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1 Introduction

The revenue raised for the public purse plays an important role for the functioning of the state. Especially, taxes on personal and corporate incomes are the crucial source of revenues. (OECD, 2016) Corporate taxes, among other revenues, accounted for about 8.8 percent of OECD state income on average in 2014, as analysed from Table 3.12. of Revenue Statistics 2016 (OECD, 2016). Although most of the countries are dependent and levy tax on corporate incomes, they also seek to attract business by offering them lower tax rates. These policy strategies have created loopholes for multinational corporations (MNCs) to avoid paying taxes.

Following “Luxembourg leaks” (ICIJ, 2014), the tax rulings that were set up by PricewaterhouseCoopers (PwC) drew international attention. It revealed tax rulings between the state of Luxembourg and more than three hundred MNCs that collectively sought to reduce their tax payments. While the issue of tax evasion with the application of transfer pricing has been a controversial matter, it has not been tackled in depth. Tackling the tax issue is not simple as it deals with international tax rules and regulations that were originally laid more than hundred years ago. There is therefore a need of attention to the international tax rules.

This thesis aims to study the practice of transfer pricing and its association with tax evasion. The case studies of Starbucks and Amazon are taken to discuss examples of ways in which MNCs evade their taxes through manipulation of transfer pricing.

In response to the growing problem of corporate tax avoidance and the exploitation of transfer pricing and more sophisticated tax planning through services provided by PwC and similar consulting firms, the Organisation for Economic Cooperation and Development (OECD) initiated its Base Erosion and Profit Shifting (BEPS) programme in 2013 (OECD 2014). This aims to bring states together as part of a cooperative effort to reduce corporate tax avoidance and restore part of the tax base.

Further in this thesis, the BEPS project report is taken into consideration to see how implementation of the action plans set will help avoid evasion of taxes. The actions 8-10 and 13 are examined closely as they are focused on transfer pricing. The major concern in this report is for MNCs to take their corporate responsibility in the global economy.

2 Literature Review

2.1 Taxation

Tax revenue can be defined as the revenues gathered from taxes on income and profits, social security contributions, taxes on goods and services, payroll taxes, taxes on the ownership and transfer of property, and others (OECD Data, 2016). From the Revenue Statistics, OECD defined taxes as compulsory unreturned payments as the benefits received by the taxpayers are not in proportion with their payments (OECD, 2016).

Total tax revenue as a percentage of GDP shows the part of output which is collected through taxes. This indicates the extent of government control on its economy's resources (OECD Data, 2016). That is why the tax revenue raised for the state plays an important economic role.

2.1.1 Corporate Taxation

There are various sources of tax revenue for a state. It was reported that OECD countries are mostly dependent on consumption taxes, such as the value added tax (VAT), and social insurance taxes, such as the payroll tax (OECD, cited in Pomerleau, 2015). On the other hand, their corporate tax revenue constitutes about 8.8 percent of total tax revenue on average in 2014, as analysed from Table 3.12. of the Revenue Statistics 2016 (OECD, 2016). All OECD countries impose a tax on corporate profits but have different definitions of taxable profit and how tax rates are applied. (Pomerleau, 2014) As illustrated in Figure 1 below, OECD countries have different corporate taxes rates, whose definitions vary according to the state. The difference in how they define corporate taxation has resulted in countries that seek to attract business by offering lower tax rates. Shaxson (2011) defines these countries as tax havens, as they provide other individuals or companies an escape from the duties engaged from living in and gaining benefits from society.

Currently, tax havens are causing a controversy and being very common globally. Shaxson (2011) claims that over half of world trade and most international lending are processed through tax havens. Additionally, the international consortium of investigative journalists (ICIJ) reported that Luxembourg has been offering secured secret deals to more than 340 multinational companies (MNCs) as shown in the leaked documents.

These companies have channelled hundreds of billions of dollars through Luxembourg and saved billions of dollars in taxes. (ICIJ, 2014) Companies apply transfer pricing in booking their tax saving by creating complicated accounting and legal structures. This is done with the help of specialist firms like KPMG, PwC, EY and Deloitte, among others (ICIJ, 2014).

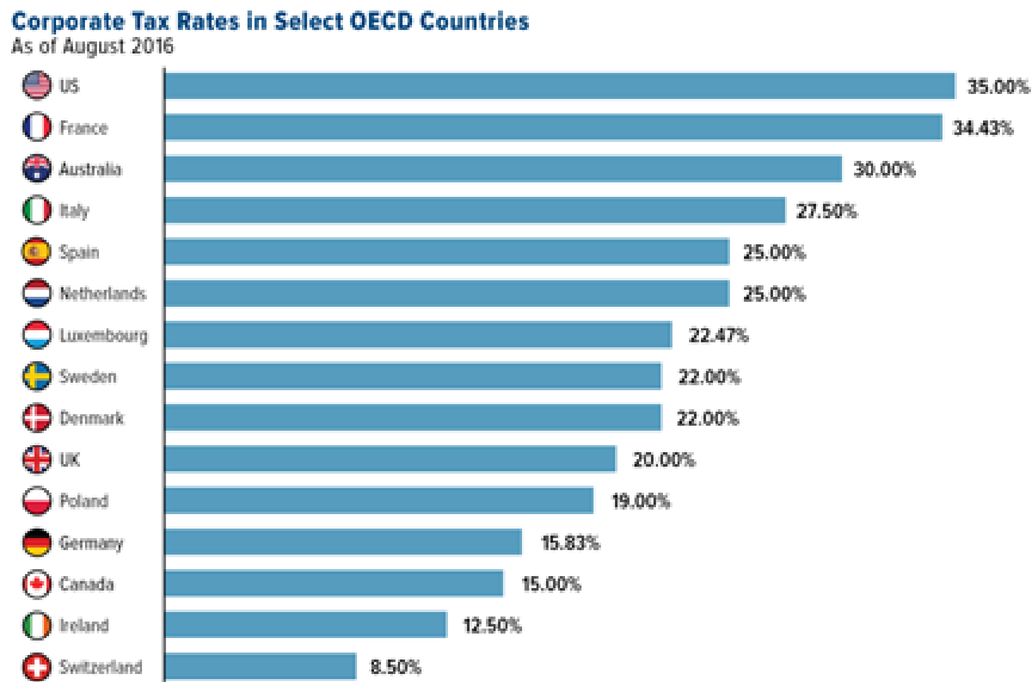

Figure 1. The Corporate Tax Rates in Selected OECD Countries (OECD, 2016)

As seen from the figure above, the U.S. currently has the highest rate of corporate tax at 35%. However, in practice there are loopholes and special allowances providing a tax break to U.S. companies (Johnston, 2017). Some of these loopholes are carried interest, “rent-a-cow”, accelerated depreciation, loss carry-overs and so on. The carried interest is a special tax break used for operators of hedge funds and private equity funds (Stewart, 2016). The hedge funds or general partners of private equity are compensated for their management services in two ways. The first way is when about one or two percent of the total assets managed is received as a management fee. The other is the carried interest, in which the general partners are rewarded for around twenty percent of profits that have accumulated above a specified ‘hurdle rate’, which is usually about eight percent. Although the management fee is taxed with ordinary rate of 35%, the carried interest is taxed as a capital gain at a rate of about 20%. (Johnston, 2017) The Florida Greenbelt law, which is also known as “rent-a-cow”, was created to preserve farms and ranches, allowing special low tax rates. (Weissmann, 2012) This was very successful. However, more than 90 percent of people benefiting from this tax break are developers

and not farmers or ranchers. They avoid high taxes by temporary raising of cattle or planting pine trees, sometimes even in some parts of the land where construction of their houses has begun. The owners of 27,000 acres of land would have had to pay 11 million USD in property taxes in 2013 without the greenbelt designation. However, with the Greenbelt law, they paid only 1.95 million USD. (Wiatrowski and Salinero, 2014) All states, whether with low or high corporate tax rates, are faced with tax issues. There are tax havens with lower tax rates and at the same time loopholes in countries with higher tax rates. This is apparent as loopholes are more necessary in countries with higher tax rates. In other words, the official tax rate is not necessarily the real tax rate as people presume.

2.1.2 Tax Evasion through Tax Havens

As was recognised in the 1987 Report by the OECD, there were difficulties involved with acquiring a clear definition for tax havens. Its 1998 Report sets out various features of tax havens. From this report, tax havens are shown to possess features such as no or only low taxes, lacking efficient exchange of information, lacking transparency and no substantial activity requirement (OECD, 1998). Shaxson (ed. 2016) loosely defined a tax haven as a ‘place that seeks to attract business by offering politically stable facilities to help people or entities get around the rules, laws and regulations of jurisdictions elsewhere’.

Thirty-five secrecy jurisdictions have been identified in the OECD’s blacklists of 2000 report. However, OECD’s project died as Paul O’Neill, the former President George W. Bush’s first Treasury secretary, did not seem to understand the issue of tax havens in the beginning (Shaxson, ed. 2016). This was well reviewed by Sullivan (2007) of the Tax Justice Network, mentioning that there was no improvement despite the efforts put in by OECD to tackle the issues. The U.S., however, came to realise the seriousness of the issue from discovering that it lost about seventy billion dollars annually from offshore evasion. This is a really huge amount - if only half of it would be collected it could support the Medicare prescription drug program without collecting any other means of tax or reducing other budgets (Shaxson, ed. 2016).

Two months after the death of the OECD’s tax haven project, there was the attack of al-Qaeda on 11 September 2001. There was an urgent need for better cooperation and transparency concerning financing of terrorists by secrecy jurisdictions by the

administration of the former President George W. Bush. This led to the endorsement of U.S. administration for ‘on request’ sharing of information. A country will give information about their taxpayers on a case-by-case basis if requested, under specific conditions. That is to say, the requester has to prove exactly why they need this information. This could not be called transparency, however, as it was very conditional.

As clarified by Shaxson (ed. 2016) in *Treasure Islands*, finding out how much of information is exchanged on request globally is difficult. As admitted by Geoff Cook, chief executive of Jersey Finance (cited by Shaxson ed. 2016), in the seven years after Jersey agreed for exchange of information with the U.S., it only exchanged information on ‘five or six’ cases. This is a minuscule amount as the U.S. was estimated to be losing 70 billion USD every year, which means there must be more than a million-plus U.S. offshore accounts. In addition to this, there was a huge problem because receiving information after the request has been made would take several months or years. The situation got worse after the economic crisis of 2007, as the OECD eliminated the tax havens from the blacklists if countries signed twelve agreements to share information with other countries (Gravelle, 2015). Another issue for the exchange of information is that the countries themselves do not have sufficient information of the value. For instance, the British Virgin Islands where there are more than 400,000 registered corporations, the laws do not require identification of shareholders or directors and financial records. Signing of agreements to share information does not help as it is unclear what kind of information can be exchanged.

2.2 Transfer Pricing

Transfer pricing refers to the application of profits for tax and other purposes between parts of a multinational corporate group (OECD Observer, 2008). This is important for both the corporate group and the government as it determines the corporate tax paid.

The example featured in the OECD Observer report well illustrates this phenomenon. Consider a profitable company (the parent) that buys micro-chips from its own subsidiary in a country with a higher tax rate. The price the company pays to its subsidiary is the transfer price. This will determine how much profit the subsidiary reports and how much local tax it pays. When the parent sets the transfer price lower than its normal local market price, the subsidiary appears to have incurred losses while the parents record profits. Additionally, as the subsidiary is located in a country with a higher corporate tax rate, the company as a whole pays less tax and is more profitable (OECD Observer,

2008) In this case, the companies are manipulating the transfer pricing as the companies are trying to escape from the duties that come with operating and benefiting from society in its operations.

On the contrary a MNC could suffer double taxation on the same profit without the proper application of transfer pricing. Considering the example above, the tax administrator in the location of the parent company is happy with much profit to tax whilst the tax administrator of counterpart subsidiary is unhappy as they do not have much profit to tax. The tax authority of the subsidiary's location then would want to record the profit when it finds out that the transfer price of a micro-chip was set at a lower price than the normal market price. But this poses a problem for the parent company as it is already paying tax on its overall profit as shown in its account. Since the company operates as a group, it is liable for tax in all the countries of its operation and in dealing with two or more different tax authorities it cannot simply reject others against the one or pay many times (OECD Observer, 2008) For such reasons, the complexity around volatile application of transfer pricing has to be considered when designing and implementing the transfer pricing. Such measures will help both corporates and governments with securing as well as maximising their profits and tax revenues, respectively.

2.2.1 OECD Transfer Pricing Guideline

The OECD provided an extension to Article 9 of the OECD Model which is a first report purely on transfer pricing matters, which comprises the arm's length principle (Lohse, Riedel and Spengel, n.d.) This served as a basis for Transfer Pricing Guidelines for MNCs in 1995 and has been continually revised since.

The MNCs are at the centre of the global economy. These guidelines are needed as governments must ensure that taxable profits of MNCs are not shifted out of their jurisdictions but are taxed accordingly. Additionally, taxpayers need to guard themselves from double taxation resulting from a dispute between two countries on the determination of the transfer pricing for their cross-border transactions. The Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations provide guidance on the application of the "arm's length principle" for the valuation, for tax purposes, of cross-border transactions between associated enterprises. (OECD, 2010) However, it was conservatively estimated by the OECD that there are about 100 billion USD to 240 billion

USD, approximately 4 to 10 percent of tax revenue lost from global corporate income because MNCs shift their profits to exploit arbitrage opportunities (APPG, 2016).

2.3 Base Erosion Profit Shifting (BEPS) Project

With the "Luxembourg leaks" scandal (ICIJ, 2014), it was revealed that more than three hundred multinational companies (MNCs) have been evading taxes with current rules, which includes the "arm's length principle". This incident has made it evident that the current rules are weak and this has led to OECD and G20 countries working together to tackle international tax issues. The base erosion profit shifting (BEPS) project aims to restore confidence in the system of international tax rules and to ensure that profits are taxed where economic activities take place and value is created (OECD, 2015).

There are positive views towards the move of the OECD and G20 as they have succeeded in engaging 39 countries to sign up bilaterally to automatic exchange of country-by-country reports. However, there are more concerns over its effective implementation as it is difficult to examine its implementation progress. Additionally, as the OECD could not achieve public country-by-country reporting for this. Although there is opportunity for the government tax authorities to access the country-by-country data, the data may not be reliable due to lack of transparency as it is not made open to the public. Another major concern is about the non-participation of key countries like the U.S. and secret jurisdictions such as the British Virgin Islands. (APPG, 2016)

The BEPS Action plan, which was agreed by the G20 finance ministers, identified 15 key areas to be tackled. The actions are laid out to provide governments with solutions to handle the international tax rules which permits shifting of profits (APPG, 2016).

2.3.1 Action 8, 9 and 10

"The stated objective of BEPS Actions 8, 9 and 10 is to come up with transfer pricing rules which are in line with value creation in particular rules to prevent BEPS by transferring risks or moving intangibles among, or allocating excessive capital to, group members, and by engaging in transactions which would not, or would only very rarely, occur between third parties", as summarised in *EY Tax Insights* (van Herksen 2016). The newly introduced concept is aiming at accurately delineating the controlled

transactions through identification of economically relevant characteristics or comparability factors to test. That is, checking is required if the transaction between associated entities is realistic when compared to other independent entities in such transactions. (van Herksen, 2016) A new six-step process is also introduced for analysis of risk assumed in a controlled transaction. In this process are: the identification of economically significant risks with specificity, the determination of contractual assumption of the specific risk, the functional analysis in relation to risk, the interpretation of steps 1 to 3, the allocation of risk and pricing the transaction, and taking into account the consequences of risk allocation. (Ashurst, 2015 & van Herksen, 2016)

There is new guidance on the transfer or use of intangibles to verify that the group members are compensated accordingly with the economic activity that produced the profits, that is value creation through performance functions, use of assets and risks assumed, enhancement, maintenance, protection and exploitation of intangibles (van Herksen, 2016). It includes goodwill and going concern value but does not include group synergies and market-specific characteristics (Ashurst, 2015) This new guidance is expected to be implemented in the domestic laws of many countries including G20/ OECD member countries (van Herksen, 2016).

2.3.2 Action 13

There are two main goals in the Action 13. The first is to increase transparency in terms of tax affairs of MNCs by asking them to provide tax authorities with all the information related to global allocation of incomes, taxes and its location of economic activities in different tax jurisdictions with the help of country-by-country template. The second is to simplify transfer pricing documentation regulatory burdens for taxpayers, that is the administrative cost of regulations, and to make the documentation more valuable for tax authorities. (van den Brekel, 2016) Action 13 on transfer pricing documentation and country-by-country reporting is in direct contact with Actions 8, 9 and 10 (van den Brekel, 2016). The tax authorities could use a country-by-country template as a risk assessment tool. This could serve as an audit roadmap to detect any inappropriate tax planning.

Country-by-country templates raised many concerns, but the matter was finally decided to be kept confidential from the public and only open to the tax authority in the country of their ultimate parent company. This will enhance security for exchanging of information

with countries with which the companies want to have their confidentiality. About 12 countries introduced legislation to implement the new transfer pricing documentation and country-by-country requirements in 2015. In 2017, KPMG updated a summary of country implementation as shown in the figures below.

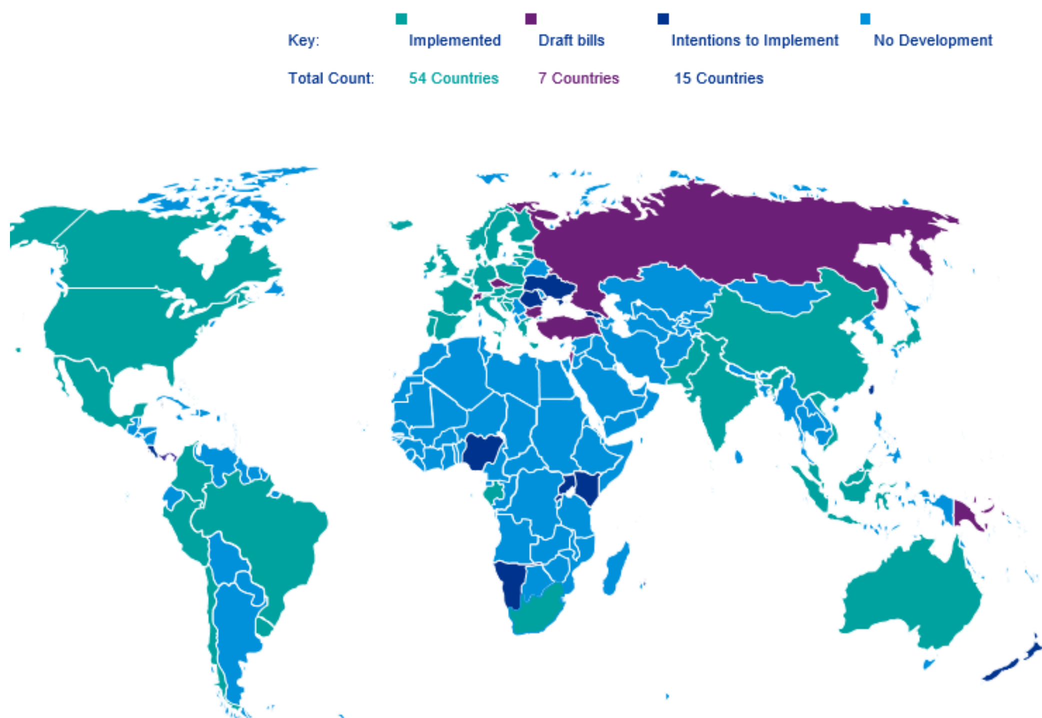

Figure.2 Country-by-country Reporting: Country implementation summary (KPMG, 2017)

From the figure above, it is noticed that there are 54 countries that have implemented country-by-country reporting, 7 countries with draft bills and 15 countries with the intention of implementation. At the same time, for master file and local file implementation, there are 25 countries which implemented, 5 countries with draft bills and 21 countries with intentions of implementation (see Figure 3 below).

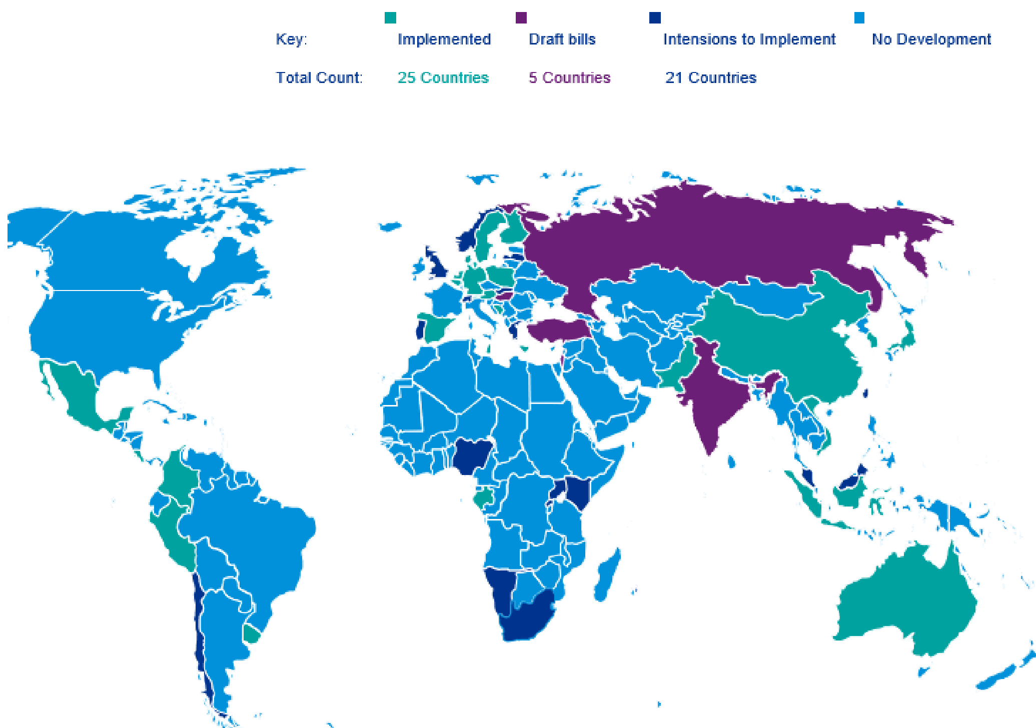

Figure.3 Master File/ Local File: Country implementation summary (KPMG, 2017)

As shown above, there are many countries that have either already implemented, with draft bills, or with intentions to implement the Action 13. However, it was observed that there are variations in the way countries are implementing for things such as timing, materiality thresholds and definition of terms. These might result in uncertainty in the reporting (van den Brekel, 2016).

2.3.3 Other concerns toward BEPS

There are negative opinions, as the implementations of BEPS add up to a global tax system which is already complicated on its own (APPG, 2016), it was mentioned by the All-Party Parliamentary Group (APPG) in the United Kingdom (UK) that this new set of rules could rather provide even more opportunities for the players such as accountancy firms, banks, lawyers and advisers. There are concerns that this will only improve the situation in the short term, rather than in long term. This is because the OECD concentrated on counteracting the international tax system's immediate harmful consequences rather than reconstructing the principles of the international tax system. A close examination of the principles is required as the international tax system for corporate tax that was created nearly a century ago is no longer relevant. Additionally, globalisation of business and other transformations have been made due to digitalisation.

This makes it more complicated for determining the exact location for value creation to decide which country should obtain its tax revenue.

The developing countries, due to their lack of capacity, might find it difficult to ask for and use the relevant data they need in order to secure their tax revenues from MNCs. There are therefore concerns about the capacity and capability of developing countries in the implementation. It is recommended that the resulting data should be made public, as it would be crucial for developing countries to have access to data. Public transparency does not only benefit developing countries but it is also the best way to restore people's trust in the international tax system.

2.4 The U.S. Tax System

From the study of corporate inversions, the reasons behind the behaviours of many American originating MNCs can be understood to some extent. The American approach to corporate taxation differs from that of other countries. Whereas other countries tax only the corporate income of domestic corporations, the U.S. government taxes an American corporation no matter where it is situated for its operation. American corporations that are therefore operating abroad are liable for 35 percent of income earned abroad and are credited for the foreign taxes paid to other governments. (Chiu, 2015) Although it has the high corporate tax rate compared to other OECD countries, its corporate tax revenues as a share of GDP are only the OECD's average. For example as reported by Brookings, corporate *profits* were 12 percent of GDP but corporate tax revenues collected were around 2 percent of GDP (Krupkin and Gale, 2016).

As has been documented, U.S. corporations are globally notorious for their tax avoiding behaviours (Clausing, 2016). Due to the U.S. system of taxation, many U.S. corporations have shifted their income-deriving operations outside of the U.S. and into low-corporate tax jurisdictions. This can be seen in the recent trend for corporate inversions, which is referred to as the action of American corporations legally moving to a foreign jurisdiction to be free from their corporate tax burdens within the U.S. (Chiu, 2015). The "inversion" can take place via three different paths: the substantial business presence, a merger with a larger foreign company, and a merger with a smaller foreign company. In the substantial business activity, a U.S. corporation forms a subsidiary abroad. The U.S. corporation and foreign subsidiary exchange stocks usually in proportion to the respective company valuations. It does not require any change in the control of the

corporation and so is known as a 'naked inversion'. After the exchange of stock, the new subsidiary is a foreign corporation with a U.S. subsidiary. (Marples and Gravelle, 2017) The second way in which a U.S. corporation can re-incorporate abroad is by making a foreign company buy the U.S. corporation. Then the foreign company owns the company and the old U.S. corporation disappears. However, it still takes its daily operations but domiciled in a new country. (Investopedia, n.d.) The final path in which a U.S. corporation can be incorporated is a merger with a smaller foreign corporation. However, the majority of the shares of the new merged company is owned by the U.S. shareholders. (Marples and Gravelle, 2017) As cited by Chiu (2015), there were over 12 corporations in 2014 alone that proposed inversions, completed the inversion process, or are in the process of inversion with varying success. The well-known brand names of inverting corporations in 2014 are Pfizer, Chiquita Brands International, Medtronic and Burger King. Although new regulations have prevented several proposed inversions, there will still be continuous attempts by these MNCs to free themselves from tax burdens.

The merger of two pharmaceutical companies AbbVie, which was a Chicago Illinois-based and Shire, a Channel Islands-based Company brought about formation a subsidiary in the Channel Island of Jersey, "New AbbVie". It then became a U.K. resident for tax avoiding purposes. (Gelles and Scott, 2014) AbbVie expected the merger to result in about a 13 percent of reduction of its effective tax rate by 2016. The United States Department of the Treasury announced guidelines that purportedly would reduce the tax benefits of American corporations from performing the same re-domiciling merger. Only a few months later AbbVie ended its merger plans with Shire and AbbVie will have to pay 1.635 billion USD as a break-up fee. (Gelles, 2014) Burger King, on the other hand, was successful in its acquisition of Tim Hortons although it was accompanied by scrutiny from the U.S. government. Usually, the primarily reason for mergers are due to tax benefits. However, the Burger King-Tim Hortons merger has other benefits apart from the tax benefits. Firstly, the headquarters of Tim Hortons has to be located in Canada as most if its operations and sales are done in that country. Secondly, Burger King plans to expand globally not only as a fast food chain but as a coffee chain in line with Wendy's, McDonald's and Dunkin' Donuts. (Trevir, n.d.)

It was mentioned above that U.S. has loopholes and special allowances to provide tax breaks through carried interest, rent-a-cow, accelerated depreciation, loss carry-overs and so on. (Stewart, 2016) The U.S. tax system encourages a lot of behaviour that is destructive to the financial health of its federal government, and to the economy at large.

High corporate tax rates encourage use of debt finance and discourage selling of appreciated assets and repatriation of foreign subsidiary profits (Merrill, 2007). The U.S. companies on the other hand, do not pay taxes on debt-financed investments, amounting to what can be classified as a subsidy (Clausing, 2016). For instance, there are tax allowances given to corporations that accumulate debt. These can be manipulated so that a company like Apple, officially the world's richest company, borrows billions of USD by selling bonds so that it can reduce its tax liability. This is done by using rules that were designed (at least officially) to help start-up companies. The same tricks are used by private equity firms (Platt 2016).

In the U.S., the federal and state business and tax laws support corporations with flexible legal forms of organisation. That is, a business does not have to be organised as regular corporations under two levels of tax which are the corporation and the shareholder levels but it can operate as corporations, partnerships, or limited liability companies that are not under the entity-level tax. (Merrill, 2007)

The former President Obama wanted to prevent U.S. corporations from taking inversions, if at least 50 percent of the shares are owned by the U.S. parent's corporation. His administration called on Congress to make inversions difficult for companies. (TaxFairness, 2014) Democrats and Republicans both agreed that a short-term solution was required. However, they did not come to agree about how anti-inversion legislation should be like. (Shear and Gelles, 2014) On April 4 2016, the Treasury Department took action to limit "corporate inversions". The former President Obama was delighted about the action as he has been supportive about the closing of inversions loophole for years. Additionally, he has immediately called Congress to close the inversions loophole for good. (Zients and Hanlon, 2016) The Obama administration put in effort to stop corporations from fleeing the country to low-tax countries, shifting taxable income out of the U.S. However, the President Trump asked for a review of the 2016 tax regulations of Obama, hoping to overturn the anti-inversion rules. Republicans and businesses are happy that the Trump administration is having a second look at the 2016 tax regulations. (Lawler, 2017) This originates from his tax plan that "the lower rate makes corporate inversions unnecessary by making American's tax rate one of the best in the world" in 2015. (Schroeder, 2015) He recently announced his proposal of cutting the corporate tax rate from 35 to 20 percent, and to shift the tax base from a worldwide to a territorial system. (Cnossen, Lejour and Riet, 2017)

The Fiscal Times (2017), CNBC (2017) and Forbes (2017) mentioned that the tax reform framework released by the Trump administration and congressional Republicans appears to have several problems. The main problem is associated with the budget deficit and level of federal government debt. It was concluded by Yahoo Finance's Rick Newman that "the biggest break Trump wants to kill – the deduction for state and local taxes". Without killing this, the revenue has to be raised elsewhere. (Rainey and Rosenberg, 2017) Additionally, this reform creates a tax bill which adds to the deficit. Senator Bob Corker of Tennessee is against the cutting of taxes as he believes that it will be the greatest threat to the U.S. The tax reform is forecasted through analysis to add 1.4 trillion USD to 1.6 trillion to the deficit over the first decade and maybe much more. Despite all these, the Trump administration claims that economic growth from passage of the bill can compensate the lower corporate tax rates and tax cuts which benefit the rich. (Werner, 2017) The position of U.S. tax policies is critical at this point as it determines the behaviour of corporations.

3 Cases

3.1 Starbucks

From the case of Starbucks, the following ways in which giant MNCs escaped the corporate tax were discovered. The case of Starbucks was on the surface and was known to the public.

Starbucks is a Seattle-based group with a market capitalisation of 40 billion USD and is the second-largest café chain globally. However, Starbucks paid only 8.6 million pounds in corporate tax for 14 years of its operation in the U.K. and nothing was paid in the three years up to 2011 (Geoghegan, 2012). It had U.K. sales of nearly 400 million pounds in 2011 but paid no corporate tax at all (Peston, 2012). This was appalling as the number one ranking McDonald's paid over 80 million pounds on 3.6 billion pounds sales in U.K. and Kentucky Fried Chicken, the number 3 global restaurant or café chain paid 36 million pounds on 1.1 billion pounds of sales in U.K. (Bergin, 2012) It filed losses of several millions of pounds yet informed its investors that the business was successful. Additionally, Starbucks mentioned that it was taking the successful lessons learnt in U.K. to apply to the company's largest market and also promoted the former head of the U.K. and Europe, to head the U.S. Business.

Unfortunately, there was no concrete evidence that Starbucks had broken any laws. Additionally, they defended themselves by saying that the company strictly follows international accounting rules and pays the appropriate level of tax in all the countries of its operation. However, their contradicting reports were disclosed through close study of its group's financial statements and the transcripts of 46 conference calls with investors and analysts. (Bergin, 2012) There were the issues hiding behind the record of no profit.

From the in-depth investigations launched in June 2014, the European Commission concluded on 21 October 2015 that the Netherlands has granted selective tax advantages to Starbucks' coffee roasting company. The tax ruling issued by the Netherlands tax authority artificially lowered the tax paid by the company. (European Commission, 2015) One of the ways they used was through royalties on Intellectual properties. These companies shield billions from tax authorities by housing intellectual property units in tax havens, and then charging their subsidiaries substantial royalties for using it.

From the investigation of the commission, it was observed that Starbucks, after consulting the Dutch tax authorities, installed its European headquarters in the Netherlands and started a huge coffee roasting plant in Amsterdam. Starbucks created several Dutch partnerships which were not subject to the corporate tax, including one which was named Emerald City. Emerald city owned Alki, which was set up in London to own Starbucks' intellectual properties including logos and the recipe for roasting coffee beans. That is how Starbucks Manufacturing and subsidiaries paid very high royalties to Alki. Alki, thanks to its structure, was not subject to corporate tax, neither in the Netherlands nor Britain. (Alderman, 2015) The Commission claimed that this payment is not justified as it does not adequately reflect market value. (European Commission, 2015). The recipe was mainly temperature for roasting of beans (Alderman, 2015). The Commission (2015) said no other Starbucks companies or roasting operation paid royalties for the same information.

Another method of averting tax responsibility was through allocation of funds generated in the U.K. to other subsidiaries in its supply chain. Starbucks purchases coffee beans for the U.K. through a Lausanne, Switzerland-based firm, Starbucks Coffee Co. However, these beans were roasted at a subsidiary based in the Netherlands before being transported to the U.K. (Bergin, 2012) In such context, there would have been a need of setting prices with the use of "transfer pricing". It was however understood that the tracking of the transactions in these companies is difficult, even if it was clear that Starbucks implemented transfer pricing in order to evade of taxes.

As Reuters (2012) reported, it was not clear how Starbucks had allocated such costs. What was clear was that Starbucks shifted its funds to Switzerland. While its U.K. subsidiary made a loss, the Netherlands roasting operation had a small profit, which is about 1.6 million EUR from an average annual turnover of 154 million EUR. The profit was only about 1 percent of its turnover, meaning that more than 84 percent of the roasting operation is used for buying the raw coffee beans, the electricity for roasting them, the packaging and transport. Yet, Starbucks declined to give details on the charges its roaster paid to its Swiss unit for coffee beans. It also declined to disclose information about the profit the Swiss coffee-buying unit makes as Swiss law does not require the unit to publish the accounts. However, it was important to note that corporate tax rates tied to international trade in commodities like coffee are as low as 5 percent in Switzerland. From further investigation by the Commission (2015), it was revealed that Starbucks Manufacturing's tax base was unduly reduced as it pays high prices to a Swiss

company for green coffee beans. The margin on the beans has more than tripled since 2011 (European Commission, 2015).

Apart from the two methods mentioned by the Commission, Reuters (2012) suggested the third way in which MNCs cut their tax liability is through inter-company loans. U.K. tax authorities are aware of this and are trying to limit the technique as it is a well-known way for shifting profits to low-tax jurisdictions. Such loans have a double tax benefit to multinationals as the borrower can set any interest paid against taxable income, and the creditor can be based in a place that doesn't tax interest. It was determined that Starbuck's U.K. unit is entirely funded by debt, and paid group companies 2 million pounds in interest in 2011 (Bergin, 2012).

Starbucks shifted its European corporate headquarters to the U.K. in 2014 (Bowers, 2015). It has also shuttered its U.K. company named Alki that was part of escape network designed to cut taxes (Davies, 2015). It announced that the London headquarters paid 15 million USD in U.K. corporation tax in the 15 months to September (Houlder, 2016). However, the tax accountant Richard Murphy mentioned that the accounts for Starbuck's European parent company, Starbucks EMEA, have to be published before we can find out if Starbucks is still aggressively avoids tax or not. This is because they declare a profit and are appearing to be paying taxes on it but the public still do not know if it is the right profit and what royalties it is paying to its related companies. (Davies, 2015).

These kinds of problems arise as most of the big MNCs' group earning statements do not break down their profits and tax payments by country (Bergin, 2012). As mentioned by Bowers (2015) in the *Guardian*, the investigations of the commission under the European state aid regulations do not have power to tackle tax avoidance directly. They can only intervene to conclude that it is harming the competition with the proof of what the players were doing in tax avoidance. As seen earlier with the statement of Murphy, it is difficult to know what royalties are being paid and how tax havens are used and if they are paying fair taxes on fairly stated profits.

3.2 Amazon

Following the Luxleaks in 2014, Amazon's case came to the surface. The case of Amazon raised more issues concerning how huge multinational corporations continue to avoid tax payment. As Richard Murphy (2014) of the Tax Justice Network mentioned, it

is time consuming to prove tax avoidance and these cases are particularly so. Although there is enough awareness raised concerning tax avoidance of multinational corporations, it is difficult to prove this because the schemes implemented are very complex.

Amazon.com or simply Amazon is a Seattle, Washington-based company which is the largest Internet-based retailer in the world (Jopson, 2011). It was first launched in the U.K. in 1998 and won an award for its best service in 2012. As Britain's biggest online retailer, it generated more than 3.3 billion pounds sales in 2011. However, due to its transfer of ownership from U.K. to Luxembourg in 2006, its sales which were more than 7.6 billion pounds were not subject to any corporate tax for the following 3 years. Amazon therefore paid no tax on its billions of pounds sales. Amazon stated that its U.K. business is only a delivering organisation and is owned by Amazon E.U. When Amazon was asked for the reason why it did not pay corporate tax to U.K., it refused to answer but re-directed its answer explaining that it has complex operation which serves tens of millions of customers all over Europe in 27 countries only with hundreds of employees in Luxembourg. (Griffiths, 2012) The key issue that needs to be addressed is, what is sold here and what is sold 'into' here, as mentioned by Murphy (cited in Griffiths, 2012). In other words, the arrangement regarding the distance sellers who sell things in the U.K. is required to be clarified for tax matters.

The tax planning scheme of Amazon began in 2000 and came into function in 2006 to save billions by setting up operations in Luxembourg. This scheme was finally revealed to the public from a landmark court case in Seattle between Amazon and the U.S. Internal Revenue Service (IRS). (Marks, 2016b) This case could force Amazon to pay more than 1.5 billion USD (Marks, 2016a). It was realised that Project Goldcrest is a highly complex 28-step scheme, which took more than two years to complete (Davies, 2016). It was also revealed that Amazon employed an economist who worked in the global financial advisory company Deloitte to invent ways in which its tax burdens may be reduced (Marks, 2016a). At this instant, until there is a final decision on the IRS case, Amazon is safe. Jack Blum, a leading defence attorney in the U.S. specialised in money laundering mentioned that it features "so many layers of complexity that no auditor for a national tax service can possibly penetrate it" (cited in Marks, 2016a).

Project Goldcrest started its investigation from series of complex intercompany contracts which transferred intangible assets such as vital software, trademarks and other

intellectual properties to Amazon Europe Holding Technologies (AEHT) based in Luxembourg. So, it is AEHT which holds the rights to use Amazon's intellectual property. AEHT then licences it to Amazon EU Sarl (AEU) in Luxembourg, which operates Amazon's businesses in Europe. AEU pays hundreds of millions of euros for using the IP in a form of royalties every year, helping it to reduce the amount of taxable income within the company. Although large profit is made in AEHT, it is not taxable as the partnership between AEU and AEHT are considered not taxable in Luxembourg. Finally, AEHT pays Amazon's U.S. Company for managing the European licensing rights (Davis, 2016). Amazon experiences benefit from Luxembourg ownership in the battle for lucrative and fast-growing e-book market as they will impose 3 percent VAT rather than 20 percent VAT imposed on British-based e-book retailers (Griffiths, 2012)

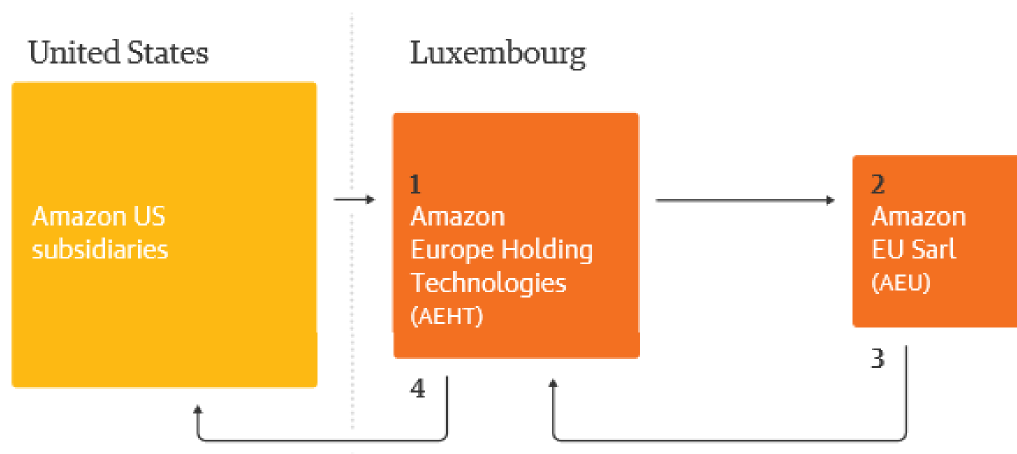

Figure. 4 Amazon's tax structure (Guardian graphic, 2016)

The case of tax avoidance through Project Goldcrest raises tension between the U.S. and Europe concerning how multinationals should be taxed when they operate in both jurisdictions. Both governments were deprived of its huge sum of taxes revenue and it is necessary to collect back the taxes which were not paid on Amazon's multibillion dollars of income in Luxembourg. From the tax structure implemented by Amazon, US tax inspectors consider that intercompany payments from Amazon in Luxembourg, AEHT to its US Company have been too low. However, at the same time, European investigators believe that Amazon has inflated royalties from one of its Luxembourg entities to AEHT which are paid for using IP's. There was political sensitivity in Europe as the technology giants minimised their tax bills by shifting intellectual properties, which are difficult to value, into offshore havens and charge subsidiaries large royalties in return for using them. (Davis, 2016)

Following are the deductions from the ongoing case between Amazon and the IRS. The IRS claimed that Amazon's motives were clear from the outset about Goldcrest Project which they used to avoid U.S. corporate income taxes. Tax inspectors additionally claimed that they quantified costs and benefits only for the purpose of avoiding US income taxes. Amazon on the opposite side stated that their profits were used for investments and that the nature of their industry made it low margin. (Davis, 2016) They claimed to have invested over 20 billion EUR in Europe since 2010 and that they are expecting to hire 15,000 people in 2017, resulting in 65,000 people hired in Europe (Sweney, 2017). The IRS doubted the legality of methods which were implemented by Amazon in making up complex intercompany contracts to transfer intangible assets to Luxembourg. As mentioned earlier, the complicated nature of its scheme makes it difficult for the auditors to penetrate into its working mechanism (Marks, 2016a).

In 2016, Amazon paid 15 million pounds in tax on European revenues of 19.5 billion pounds reported through Luxembourg. These figures bring concerns about Amazon using complex cross-border arrangements to avoid taxes. Not only this, but its U.K. services which operate the company's warehouse and logistics operation declared corporate tax bill which was more than half the amount from 15.8 million pounds to 7.4 million pounds in 2016. There was this reduction despite its increase in the turnover from 946 million pounds to 1.46 billion pounds. (Sweney, 2017)

Amazon keeps on claiming that they are contributing to the society by creating job opportunities and that they are investing in Europe. However, will creating more jobs and investing make them responsible as a corporation? As Ana Arendar, Oxfam's head of inequality mentioned, there is urgent need of country-by-country reporting for multinationals to make sure that they pay their fair share of taxes (Sweney, 2017). Proving one's act of avoiding taxes thus ensuring transparency of tax data is critical as many critics are suggesting with the implementation of country-by-country reports. Additionally, the problem does not only lie on the multinationals like Amazon but it is due to the politicians and technocrats who created such a complicated tax code. People who are able to afford it find loopholes and exemptions in this complicated tax code and take advantage of them (This is Money, 2015) Simplification of the tax code to help easier implementation and to make it fairer is another urgent need for all countries all over the world.

3.3 Additional Problems Associated with Transfer Pricing

Apart from the ways in which MNCs escape tax responsibilities, the growth of the tax advisory sector should also be considered carefully as it is these specialists that play the major role in helping corporates with evading taxes. The profitability of these firms further attracts other accounting firms to join the row of tax evasion. The ICIJ reported that the leaked documents of Luxembourg involved deals negotiated by PricewaterhouseCoopers (PwC), one of the world's largest accounting firms, on behalf of hundreds of corporate clients. To qualify the companies for tax relief, the records show, PwC tax advisers helped the companies to come up with financial strategies that feature loans among sister companies and other moves designed to shift profits from one part of a corporation to another to reduce or eliminate taxable income. (ICIJ, 2014)

EU finance ministers took an important step towards ending banking secrecy in Europe by agreeing legislation that would require all 29 member countries to disclose assets held by foreign EU nationals in their financial institutions (Spiegel, 2014). Surprisingly, Luxembourg is also ending banking secrecy, which had been one of the "cornerstones" of its national policy. Luxembourg dropped its long resistance to EU transparency rules and said it would allow European depositors' data to be sent back to their home countries. Yet, it fought back against accusations that it helped leading multinationals avoid billions of USD of tax. (Oliver and Spiegel, 2014) The implementation will start in 2017 and this still leaves Austria alone. Additionally the EU hailed the agreement as a major step in the fight against tax evasion and made Switzerland agree to start sharing financial information with the European Union as reported by CNN (Kottasova, 2015)

4 Conclusion

Tax evasion is a result of different corporate tax rates implemented by various countries according to their own policy. Difference in tax rates and complication in tax codes has created loopholes to escape taxes by multinational companies (MNCs). Not only with the application of transfer pricing, however, there are numerous ways adapted by Multinational companies to evade taxes. This has become evident through the leakage of documents in Luxembourg in 2014, which were also discussed in this thesis. As mentioned earlier, tackling the tax issues is complicated as it deals with international tax rules and regulations. Additionally, fast changing global environment has made it even more complicated, as companies apply digitalisation.

The effort of OECD and G20 countries were successful to engage 39 countries to sign up bilaterally automatic exchange of country-by-country report. However, the progress was not evident as studied in this thesis. It still could not achieve public country-by-country report which lacks transparency. Additionally, implementation of BEPS makes the tax rules more complicated and could provide loophole opportunities for the evaders. From the study, it was evident that close examination of existing rulings and research into the fast-growing global environment are required to amend guidelines for long-term international use.

It was seen from the case studies that the profit breakdown statements for all countries that the company is operating is necessary to avoid problems. It is crucial that OECD and G20 work to aim at filling country-by-country statement for profit. Many MNCs have wrong point of view for its corporate responsibilities as deduced from Amazon's claim. It has to be made clear to all MNCs that contributing to the society by creating job opportunities and investing have no relation with its responsibility for taxes.

From my opinion, the European Commission requires more power to tackle tax issues directly as they are currently only intervening to stop activities that are harmful to competition with in European Union. Empowerment will help control the misbehaviours of MNCs in EU. Additionally, making tax rulings for the tax advisory sector is urgent as these consulting firms are growing fast due to its profitability. Problem of tax issues cannot be solved by a few countries alone as it is very complicated. There is a need to raise more issues and concerns publicly, raising awareness of people such that these problems would be tackled comprehensively.

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