PUBLIC SERVICES
INTERNATIONAL
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BRIEF 2 ENGLISH

2

Fixing Corporate Tax

UNION DEMANDS | UNITARY TAX

TAXING MULTINATIONALS AS SINGLE GLOBAL FIRMS

UNITARY TAXATION

TAXING MULTINATIONALS AS SINGLE GLOBAL FIRMS

KEY POINTS:

TRADE UNIONS SHOULD CALL ON GOVERNMENTS TO:

- START TAXING MULTINATIONALS BASED ON THEIR GLOBAL PROFITS
- WORK WITH OTHER GOVERNMENTS TO MAKE UNITARY TAXATION WITH FORMULARY APPORTIONMENT A REGIONAL AND THEN A GLOBAL STANDARD

The root of many of the problems with corporate taxation is that multinational corporations are not taxed as single global entities, but as collections of subsidiaries trading with each other as if they were separate companies. While no one genuinely believes that subsidiaries of multinationals can act independently of each other, that is how they are treated for tax purposes. The reasons for this go back to arcane international debates nearly a hundred years ago, when multinationals were smaller and far fewer in number than they are now.

THE PROBLEM: MULTINATIONALS PLAYING A FRAGMENTED TAX SYSTEM

More than a third of world trade is estimated to take place within multinationals. The "arm's length principle", which is the cornerstone of corporate taxation, requires that these trades are priced as if they were transactions between independent companies in an open market.

In reality, the arm's length principle is nonsense. Multinationals have a high degree of control over their subsidiaries, which would never exist in an open market, and many transactions nowadays involve intangible assets like software or brands which are very hard to value anyway. The result is that multinationals can manipulate their internal transactions so that the profits end up in tax havens, not in countries where they actually do business.

Multinationals have shifted huge amounts of profit offshore by placing capital or intellectual property in offshore tax havens or, increasingly, in countries which offer special low-tax regimes for foreign capital. The tax-haven companies then charge their fellow-subsidiaries to use these assets. The latter can deduct these charges from their own profits, thus slashing their tax bills, while the money ends up in the tax havens. These practices are so endemic that tax havens are hard-wired into the global structures of many corporations.

Thousands of pages of rules and guidelines have been written to try and make the fiction of the arm's length principle appear to match reality, while industries of well-paid tax experts advise corporations on how to exploit the principle to avoid tax. Yet the growing dominance of the digital giants – creating and selling their products via cyberspace and paying minimal tax in many countries – is making it even clearer that the arm's-length principle is broken.

PROGRESS TO DATE

A round of reforms led by the Organisation for Economic Cooperation and Development (OECD) between 2013 and 2016 were supposed to make it harder for multinationals to book profits in tax havens where they have little or no genuine business. These reforms were known as Base Erosion and Profit Shifting (BEPS) – a technical term for tax avoidance. Although BEPS may have had some effect on multinationals using tax havens, there is no evidence to suggest the reforms have come close to solving the huge global problem of tax avoidance.

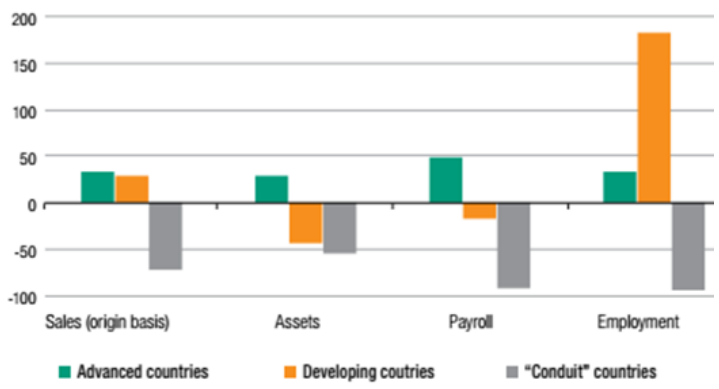
OECD member states and other countries are now working on another round of reforms aimed at the problems of taxing digital companies, which were not addressed in BEPS. Recognition has crept into the debate that the arm's length principle does not work in an online business world where companies may have no physical presence at all in the countries where they sell their services. Some countries are moving ahead despite the OECD process, and are introducing their own, ad-hoc taxes on revenues.

FORMULARY APPORTIONMENT

The solution is for governments to tax multinationals as what they really are: single global firms. This is called unitary taxation and it is one of the options being considered by the OECD, though only in a very limited form which is tacked onto the status quo rather than replacing it. The way it would work in practice is by "formulary apportionment": this means that the multinational's profits would be divided up for taxing purposes between the different countries where it does business, based on a formula which considers where the company has its sales, where its employees are and what physical assets and resources it uses. Each country would then tax its allotted portion of the multinational's profits.

The advantage of unitary taxation is that transactions within multinationals – which are often manipulated to steer profits into tax havens – would no longer matter because the multinational would be taxed on its global profits, wherever those profits are. The importance of formulary apportionment is that unlike intangible assets such as capital or software, a company's employees, customers and physical assets cannot be easily moved into tax havens in order to game the tax rules.

FORMULARY APPORTIONMENT OF US CORPORATIONS WOULD MEAN LESS PROFITS BOOKED IN "CONDUIT" TAX HAVENS AND MORE IN OTHER COUNTRIES.



Source: IMF

At the same time, the choice of formula could have large effects on different countries. For example, a formula which gives a heavy weight to labour costs would be more beneficial than one based on sales for developing countries where goods are produced for export, but which are not themselves big consumer markets. This is why it is important that global debates on changing the tax system are held in forums where all countries, including developing countries, also have a voice. This was not the case with BEPS. The current negotiations do give a place to developing countries but the OECD's claim to be truly inclusive will depend on the extent to which their concerns are taken into account.

Unitary taxation with formulary apportionment would not stop countries from competing against each other for investment. Governments could still try to lure multinationals to move staff or physical assets into a country by offering lower taxes on the portion of profits allocated to that country. At the very least, this would mean that tax incentives would be based on the transfer of actual jobs and investment and not just on transfers on paper, but the current problem of countries undercutting each other's tax revenues would continue. To deal with this problem, all countries would also need to adopt a minimum effective rate of corporate income tax which PSI, EPSU and the European Trade Union Confederation believe should be 25 percent.

WHY UNITARY TAXATION MATTERS TO WORKERS

- TAXING MULTINATIONALS AS SINGLE GLOBAL ENTITIES, RATHER THAN AS COLLECTIONS OF SEPARATE FIRMS, WOULD STOP THEM USING INTERNAL TRANSACTIONS TO MOVE PROFITS INTO TAX HAVENS AT THE COST OF THE PUBLIC REVENUES AND PUBLIC SERVICES.

- THE STATUS QUO MAKES IT EASIER FOR CORPORATE MANAGERS TO SHIFT PROFITS INTO TAX HAVENS, THEN CLAIM TO WORKERS THAT MONEY IS NOT AVAILABLE FOR PAY RISES.

- A GLOBAL SYSTEM BASED ON UNITARY TAXATION WOULD BE FAIRER, SIMPLER TO ADMINISTER AND WOULD BE LIKELY TO RAISE MORE REVENUES.

- UNITARY TAXATION IS BETTER ABLE THAN THE STATUS QUO TO REFLECT THE CONTRIBUTION OF LABOUR TO CORPORATE PROFITS.

Unitary taxation requires cooperation and agreement between the different countries where the multinational does business. The European Union has taken some steps in this direction through its plans for so-called Common Consolidated Corporate Tax Base (CCCTB). As the name suggests, the aim is to create a single Europe-wide tax base for corporations, on which they can be taxed in a unitary fashion.

However, at the time this briefing was written, the CCCTB plan was generally seen to have stalled because of opposition from lower-tax countries within the EU which would find it harder to undercut their neighbours.

WHAT NEEDS TO BE DONE?

Trade unions should call on their governments to:

1. **Tax multinationals as single global firms, based on a formula which gives due weight to the contribution of labour to the creation of corporate profits.**
2. **Underpin unitary taxation with a minimum effective tax rate of at least 25 per cent, to prevent tax competition based on the factors used in**

A shift to unitary taxation will take time, but there are interim steps that governments can take. Public country-by-country reporting, by which multinationals would disclose their profits and tax payments and other key financial data for each country where they operate, would make it easier to apply a unitary approach.

Governments could also make more use of two methods of transfer pricing assessment which, although part of the OECD's status-quo approach, move in the direction of unitary taxation by considering a multinational's global profits. These are the profit-split method and the shared net margin method. Another approach would be to use formulary apportionment in an alternative minimum corporate tax (see Technical Summary).

Given the need for international cooperation, and the OECD's reluctance to push for deeper reform, governments should work for a global tax convention against tax avoidance and tax competition, overseen by a global tax body at the United Nations which is the only international institution with enough legitimacy among all countries to take on the task. Such a global body is needed to ensure an equal voice for low- and middle-income countries outside the OECD to ensure that their interests are taken into account.

25%

THE MINIMUM EFFECTIVE GLOBAL RATE OF CORPORATE INCOME TAX, SUPPORTED BY PSI

TECHNICAL SUMMARY

Governments should support the adoption of formulary apportionment, with the widest possible application. Countries in the European Union should agree to a Common Consolidated Corporate Tax Base (CCCTB), along the lines proposed by the European Parliament and include the digital presence of a company and the gradual lowering of the threshold at which the CCCTB applies, until it covers all companies trading across borders.

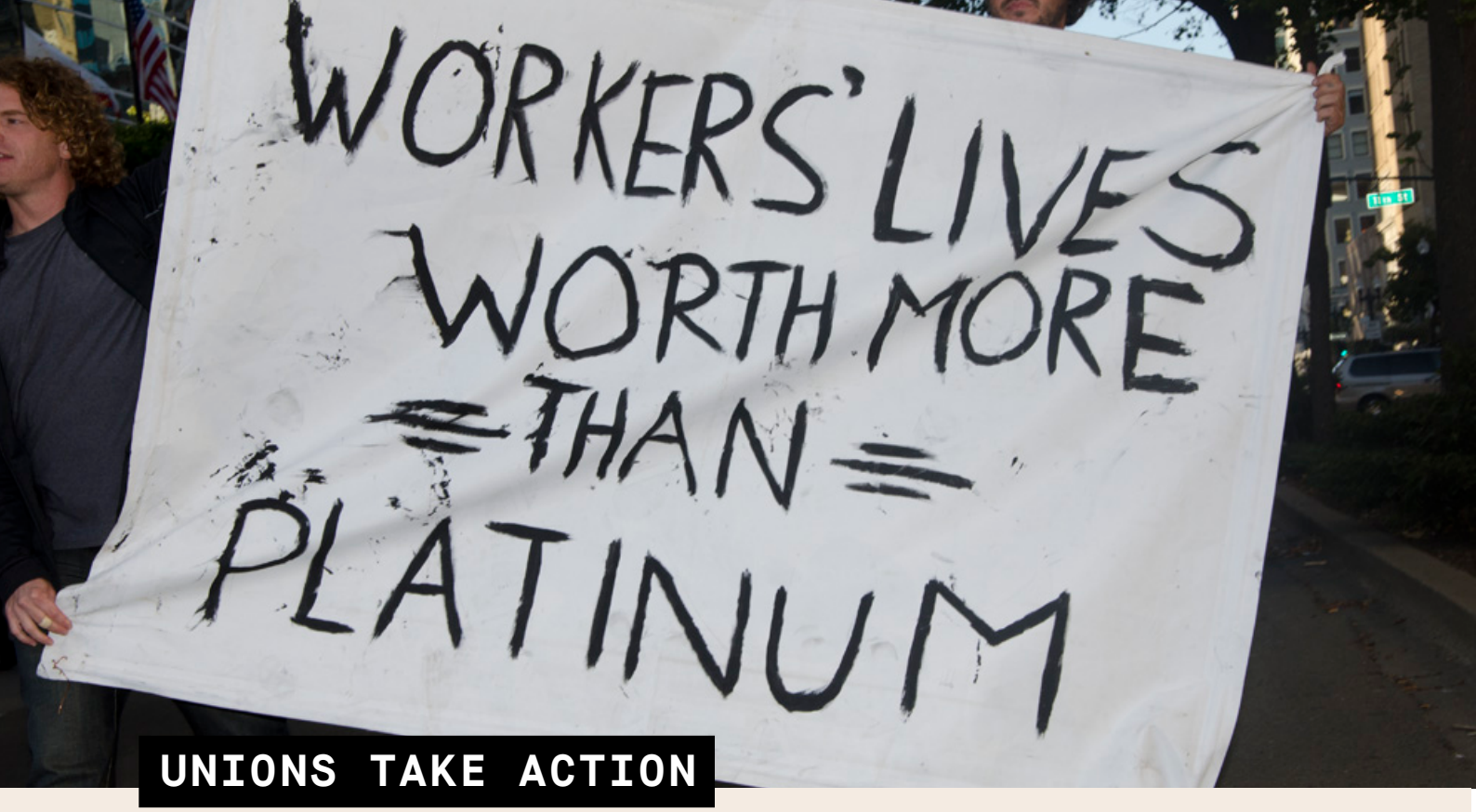
Other regional bodies, such as the African Union, should consider introducing a regional CCCTB in line with that being developed in the EU with formulary apportionment based on sales, numbers of employees, physical assets and resources used.

In the longer term, unitary taxation with formulary apportionment will need to be embodied in a global convention as the OECD only has 36 member states and is not equally representative of all countries in the world.

Regions and individual countries should also consider intermediate steps towards unitary taxation, including for example:

- Requiring public country-by-country reporting by multinationals under their jurisdiction, which would provide much greater clarity about where profits are booked and where the tangible factors which contribute to them are located.
- Making more use of the profit-split and shared net margin methods for transfer pricing, both of which are OECD-approved methods, but which calculate the local taxable income of a multinational with reference to its global profits.
- Introducing an alternative minimum corporate tax, calculated as a country's share of a corporation's global profits based on a formula, which would act as a backstop to existing corporate taxes.

To establish unitary taxation with formulary apportionment as a global norm, a global tax convention should be created, which also establishes a minimum effective corporate tax rate of at least 25 per cent, and which is supported by a well-resourced global body at the United Nations with a mandate to curb tax competition, promote tax cooperation and make sure that the concerns of poorer countries are given the same weight as those of richer ones.



UNIONS TAKE ACTION

SOUTH AFRICA: TAX DODGING DRIVES DOWN WAGES – AND KILLS

At the Marikana Mine in South Africa, workers were told by their employer, Lonmin, that their demands for a wage increase were outrageous. In a widely reported tragedy during a strike over wages, more than 30 miners were brutally killed in 2012.

But in 2014, the Marikana Commission of Inquiry (MCI) gave researchers access to the financial statements of Lonmin's subsidiaries in South Africa. One question was, if the striking workers' demands were, in fact, affordable for the company (which refused to negotiate).

The confidential financial statements showed that Lomin's South African Subsidiary transferred an average $16 million in 'sales commission' to a letter box company in Bermuda each year. But there was no one in Bermuda selling anything. The company receiving these millions had the exact same address as Appleby Services – the lawfirm at the heart of the Paradise Papers. If the money sent to Bermuda were divided by 4000, the number of striking workers, this alone covered a wage increase of about 100 percent.

The books also revealed how more than USD$10 million per year was spent on 'management fees'. This helped to pay huge salaries to forty managers. From 2010-2012, they also received share based bonuses, costing USD$6.5 million per year.

Profit shifting is a key issue for public sector workers – who rely on government revenue to pay their wages. But it is also a huge issue for private sector workers – such as the striking miners – as it obscures the real profits of a company and undermines their case in wage negotiations.

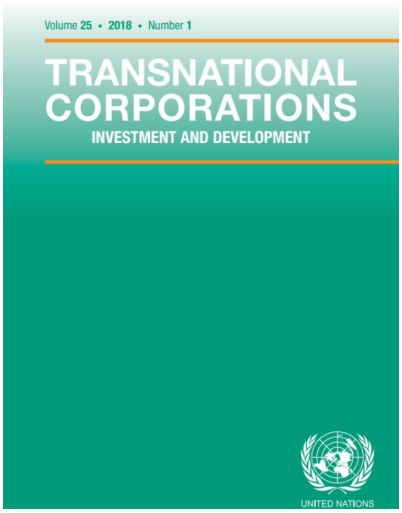
The Lonmin striking workers were told that their demands were outrageous. When the books of all Lonmin's companies were opened, this was revealed as untrue. Public and private sector unions must step forward. The space for higher wages for all workers is huge.

FURTHER INFORMATION

THE INTERNATIONAL COMMISSION FOR THE REFORM OF CORPORATE TAXATION (ICRICT)

A road-map to improve rules for taxing multinationals.

Accessible at www.icrict.com



UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT - REPORT

Sharing the corporate tax base: equitable taxing of multinationals and the choice of formulary apportionment.

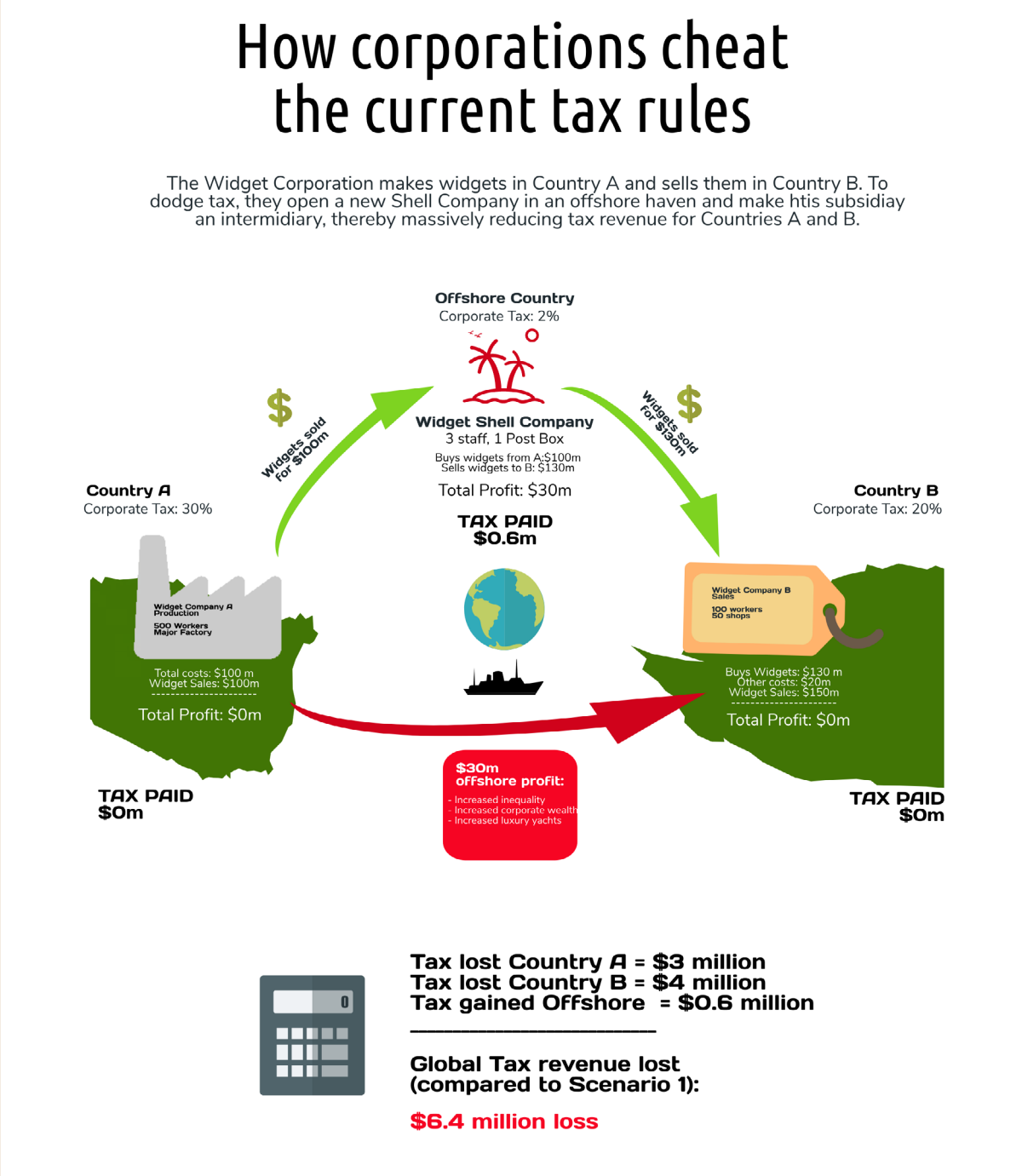
By Tommaso Faccio and Valpy Fitzgerald

Accessible at https://unctad.org/en/Publication-Chapters/diae2018d4a5.pdf

APPENDIX - INFOGRAPHICS

THE FOLLOWING INFOGRAPHICS ARE DESIGNED TO GIVE A SIMPLE OVERVIEW OF HOW NEW GLOBAL TAX RULES, INCLUDING UNITARY TAXATION, WOULD BENEFIT BOTH PRODUCING AND CONSUMING NATIONS, COMPARED WITH THE CURRENT GLOBAL TAX REGIME.

For reasons of simplicity this example uses transfer mispricing (the manipulation of prices paid for goods and services between related parties) as the means of shifting profits to tax havens. In the modern economy the methods more likely to be used involve placing intangibles in the tax haven such as intellectual property, debt finance or risk. The company would then charge itself for these services to shift the profits to the tax haven.



How Unitary Taxation would allocate $30m global profits from "the Widget Corporation"

Unitary Taxation allocates taxing rights to where economic activity takes place.
This requires a formula based-on key business and production factors:

	Production Country A	Sales Country B	No real activity Offshore
Employees	500 (83%)	100 (16%)	3 (0.5%)
Fixed Assets	$100m (50%)	$100m (50%)	$0 (0%)
Sales	$0 (0%)	$150m (100%)	$0 (0%)
Proft allocation (simple average of production factors)	44.3%	55.3%	0.2%
Profit allocation from $30m:	$13.29m	$16.59m	$0.6m
Country tax-rate:	30%	20%	2%
Tax collected by country:	$4m	$3.3m	$0.0012m

Total Global Tax paid by The Widget Corporation:
$7.3 million

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Public Services International is a global trade union federation representing 20 million working women and men who deliver vital public services in 163 countries. PSI champions human rights, advocates for social justice and promotes universal access to quality public services. PSI works with the United Nations system and in partnership with labour, civil society and other organisations.