already on their agenda, therefore. It is also true that the design of the tax would mean that if a group of companies undertook some trade in a low tax territory and that trade was proportional to the global economic impact of the country in question in its activities then its low tax rate, if applied to fairly apportioned profits would not reduce the overall rate of tax in the company to the level where fair international tax was to be charged. If a company is only located in a low tax country then fair international tax would not apply to it. Fair international tax can, of course, only apply to multinational corporations. In that sense, fair international tax does not in any way threaten the right of a country to set a tax rate of its choosing to be applied to its own domestic corporations, which in developed countries at least represent up to 97% of all registered companies.
4. The financial services sector should not be seen to be promoting tax avoidance and if it is then that issue needs to be challenged in its own right.

Why business has nothing to fear

Business should have nothing to fear from this proposal. As is noted above, if the trade it undertakes in low tax territories is of a genuine nature and proportional to other territories with higher tax rates then it is unlikely that fair international tax charges will apply to it.

Fair international tax would never apply to companies that operate in only one territory.

It is, therefore, only those companies who companies that are seeking to exploit the opportunities that multinational status provides to them to avoid tax who have anything to fear from fair international tax. For those companies who seek the genuine level playing field that allows fair competition to take place fair international tax is, therefore, a bonus in beating unfair competition. That means that a relatively small number of companies who are abusing international tax rules will, in practice, be affected by it.

How much would it raise?

This is not known at present. That's because the full scale of losses to tax avoidance are not known: it is highly likely to run to billions of pounds a year in the UK alone.