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Tax justice in Europe: why does it matter for workers?

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Policy recommendations

Through a number of leaks and scandals (for example, Panama Papers, LuxLeaks, Paradise Papers), public awareness of the magnitude and mechanisms of tax evasion and avoidance has dramatically increased. Workers are affected in a number of ways by this, including pressure on public jobs and services caused by a loss of tax revenues, and a lack of transparency about their employers' financial standing. Following the numerous scandals, tax and transparency have become central issues on the EU agenda, and the political pressure for change has grown

dramatically. Workers' rights advocates should seize this opportunity to bring their arguments to bear onto the debate. Important measures to reduce tax evasion and avoidance being considered by the EU Parliament, Commission and Member States include country by country reporting and public registers of beneficial owners of companies and trusts. However, transparency is only the first step. Trade unions should also join the call for new international tax rules which consolidate the profits of multinational groups and fairly apportion these profits between countries for taxation. Finally, legal protection is needed for whistleblowers reporting tax dodging.

1. Introduction

Many large-scale, international tax-dodging scandals have grabbed the headlines in recent years. Some of them – including the so-called Panama Papers and Bahamas Leaks in 2016, Swiss Leaks in 2015 and Offshore Leaks in 2013 – primarily focused on wealthy individuals, celebrities and politicians using shell companies, trusts and other offshore structures to evade taxes or conceal ill-gotten wealth. Other cases, such as Luxembourg Leaks in 2014 and the European Commission's State Aid cases¹ regarding corporate tax avoidance, have shown how some multinational corporations have been using complex international corporate structures and secret deals with governments to lower their tax bills dramatically – in some cases to less than one per cent (International Consortium of Investigative Journalists 2014). At the end of 2017, the Paradise Papers scandal broke and created renewed attention about both corporate and private tax dodging.

While some of the practices revealed have been about *tax evasion*, which is illegal, many of the cases concerning multinational corporations have focused on *tax avoidance*, which is often (technically) legal, albeit, many would argue, highly immoral.

The world of tax is normally thickly veiled in secrecy, but these leaks and scandals have shown us how international tax dodging works,

and that corporate structures can be abused to dodge taxes. But what are the implications for workers and the broader public? And what are the possible solutions to these problems?

This policy brief will explain problematic features of the international tax system and explore the potential impact of a range of possible solutions which are currently under discussion in policy-making circles. The policy brief covers both corporate and individual taxation, since problems in both regimes cost society enormous amounts.

2. The magnitude of the problem

The lack of publicly available information on tax matters in general makes it difficult to obtain exact estimates of the total amount of taxes lost to tax evasion and avoidance. Estimates that have been made are generally conservative, since they only estimate specific aspects of tax dodging, rather than cumulative calculations.

¹ The European Commission can initiate a State Aid case when it finds that a Member State of the European Union might have violated the Treaty of the European Union by granting impermissible support to a company. For more information see European Commission (2016a).

One such (conservative) estimate, commissioned by the European Parliament, says that corporate tax avoidance costs the EU between €50-70 billion per year (Dover *et al.* 2015). Another (equally conservative) estimate by the United Nations Conference on Trade and Development (UNCTAD) says that corporate tax avoidance costs developing countries between US\$70-120 billion per year (UNCTAD 2015).

In relation to specific cases, the European Commission's State Aid cases have provided a rare insight into the tax arrangements of the multinational corporations being investigated. In the State Aid case against the Apple group, the Commission's estimate says that, during the period 2003-2014, Apple avoided taxes worth up to €13 billion on profits generated in Europe, Africa, the Middle East and India (European Commission 2016b). The Commission also found that in 2014, Apple paid as little as 0.005 per cent of its profits in taxes (*ibid*). Ireland has appealed the Commission's decision, among other things arguing that the Commission lacks competence to take such a decision, has breached procedural requirements, and has made errors in its interpretation of Irish law and relevant facts (Court of Justice of the European Union 2017). The case is now pending at the European Court of Justice.

Data on individuals who evade taxes is even rarer. Civil society organizations have called for statistics to be released that show how many foreign clients hold accounts in low-tax jurisdictions, but so far in vain. The leaks provide a glimpse into the problem. For example, the so-called Swiss Leaks scandal revealed that over 100,000 clients from more than 200 countries had assets worth US\$100 billion in just one bank in Switzerland (HSBC) (International Consortium of Investigative Journalists 2015). While having a bank account in Switzerland is fully legal, the information nonetheless raises many questions about why so many people have salted away so many resources in one of the world's most secretive countries. The leak also revealed that HSBC staff openly discussed with foreign clients how they could dodge taxes in their home countries, and repeatedly reassured these clients that the authorities would not receive information about the secret account (*ibid*).

3. How multinational corporations avoid taxes

In order to better understand the potential effects of various policy solutions, this section will explore the ways in which multinational corporations avoid taxes by exploiting international rules, by applying fictional pricing regimes for internal transactions, and by concluding secret agreements with governments.

The international loophole

For corporations, the first step towards avoiding taxes is to become multinational. This is because, when determining the tax base for a multinational corporation, most tax administrations look at the officially recorded profits of a multinational company in their country rather than what proportion of the multinational's business actually took place there. In this way, and from a tax

perspective, multinational corporations are treated as a collection of smaller, independent enterprises rather than one large entity. And this is where the opportunities for tax avoidance arise. By setting up branches in low-tax jurisdictions, multinational corporations can use internal trading between the different branches of the corporation to shift profits from jurisdictions where corporate tax rates are high to jurisdictions where corporate tax rates are low or completely absent. The branches in low-tax jurisdictions often take the form of 'letterbox companies', which are companies that do not carry out any real economic activity in the country where they are located, and are often, as the name suggests, little more than a nameplate on a letterbox.

The (broken) 'arm's length principle'

Most national laws that regulate internal trading ('transfer pricing') between branches of multinational corporations use the so-called 'arm's length principle', which in essence means that multinational corporations should use the same prices during internal trading as would be used if the trade had been between two independent companies.² In theory, this is supposed to ensure that multinational corporations do not use artificial price levels to shift profits around and avoid taxes.

However, in reality, it is often extremely difficult (if not impossible) to determine the market price of the type of assets that multinational corporations trade internally, including 'management advice', 'intellectual property rights', 'know-how' or the right to use a corporation's logo. This makes the arm's length principle anything but an exact science, and as a consequence, it is difficult to predict in which jurisdiction the profits of a multinational corporation will be booked. Adding to this complexity is the fact that the general regulation of multinational corporations varies significantly from country to country, and that multinational corporations often use highly complex corporate structures. As a result, national legislation will often not give a clear picture of what multinational corporations will actually pay in taxes.

The OECD recently revised its international standards for taxing multinational corporations through an intergovernmental negotiation known as the Base Erosion and Profit Shifting (BEPS) process (OECD 2016). However, the BEPS process was more of a review and adjustment of the international system, rather than a real reform. While addressing many smaller elements of the system, it did not, for example, consider alternatives to the arm's length principle. The BEPS process was also criticised for increasing the level of complexity in the international tax system. A Parliamentary Committee in the United Kingdom called it a sticking plaster on a system not fit for the twenty-first century', and raised the concern that 'the OECD proposals are likely to add to an already complicated global tax system.' The Committee also highlighted that the new complex rules could provide opportunities for new loopholes to be identified by accountancy firms, banks, lawyers and advisers [...]' (All-Party Parliamentary Group 2016).

² The 'Arm's length principle' is described in the OECD Transfer Pricing Guidelines (OECD 2017).

Secret tax agreements

Multinational corporations do not like the uncertainty that results from unclear international taxation standards. To accommodate this, tax administrations and corporations have developed a practice of special tax deals or 'rulings'. This practice means that a corporation can ask for an upfront negotiation with a tax administration about the transfer prices and/or corporate structures the corporation is considering applying. These negotiations result in agreements that set out how the tax laws will be applied to the individual corporation. In most cases these agreements mean that the tax administration signs off on the technical aspects of the corporate tax plan before they see in which jurisdictions the corporation's profits will actually end up once the plan is applied.

These agreements are highly confidential and received little international attention before the so-called Luxembourg Leaks (LuxLeaks) scandal that unfolded when 548 tax rulings from Luxembourg were leaked to the media (International Consortium of Investigative Journalists 2014). The scandal revealed that, thanks to these agreements, multinational corporations could reduce their tax rates dramatically, in some cases to less than one per cent (ibid). As regards the corporations involved in the scandal, it is important to note that tax planning is normally not illegal, and there have so far been no direct legal consequences for the corporations involved.

Perhaps even more surprisingly, the scandal has not stopped tax administrations from signing secret tax agreements with multinational corporations. In fact, following the LuxLeaks scandal, there has been a dramatic increase in a specific type of tax ruling – namely 'advance pricing agreements' – in Europe (Eurodad 2018). As the name suggests, these deals provide an advance agreement on which prices the corporation can use in its transfer pricing arrangements.

The public is not allowed to know the names of the corporations that have obtained these agreements with tax administrations in the EU, let alone are they allowed to know the specific content of the agreements. The public is also not allowed to know how much tax a multinational corporation pays, or how much business activity it has in their country.

4. How wealthy individuals evade taxes

For individuals wishing to keep large assets out of sight of tax authorities, one of the main difficulties is finding a way to keep control of those assets without being officially linked to them. As the Panama Papers showed, a popular solution is to be the secret owner of a company or trust. The law-firm Mossack Fonseca, which was at the centre of the Panama Papers scandal, created such anonymous structures and sold them to wealthy customers through banks around the world (International Consortium of Investigative Journalists 2016). In order to conceal the real owner, Mossack Fonseca offered nominee directors; these are individuals who agree to appear as the official owner, but don't have any real control over the assets (i.e. the control remains in the hands of the real, but now hidden, owner). Just to illustrate the absurdity of such arrangements, it was found that one woman living in the

slum area of Panama City was found to be the official director of over 25,000 companies (Obermayer and Obermaier 2016).

5. Solutions

These problems can be solved if there is political will to address them. A number of important solutions are already on the table, and have in some cases already been tested in specific countries.

Transparency

The first step is transparency. The public should be allowed to know what multinational corporations pay in taxes, and how much business activity they have in each country where they operate (also known as 'public country by country reporting') (Eurodad *et al.* 2015). The EU has already introduced this for banks³ and is now considering introducing it for all sectors (European Commission 2016c).

Furthermore, the public should have access to information about which corporations have signed secret tax deals with governments, as well as the key elements of which these deals consist.

Lastly, civil society is calling for an end to secret shell companies and anonymous trusts by creating public registers showing the real ('beneficial') owners of such structures. Public registers of company owners have already been introduced in some countries, such as the United Kingdom,⁴ and at the end of 2017, the EU reached agreement on introducing such registers in all its Member States (Eurodad 2017). Such transparency allows civil society, unions, journalists, parliamentarians and the broader public to know who owns the companies operating in our societies, and at the same time reduces the opportunities for tax dodging through anonymous ownership of assets. Unfortunately, the new transparency rules do not include owners of trusts; thus, opportunities for anonymous ownership of assets still exist.

New international tax rules

Ultimately, the system for taxing multinational corporations will need to be replaced by a system that is fit for purpose. At the EU level, the European Commission has for years been advocating a 'Common Consolidated Corporate Tax Base' (CCCTB) (European Commission 2017), which would consolidate all the profits a multinational corporation has made in the EU, and allocate the profits between the Member States based on the level of business activity the corporation has had in each specific country. It would still be up to the individual Member State to set the tax rate, but the amount of profits available

3 Public country by country reporting for banks is part of the 4th Capital Requirements Directive (paragraph 89). See Official Journal of the European Union. (2013). Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC. <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:176:0338:0436:En:PDF>

4 The UK register can be found online under the Companies House. Accessed 20 March 2018: <https://beta.companieshouse.gov.uk/>

to be taxed in each country would depend on the level of business activity, rather than on the arm's length principle. It would, however, require unanimity among all EU Member States to adopt the CCCTB, and so far this has not been possible.

Whistleblower protection

The current political momentum on tax justice is in no small part the result of many information leaks, and until a fair and transparent system is in place, the public will have to rely on leaks and whistleblowers to reveal the true state of the tax system. However, the poor – and in some cases completely absent – protection of whistleblowers means that these actions can come at a high price for the individuals who take action. Therefore, whistleblower protection is urgently needed.

6. Implications for workers

The tax agenda is linked in five ways with the issue of workers' rights. The first and most obvious connection is through public services. As tax dodging by multinational corporations and wealthy individuals deprives public budgets of billions of Euros, the level of funding available for public services drops. This leads to austerity and loss of public sector services and jobs. Therefore, action to address tax dodging is essential for protecting and expanding public services. But the solutions to tax dodging also hold other important win-win opportunities for the workers' rights agenda.

Secondly, tax avoidance has important implications for collective bargaining, and public country by country reporting could become an important tool for workers negotiating pay with multinational corporations. Without such reporting it is very difficult to show that a multinational corporation is shifting profits out of a jurisdiction where employees are located, and into low-tax jurisdictions where the corporation may have few or no employees. This creates the risk that the multinational corporation will reject calls for salary improvements with the argument that they are making no profit in that particular country. Public country by country reporting would grant employees the information needed to challenge the claim that the corporation is not making profits. Furthermore, tax avoidance undermines the fundamental compromise reached in many EU countries, whereby productivity gains should be shared. If profits are shifted, however, it's impossible to localise productivity gains.

Thirdly, workers in multinational complex companies need to be able to comprehend the multi-level dynamics of their company. Across the EU, at the local, national, and cross-border levels, employee representatives have the right to be informed and consulted about the financial performance and outlook of their company. More transparency about the company's internal financial relationships would at the very least provide an important source of verification for information received by employee representatives in the context of information and consultation processes. The transparency provided by country by country reporting would be a step forward, and could be supplemented by increased transparency to give employee representatives better insights into the complexity of the

company's internal contractual relations and resource allocations, since these are often the drivers behind decisions about capacity and investment, and hence, ultimately, the availability and quality of jobs. A lack of transparency about these arrangements, which are likely to be as much shaped by taxation considerations as other reasons, makes it very difficult for employee representatives to fulfil their functions at both the national and international level. Moreover, even such a relatively straightforward instrument as a public register of beneficial owners would put a stop to the absurd situation in which employees are often not even able to find out who owns the company for which they work.

Fourthly, protection of whistleblowers, both in the private and public sector, will also be vital to ensure that workers are able to speak out when confronted with practices that are illegal or highly immoral.

Finally, similar practices (such as the use of letterbox companies) that are used to avoid taxes are also used to circumvent worker's rights and social protection laws; thus, this issue links to a more fundamental question about how to regulate multinational corporations. In relation to the more fundamental changes needed in the international tax system, the tax justice movement is advocating that multinational corporations be seen as coherent entities, rather than a group of unrelated enterprises, and insisting that corporations should be regulated by laws of the countries where they have their real business activity. This aims to address the corporate practice of using international structures and subsidiaries in countries with more lenient laws on taxation and lower working standards and social protection.

7. Conclusions

Public awareness of the magnitude and mechanisms of tax evasion and avoidance has dramatically increased through recent scandals. An opaque and unfair tax system directly affects workers in a number of ways, by putting pressure on public jobs and services through a loss of tax revenues, and leading to a lack of transparency about their employers' financial standing. International loopholes, complex and ineffective transfer pricing rules, and secret tax agreements allow multinational corporations to divert profits and reduce tax payments. Similar mechanisms, such as the use of letterbox companies, are used by multinationals to not only avoid taxation, but also to circumvent workers' rights and social protection laws.

Public policy-makers have responded in part to these scandals; as a result, new policy measures, including public country by country reporting, public registers of beneficial owners of companies and trusts, a reform of international tax rules, and whistleblower protection are currently being considered. But despite strong public support for change, governments are still hesitant when it comes to introducing fundamental reforms. Unless further political pressure is added, there is a risk that policy makers will opt for policy options that tweak the system, but fail to address the real root causes of the problems. The current political discussion provides an important opportunity for trade unions to join the debate and highlight the wide-ranging impacts that these problematic practices have. This is not merely an issue for accountants and tax planners, but for all of society. Civil society organisations and trade unions

6 UK Corporate Governance Code 2016, Section D.1, supporting principles.

need to work together, for example in the rapidly growing Global Alliance for Tax Justice, to explain and advocate for the right policy proposals, and to ensure that they are adopted, implemented and effectively enforced.

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