Joint ITUC-TUAC expert meeting on Corporate Tax Planning
OECD Conference Centre, Paris, 29 November 2013

REPORT
Prepared by the TUAC Secretariat
Paris, 19 December 2013

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Introduction

The TUAC held an expert meeting on aggressive tax planning and its impact on workers at the OECD conference centre on 29 November in partnership with ITUC and Syndex, a French labour-oriented accounting consultancy working exclusively for works councils. In addition to TUAC affiliates, participation included representatives from the Council of Global Unions, the PSI, EI, EPSU as well as NGO experts from Tax Justice Network and from Alliance Sud.

The aim of the meeting was to take stock of the OECD Action plan on Base Erosion and Profit Shifting (BEPS) adopted by the G20 meeting in St Petersburg in September 2013. The BEPS Action Plan represents the first global initiative to effectively curb tax avoidance practices by corporations and by multinational enterprises (MNEs) in particular.

The meeting also aimed at investigating the impact of tax planning on workers' employed by MNEs – including remuneration, collective bargaining and access to information – a topic that is relatively unexplored and would deserve greater attention in the context of industrial relations during a business restructuring process.

While tax evasion has been addressed by the G20 since 2009 and is dealt by the OECD-supported Global Forum on Tax Transparency, tax avoidance has become a policy priority at global level only very recently. Unlike tax evasion – which is illegal – tax avoidance is in the grey area of legal compliance. It poses nevertheless a major problem in terms of government revenues. Data about corporate tax receipts in OECD countries do not show a dramatic drop in corporate tax receipts even though tax rates have been falling over time. But this can be misleading because tax bases have broadened in the past decade, and because of the rise of private sector (more incorporated firms created) and higher profitability. New data collected by the OECD show there is an issue. The way foreign direct investment is being allocated worldwide points to some inconsistencies; for example the British Virgin Islands is the second largest investor into China behind Hong Kong. In the same vein, corporate reporting shows low effective tax rates for MNEs.

As highlighted in a written contribution by the Unión Latinoamericana de Trabajadores de Organismos de Control (ULATOC), it is important to set the context to this agenda: a global crisis. Many governments have responded by implementing austerity measures aiming at severe cuts in public services and administrations – including tax administrations. The loss of revenues arising from the inability of governments to tackle aggressive tax planning effectively should be seen as a direct threat to the basic function of the modern democratic state which is to collect revenue through taxation in a fair, progressive and equitable way to among others finance quality public services and social security.

The OECD Action Plan on Base Erosion and Profit Shifting

The OECD Secretariat gave an overview of the BEPS Action Plan and its 15 key measures aimed at preventing double non-taxation through aggressive tax panning practices by (i) reducing the taxable income base (i.e. “Base Erosion”) and/or (ii) moving profits away from economically relevant but high tax-jurisdictions to economically irrelevant but low-tax jurisdictions (i.e. “Profit Shifting”). The presentation was followed by comments by Sol Piciotto, advisor to the Tax Justice Network.

Presentation by the OECD Secretariat

The Action Plan consists of 15 actions which can be regrouped in four pillars:

- The specific business model of the digital economy (Action 1). The Action Plan highlights the specific challenges posed by IT companies, including: unparalleled reliance on intangible assets, cash generated based on “free” products and service, difficulty of determining the jurisdiction in which value creation occurs.

- The lack of coherence between domestic tax rules (Actions 2-5). Differences in tax treatment between jurisdictions may be exploited by MNEs through inter alia “hybrid mismatch” arrangements (asset considered as equity in on jurisdiction and as debt in another), illicit use of controlled foreign companies (CFC) status, and excessive interest service and other financial deductions from the income tax base.

- The disconnect between contractual arrangements and the economic substance of MNEs’ activities (Actions 6-10) through: treaty abuse (“treaty shopping”) and opacity

of rulings (by tax authorities) related to preferential tax regimes, artificial avoidance of the permanent establishment status and illicit use of intra-MNE transfer pricing.

- The limitations of corporate tax reporting frameworks (Actions 11-14) among others would require greater disclosure (to tax authorities) of specific tax planning arrangements, improvement in the transfer pricing documentation and more effective dispute resolution mechanisms.

The Action Plan spans over a short period considering the scope of the work and the ambition. Most deliverables are expected by end-2014 or end-2015 and would consist in changes to the existing OECD instruments – the OECD Model Tax Convention and the Transfer Pricing Guidelines. Given the sheer number of bilateral treaties that would be affected, the Action Plan n°15 suggests the creation of a new "multilateral instrument" (possibly a new OECD convention) to ensure all existing treaties are re-aligned with the outcomes of the BEPS process.

Comments by Sol Picciotto (Tax Justice Network)

In essence the Action Plan would consist in strengthening existing rules within the same global tax framework that prevailed prior to the crisis; indeed, it would retain the same basic principles first formulated in 1928. Given the complexity of the current tax framework, strengthening the rules could unintentionally lead to more legal uncertainty and conflicts between jurisdictions. What is needed is a fundamental shift in the OECD approach, based on the recognition that multinational corporations are unitary firms. This is the only effective way to achieve the goal stated by the G20 in the Tax Annex to the St Petersburg Declaration that international tax rules should "ensure that profits are taxed where economic activities occur and value is created". A major step forward towards this would be the establishment of comprehensive country-by-country corporate tax reporting and disclosure, which is now also mandated in that Declaration, and is part of the Action Plan. Other steps could be taken by strengthening elements which are already part of current practice, such as the profit-split method for fixing intra-group transfer pricing, which is favoured by developing countries such as China and India. Systematizing profit-split and identifying suitable allocation keys could be a significant step towards shifting from the current OECD Arm's length principle to unitary taxation (a.k.a. formulary apportionment method).

Regarding reporting, the Action Plan will develop a template for MNE-level corporate reporting to tax administrations, to facilitate transfer pricing risk assessment, especially for complex aspects such as financing (including use of derivatives). But the details are still under discussion, with regard to the definition of profits (by country or by business segment?), the way they are reported (tax or financial accounting basis?), the measurement of taxation (tax liabilities & taxes actually paid?), the disclosure of profit drivers (employees headcount & payroll, physical assets, sales to third parties by destination) and to whom the report should be sent to (all relevant tax authorities, or only the administration where the headquarters are located?).

Importantly it is far from clear whether the expected enhanced reporting framework will include some form of public disclosure, a central NGO and trade union tax campaign issue. So far, the OECD opposes public disclosure (as do, unsurprisingly business groups).

Unlike the OECD arm's length principle, the unitary taxation method for transfer pricing assumes that profits are earned by the firm as a whole, not by its separate entities where incomes are reported to be "earned". From there, profits are reallocated to each entities based on objectively defined set of criteria such as physical assets in a country (not intangibles), employees & payroll, sales by location of customers and balance of production/consumption factors.

Unitary taxation at global level would make sense. It would considerably reduce compliance and enforcements costs for business and tax authorities respectively – and hence save money. And it would effectively contribute to a level playing field by reducing incentives for companies to exploit the use tax havens and for governments to offer generous tax incentives and preferential treatment to attract FDI.

Various forms of unitary taxation system are in place in several OECD countries, including in the US, Canada and Switzerland. In Europe a proposal for a Common Consolidated Corporate Tax Base was under consideration in 2011. The OECD stands firm in its opposition to unitary taxation as a standard method for transfer pricing – the OECD guidelines tolerate the use of the "profit-split method" on a case-by-case and only for certain types of transfers (incl. intangibles) that are hard to measure based on the arm's length principle.

Case studies

Two concrete case studies were presented at the meeting to help illustrate the social dimension of aggressive tax planning and its impact on workers at three levels: (i) wages and profit-sharing agreements, (ii) working conditions and collective bargaining, and (iii) corporate transparency and workers' right to information. The case of the French subsidiary of a US multinational was presented in detail by members of the company's works council and by certified accountants. Another case study involving the Korean subsidiary of BBB was briefly addressed as well.

The restructuring of AAA France in 2004

Up until the mid-2000s, AAA had a decentralised organisation outside the US. The French subsidiary was structured around a holding company which controlled all operational activities, including two production sites and several local commercial companies. From a tax point of view, the holding company was the "primary contractor" and hence reported all profits and net income generated in France.

In 2004 the European operations went through important structural changes. A new company was created in Switzerland (hereafter "the Swiss entity") and became the primary contractor for the entire operations in Europe. In France, the commercial companies changed status to become "limited risk distributors", the industrial sites sub-contracted manufacturers with specific terms of reference and pricing set by the Swiss entity. The French holding company, which previously had a primary contractor role, became a service provider for the other French entities or for the Swiss entity.

As a result of the restructuring, profits reported by the business entities in France fell sharply. The operating margin of the French commercial companies was divided by 4, falling from 10% on average prior to the restructuring to a fixed rate of 2.5% afterwards. Suspecting illicit transfer pricing and transfer of profits abroad, the French tax administration launched a tax

audit of the French subsidiary over the period 2005-2008. The French administration challenged the status of the Swiss entity as the primary contractor for French operations on the ground that:

- the Swiss entity did not have the means to fulfil its responsibilities as shown by the fact that essential functions were subcontracted to the French holding company and other entities
- it was under-capitalised to cope with the operational and market risks to which it claimed to be exposed to as a primary contractor, and
- it did not owned the trademarks of the global brands.

Several millions of euros in tax arrears were claimed by the French tax administration. CP contested the decision by defending the primary contractor status of the Swiss entity and arguing that the fall in the margin rate of the French subsidiary was simply due to the transfer of risks to the Swiss entity. The Swiss entity held the licensing rights for the use of the global brands in Europe, and it controlled and was exposed to operational and market risks in France regardless of the fact essential functions were subcontracted. AAA also submitted a comparability analysis which showed that its transfer pricing policy between the French and Swiss entities was indeed within the range of its competitors. It was however located in the lowest quartile of remuneration – while the exposure of the French entities to risk was located in higher quartiles. The French subsidiary was remunerated at the lowest levels compared to its exposure to operational risk in France.

In appeal, the conciliation and arbitrage tax commission rejected the decision by the tax administration on the ground that it had not challenged the "legal reality" of the contracts binding the French subsidiary with the Swiss entity. The commission did concede however that that the application of the arm's length principle should not be limited to contractual terms only but should include a "realistic" analysis of the distribution of risks and responsibilities. Rather than capturing all the profits made in France, the Commission suggested that the Swiss entity be remunerated like headquarters of an MNE (that is remunerated for the costs plus 6%).

Impact on workers

The restructuring of 2004 has had a clear impact on the employee profit-sharing scheme of the French subsidiary. Profit-sharing schemes are relatively common in France and may represent a non-trivial part of workers' income, particularly for large companies and subsidiaries of MNEs. The schemes are regulated by law, including the formula for setting the share of profits reallocated to workers. The formula is entirely dependent on the level of equity or capitalisation of the company: the higher the level of equity, the lower the share of profits being distributed to the employees. The restructuring plan resulted in excessive levels of capitalisation of the French subsidiaries considering their supposedly reduced exposure to market and operational risks. Combined with an overall decrease in profit levels, the share of profits redistributed to workers fell sharply after the restructuring. It is estimated that the net gains for the MNE were €1.6m per year for 2005-2007 compared with 2000-2004 period.

Workers' rights to information and to representation have also been impacted. As a result of the restructuring, the status of the French entities shifted from limited liability company (*société anonyme, S.A.*) to "simplified" limited liability company (*société anonyme simplifiée, S.A.S.*). The SAS status was introduced in French corporate law to meet the specific situation

of SMEs; compared with the S.A. it grants much lower access to worker representation and information.

The fragmentation of the French subsidiary into multiple "simplified" incorporated entities led to considerable loss of information and of rights to consultation for the trade unions and for works councils, and thereby to considerable loss of bargaining power. It also led to a downgrading of the quality of the collective agreement covering the workers. In France, CB coverage is sector-based. Workers are covered by the collective agreement of the sector of activities under which the employer is registered. As a result of the shift from SA to SAS status and from primary contractor to sub-contractor roles, the French entities were registered under a different sector of activity covered by a collective agreement that had lower provisions and benefits than the one that prevailed prior to the restructuring.

Overall, the quality of social dialogue deteriorated fast following the restructuring, to the point where it can be considered as close to non-existent. The human resource management has shifted to a situation of "permanent redundancy planning". A works council representative summed up the situation: "the more distant a worker's production site is located from where value added is reported, the more worker poverty develops". The unions have attempted to bring attention to the aggressive tax planning scheme of AAA before the French parliament – including calling for an official inquiry.

On a separate note, in 2008 AAA also acknowledged that it was participating in an illicit cartel with competitors, including other market leaders in Europe. The unions have suggested that the use of an empty shell company in Switzerland by AAA – and presumably by all its competitors – could be linked to the creation of this cartel.

Korean subsidiary of BBB

The case of a Korean subsidiary of European MNE BBB was also briefly addressed at the meeting. The European truck maker has had a long standing presence in Korea through a wholly owned subsidiary managing logistics (imports of parts from the MNE HQ), sales, client relationship and after sales services, as well as production – the subsidiary operating a production site. For years, profit levels of the Korean subsidiary have been low. The trade union suspected illicit repatriations of profits to the MNE HQ. And indeed the Korean administration launched a tax audit for the period 2002-2006 which had exposed some form of transfer pricing manipulation. However, the trade union had managed to maintain satisfactory collective bargaining and annual wage agreements with the management during that period. Industrial relations changed dramatically after a change of senior management in 2012: no annual wage agreement has been concluded since then, and the management has refused to renew the collective agreement.

In the summer 2013, the Korean competition authority exposed a market cartel situation in the truck industry. The Korean subsidiary of BBB was fined 17.6bn Korean won (EUR12m) for violation of anti-cartel regulation covering the 2002-2011 period – competitors (both foreign and domestic) were fined as well. However the Korean subsidiary does not have sufficient financial capacity to pay the fine on its own and without help from the MNE HQ. The MNE has agreed to pay the fine on condition of a restructuring of the subsidiary into two separate entities:

- An "Old company" would retain sales, production and distribution functions, all the unionised workers as well as all financial liabilities, include the fine;
- A "New company" would take on the other functions, and the most profitable ones, that is logistics and import of semi-finished products by the MNE and managed by a small administrative team.

The trade union has expressed deep concern about the proposal of spinning off the main source of profit subsidiary (imported parts from the MNE HQ) and has speculated about the true motives behind this restructuring project, whether it would aim at aggressive tax planning, or, and given the hostile behaviour of the management since 2012, the restructuring would preclude a broader plan for divestment and ultimately the dissolution of the old company and the layoffs of all workers.

The management has refused to engage with the union about the economic rationale for the restructuring or any alternative options. It has retained all meaningful information that would have helped the union to assess the current situation of the subsidiary. According the trade unions, the management threatens to close the entire business operations in Korea should the spin-off not take place, and paints the decision as a non-negotiable measure taken by the MNE HQ. The management did not agree either to the recommendation by the regional labour relations commission – mediation procedure triggered by the union – to open consultation on options and changes to the restructuring plan.

Union members are on strike since September 2013. The trade union has had contacts with the unions at the MNE HQ in Europe, with TUAC and other international trade union bodies. What is under consideration among others is the filing of a case under the OECD Guidelines for MNEs.

OECD Guidance on responsible business conduct and on corporate governance

Other OECD instruments than those addressed by the BEPS Action Plan (transfer pricing guidelines, and model convention) could be relevant to the governance and transparency dimension of tax planning, including the OECD Principles of corporate governance and the OECD Guidelines for MNEs. At the meeting, the OECD Secretariat and the TUAC Secretariat gave an overview respectively of the links with corporate governance and of the potential use of the tax chapter of the MNE Guidelines in case of broader restructuring processes.

Links between tax and corporate governance

The Principles of corporate governance, the latest version of which dates back to 2004, do not pay special attention to tax. Compliance with tax laws is mentioned among other sources of law in the list of responsibilities that fall on the board of directors, but it is not considered as a particular area for risk policy and management by the board. Yet, there are many academic research reports that discuss the links and interactions between corporate governance and taxation in general, and the aggressive tax planning in particular.

For example taxation of capital gains and of dividends has a direct impact on the ownership structure of companies and on management incentives. Tax increases on dividends and capital gains are likely to force greater dispersed ownership structures – as controlling shareholders

dispose of some of their shareholdings to offset the increase in taxation. Alternatively, tax cuts on capital or lower taxation on capital than on labour have historically been decisive factors in the rise of share-based remuneration of corporate management, and hence of shareholder value-driven management.

The evidence is mixed looking more specifically at the link between corporate governance and the frequency or probability for aggressive tax planning behaviour. According to recent research better corporate governance practices – as defined by the OECD Principles of corporate governance – lead to less "extreme forms" of tax planning schemes but to more "acceptable" ones.

There is also some evidence that an increase in the level of scrutiny by tax administration has a positive impact on shareholder value. Greater tax enforcement can indeed increase shareholders' confidence in the quality of the corporate reporting and accounting – since tax reporting and auditing are usually more demanding for management than is external auditing. In the case of Russia, for example, greater tax enforcement led to higher fines and higher penalties of Russian listed companies – and hence additional financial costs. Still, the share value of those companies increased precisely because shareholders had greater confidence that the corporate accounting reflected the true value and true risk exposure of the invested companies.

The OECD Guidelines for MNEs

The 2011 update of the MNE Guidelines led to small, but substantial changes to the Chapter XI on taxation. Unlike the 2004 OECD Principles on corporate governance, the MNE Guidelines recognise tax compliance as an important part of board risk management where it reads: "Enterprises should treat tax governance and tax compliance as important elements of their oversight and broader risk management systems. In particular, corporate boards should adopt tax risk management strategies to ensure that the financial, regulatory and reputational risks associated with taxation are fully identified and evaluated".

Prior to the 2011 update very few cases submitted to NCPs[i] involved the chapter on taxation. The vast majority of cases brought by unions have been related to chapters V (employment and industrial relations) and II (general policies). This perhaps could change in the future given the new requirement on "tax governance" and importantly when combined with the Guidelines' requirements when business restructuring occurs[ii]:

- provide information on the performance of the entity/enterprise;
- give reasonable notice of restructuring/closure;
- conduct due diligence to identify and address adverse employment effects on workers of restructuring/closures;
- work with trade unions to mitigate the adverse employment effects of restructuring/closures;
- remedy where the MNE has caused or contributed to the adverse employment effects;
- use leverage so that business partners mitigate the adverse employment effects, where the MNE has contributed to or is linked to those adverse effects.

When an aggressive tax planning scheme involves a legal restructuring of the company that has potential adverse impact on employment, it could be assimilated to a business restructuring and hence the above provisions could be triggered.

Wrap-up

Key findings

The following findings and lessons can be drawn from the meeting's discussion.

Aggressive tax planning is characterised by a misalignment between legal and commercial arrangements within the MNE group:

- Under aggressive tax planning schemes contractual arrangements within a group and between a parent company and its subsidiaries can significantly depart from the commercial arrangements.
- These contracts are deemed valid because of the presumption that the contracting parties are acting in full autonomy from one another. Does a subsidiary have sufficient legal "autonomy" however when it is contracting with its parent company? Can we speak of a "contract" if, in substance, the contracting parties defend the same economic interests?
- Current OECD guidelines on transfer pricing are based on the arm's length principle which treats entities within an MNE group *as if* they are independent from one another. They may not offer sufficient protection against manipulation of transfer pricing when precisely legal contracts do not reflect commercial arrangements within the MNE group.
- There should be primacy of "substance over form" in tax law in order to deconstruct the legal arrangements that are set up for the purpose of tax avoidance. One avenue would be to reform or move away from the current notion of "legal personality" of subsidiaries and instead to recognise the MNE group as a single entity. This would pave the way toward unitary taxation system of intra-group transfers (or formulary apportionment method).

Tax avoidance does not happen in a vacuum, it is one aspect of a broader process of corporate short termism:

- Tax avoidance harms government finance and the right to public services through the net loss in tax revenues. But it also harms other stakeholders, including workers for whom aggressive tax planning can be assimilated to a legal restructuring with short termist goals.
- For example, illicit transfer pricing affects profit levels and thereby the capacity of the company to invest in productive capacity or to face its liabilities. It also affects the fair distribution of wealth created by the company, as seen in the case of employee-profit sharing agreements.
- Aggressive legal restructuring can aim at tax avoidance in the strict sense of the terms but also at avoidance of other mandatory contributions by the company such as social security contribution and contributions set by collective agreement. As such tax planning is one form of "regulatory planning" that may undermine workers' rights to collective bargaining ("aggressive social planning") when the legal restructuring ends with a change in the terms of collective bargaining.
- The impact can also have a non-financial dimension, when the legal restructuring leads to greater opacity of corporate structures and with that reduced worker access to information. When the restructuring leads to fragmentation of the company into separate entities, workers also have less access to decision making centres when these are transferred outside the legal perimeter of the company to a holding company established in a foreign jurisdiction

- The above suggests that unions and representation bodies such as works councils should considerably invest in legal and tax expertise to anticipate the consequences of legal restructurings – be it financial, social or governance impacts.
- The above would also suggest that corporate reporting to tax administration should be considerably enhanced to effectively detect aggressive tax planning schemes. Importantly, corporate tax reporting should be made public so that workers employed by the company are effectively informed of the risk for aggressive tax planning and its impact on collective bargaining rights, employment conditions and representation.

Regulation may be unfit to effectively detect and deter tax planning schemes:

- As shown in the context of France, key legal concepts for effective tax enforcement may have become inadequate, if not obsolete, to tackle the growing complexity of tax-driven corporate restructuring. This is the case of the notion of "abuse of rights" (*abus de droit*) which cannot be triggered as long as it is not proven that the legal restructuring is *exclusively* accounted for tax purposes. Even if it is proven to be *mainly* driven by tax avoidance purposes, the *abus de droit* cannot be triggered by the tax administration. Another French legal concept that is unfit is the notion of "mismanagement behaviour" or "abnormal form of management" (*acte anormal de gestion*). Under-capitalisation of a firm may be considered as a form of mismanagement; over-capitalisation however can never be considered as mismanagement.
- Governments should invest in tax administration's human resource, skills and technology more than even. No company or corporate tax arrangement should escape the scrutiny of tax administration.
- Requiring ex-ante approval of any specific tax schemes by tax administration would make sense. However, current experience with "mutual agreement procedures" and "rulings" suggest that in many cases opacity prevails over decisions and tax arrangements, as seen in Belgium and in Argentina. In the case of Belgium, for example, the "rulings" are seen as a way for the company to "legalise" its tax avoidance practices.

Next steps

To the extent possible, trade unions at national and international levels should consider investing in research and campaigning activities on aggressive tax planning by MNEs. This could happen in two ways:

Support global civil society tax justice campaigns and monitor implementation of the G20 / OECD Action Plan on BEPS.

- TUAC could set up an informal contact group of trade union-oriented tax experts to help ensure effective labour participation in the BEPS consultation meetings at the OECD in 2014
- Global Unions partners could help develop trade union capacity building in developing countries and ensure coordination with key NGO-supported initiatives such as the "BEPS Monitoring Commission".

Develop capacity building to help union representatives and works councils detect and anticipate the social consequences of corporate tax planning schemes.

- Awareness tools, such as brochures and checklists, could be prepared for specific groups such as: members of works councils, of European works councils and trade union-appointed trustees sitting on the board of pension funds.
- Deepening information sharing and research on the impact of corporate tax planning on workers.

[i] National Contact Points are government units in charge of information and mediation regarding alleged violation of the MNE guidelines by a company.
[ii] See Trade Union Guide to the OECD Guidelines for Multinational Enterprises http://www.tuacoecdmneguidelines.org/Docs/TradeUnionGuide.pdf