Funding the Future

Glencore's derivatives: the way to get profit to Switze...

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The Guardian published an article late yesterday in which they said:

A leading tax expert has accused Glencore of cutting its UK tax bill by tens of millions of pounds after profits at the commodity trader's London arm were depressed by complex insurance contracts taken out with its own parent.

The latest Glencore tax controversy, which comes as the group prepares for another landmark day in its long-running battle to acquire the minerXstrata, follows the company's Zambian subsidiary Mopani becoming embroiled in a tax avoidance row last year, as well as Glencore being called in front of parliament's international development committee in Aprilas part of an inquiry into how multinationals report tax in developing countries.

The derivative instruments being employed by Glencore are widely used by companies to insure — or hedge — financial risks. They theoretically guarantee a certain return.

Last year, Glencore UK's derivative trading with other parts of the group totalled $383bn (£267bn), more than twice the yearly budget of the National Health Service. The practice resulted in a $122.8m loss for the London-based business, effectively docking that amount from UK profits and transferring it to the main group based in the low-tax Swiss canton of Zug.

They continue:

Richard Murphy, of Tax Research UK, said: "Glencore is insuring itself with itself. If I insure my house for fire with myself and it burns down, I've got to pay myself for the house which has burnt down. That's what Glencore is doing, and the consequences are that the risk is never leaving Glencore; it's still inside the group. That's $383bn worth of trades that, on the face of it, make no sense whatsoever. We don't know, but it is highly likely that the motivation is not genuine insurance and it looks like a significant amount of tax planning takes place within this trading function."

Murphy said Glencore was not breaking any laws by employing the trades or by *benefiting from the resultant losses — and many large companies were increasingly exploring similar tactics.*

He said: "This is totally legal but what we are seeing is a significant change in the way in which multinational corporations are now looking to move their profits around the world.

"*All the evidence is that throughout the extractive industries — the* mining industry, the oil industry, the gas industry and so on — the way in which people are shifting profits now are derivative financial products."

These are some of the facts, based on the 2011 accounts:

Glencore UK's accounts show that its massive turnover of $59.8bn in 2011 resulted in a pre-tax profit of $99.1m, a margin of less than 1%. A tax credit, the result of unrelated employee share awards, took total profits for the year to $115.7m. Had the $122.8m derivatives loss remained in the UK and been added to those profits, it would have attracted taxes of about $32m.

The scale of derivative trading is revealed in note 20 on page 35: totalling some $383 billion in all, a sum more than half total UK tax revenues.

Glencore does not agree with my analysis:

Glencore insisted that lowering its tax bill was not the purpose of the derivative trades. Glencore's Baar-based spokesman said: "The derivative contracts Glencore Energy uses in London with its parent company in Switzerland are effectively tools to help it manage risk.

"*They enable risk to be concentrated at the centre, where it can be absorbed due to the size of its capital base. These are standard contracts used by many companies across many industries. This is about managing risk and nothing to do with avoiding tax. Like all major global corporations, we work closely with local tax authorities to ensure that we pay the correct and appropriate amount of tax.*"

In 2010, Glencore UK made a profit $186.5m on insuring itself with its parent, although those winnings were virtually all cancelled out by losses on external derivative contracts.

I note what Glencore say but cannot agree. There argument appears to be London cannot bear the risks of these trades so they have to be moved on but a simple guarantee (or more capital) would overcome that issue and save the enormous cost of $383 billion of trading. However, those trades do take place which means there must be an economic justification for the cost of doing them, and tax is the only one I can see.