SHIFTING PROFITS

to avoid taxes and wage increases

This cartoon booklet takes much of its information from another, longer booklet produced by AIDC

Base Erosion and Profit Shifting in South Africa

Corporate strategies to avoid taxes and wage increases

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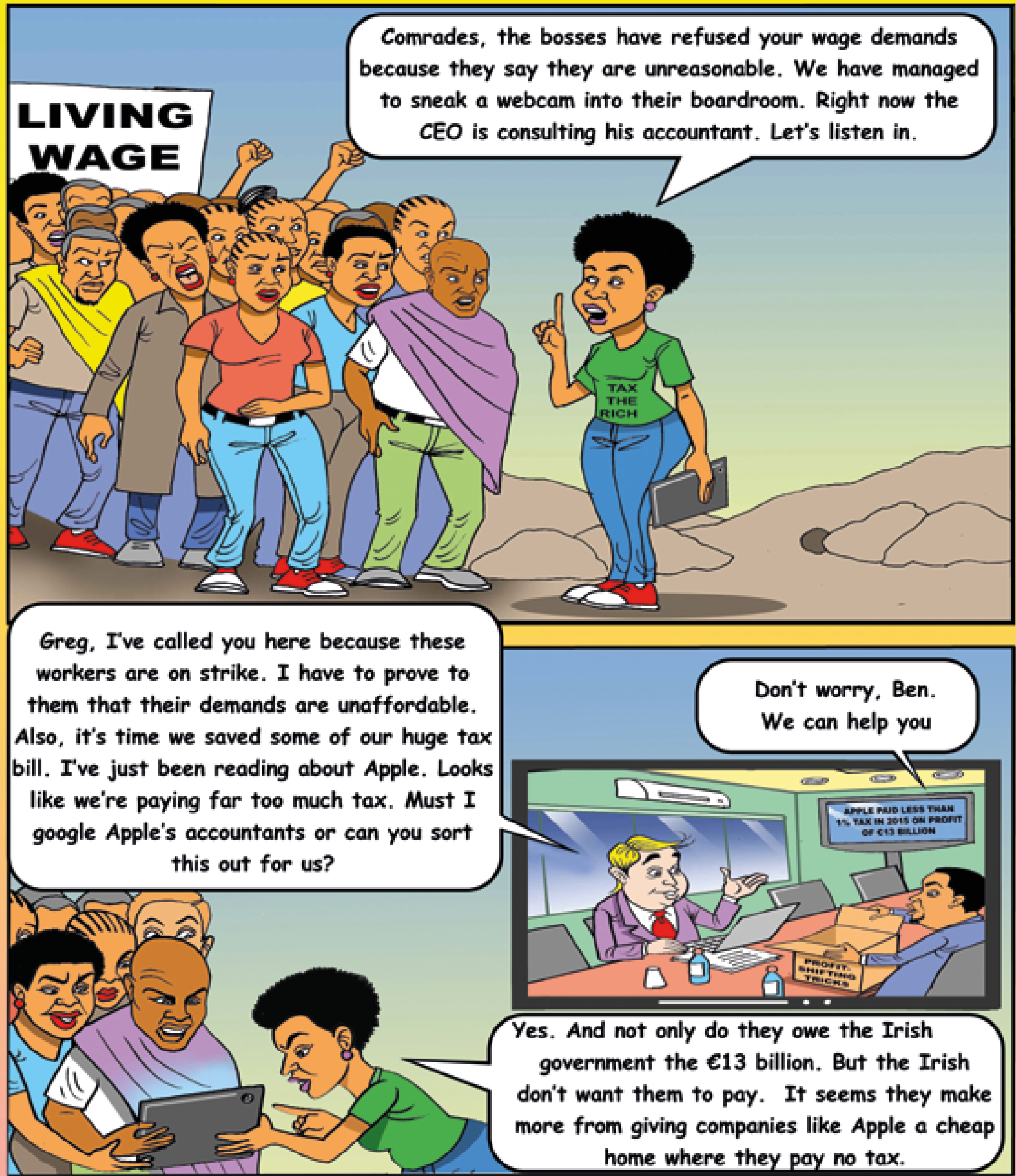
Introduction

Huge corporations like Shell, Apple, Glencore and Walmart have amassed such vast sums of wealth that they are now more powerful than many countries. Of the 100 biggest economies in the world, 51 are transnational corporations (TNCs) not countries. They are increasingly referred to as the new rulers of the world.

These TNCs have used their power to change the rules of the global economy so they can operate in every corner of the globe. They are increasingly out of reach of any national state. As TNCs have grown more powerful, the world has become vastly more unequal. Just 62 people together have wealth of trillions of dollars. That is as much as half the world's population. These 62 individuals are the owners and shareholders of these mega TNCs.

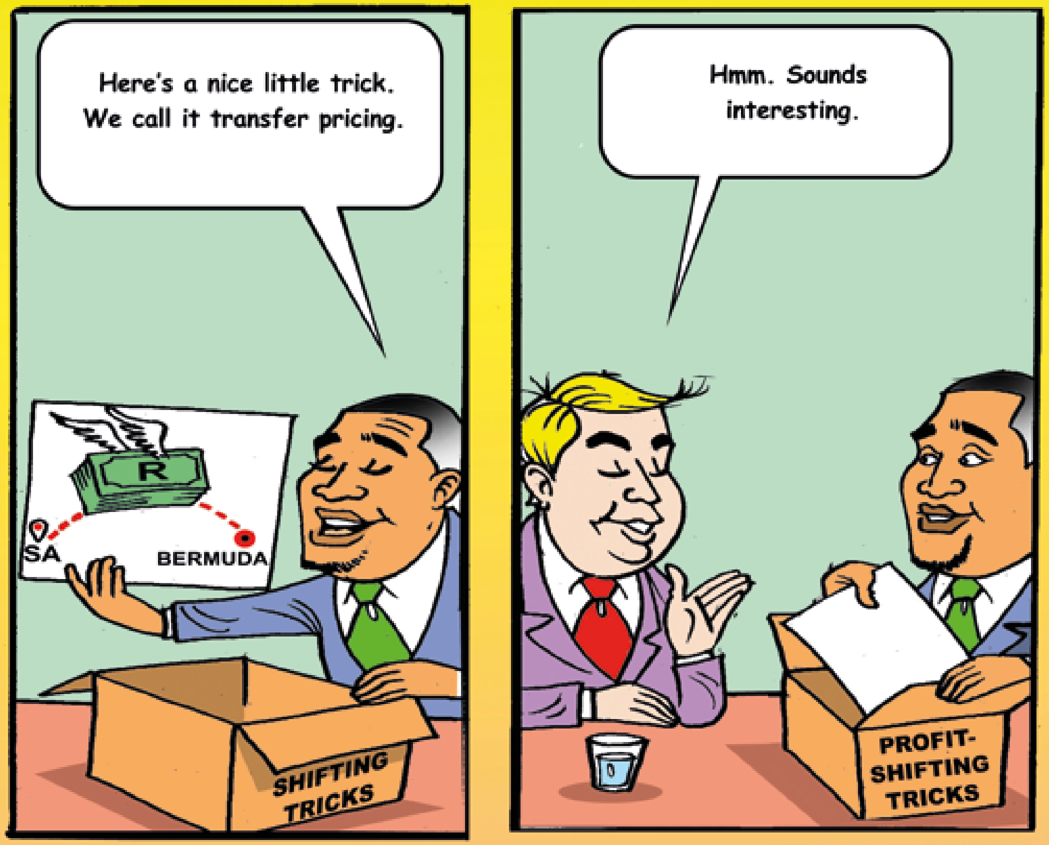
These companies all choose where they locate critical components of their operations. They choose where regulations are friendly, resources abundant, wages cheap and taxes low. Clever TNCs are often legally based in one country, have their corporate management in a second one, their financial assets in a third, and their administrative staff spread over several more. Some of the largest American-born firms — General Electric, IBM, Microsoft, to name a few — collectively hold trillions of dollars tax-free. They do this by having revenues from overseas markets paid to holding companies incorporated in Switzerland, Luxembourg, Bermuda, the Cayman Islands or Singapore. These are countries that have become known as tax havens.

Welcome to the world of smoke and mirrors and corporate deception. It is not just shifting power from states to corporations. It is also impoverishing poor and working people like never before.



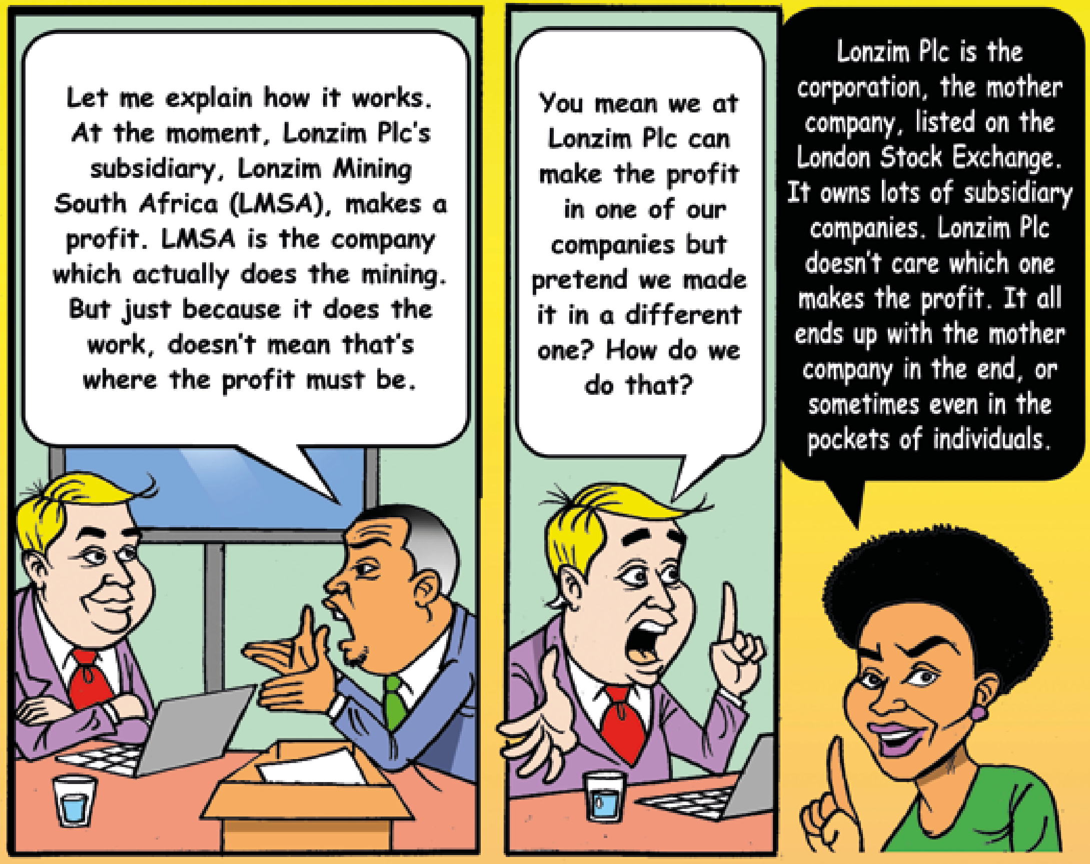
TNCs, with the help of their accountants and lawyers, are shifting vast amounts of money out of the countries they operate in. They have developed an arsenal of tricks to do this. The result is that they avoid paying tax, they fail to invest in the country where they do business, and they shift their profits out of the reach of wage bargaining.

One of the most startling facts of international trade in today's global economy is that almost two-thirds of international trade is not trade at all. It takes place between different divisions of the same corporation.



Their arsenal includes methods that are legal ("licit") and those that are illegal ("illicit"). For the vast majority of the world's people who own no capital, it doesn't matter whether the state calls the methods legal or not. They should all be illegal.

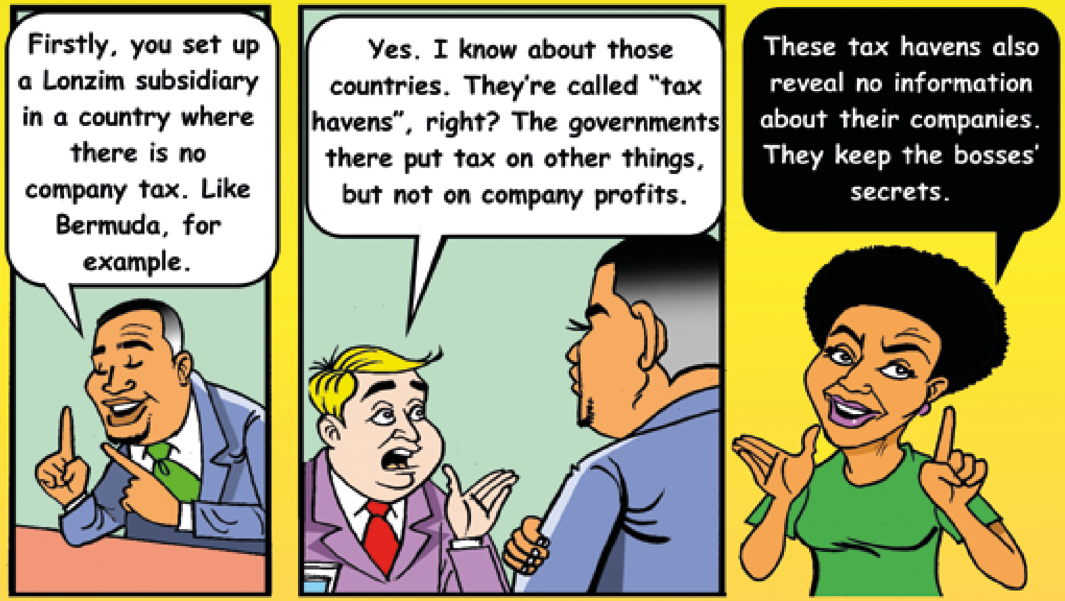
They are a way of filling the pockets of shareholders at the expense of workers and the poor. Every cent the TNCs remove from the country is a cent less to spend on the services we need. And it is a cent less they claim they have available to spend on workers' wages.



When it is illegal, it is called "misinvoicing". When it is legal (or possibly legal) it is called "transfer pricing". Whichever it is, it works the same way.

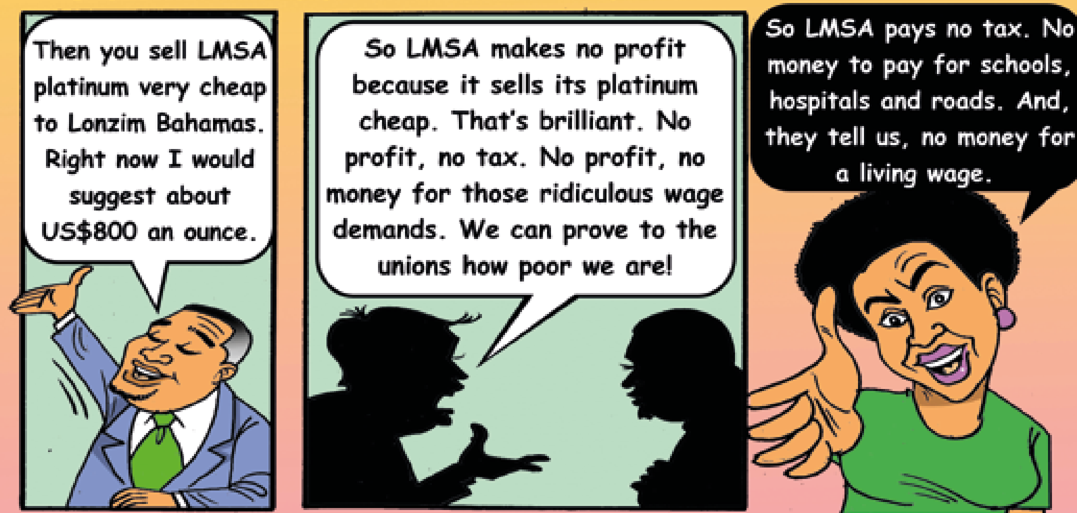
"Global Financial Integrity" (GFI) is a NGO which studies these tricks. GFI reckons that misinvoicing is the way 83% of illicit outflows of capital from poor and developing countries took place between 2004 and 2013.

Here's an example. A car manufacturer such as Volkswagen produces engines in a plant in Bochum Germany and assembles the car in Uitenhage, South Africa. The South African VW subsidiary "purchases" the engines from VW Germany. VW SA may "sell" the assembled car to VW Japan, which then sells the assembled car to the Japanese public. This opens up great opportunities for VW to shift its profits depending on what is most favourable to the company. If it wants to declare less profits in SA it can pay VW Germany more for the engines than normal and charge VW Japan less for the assembled car.

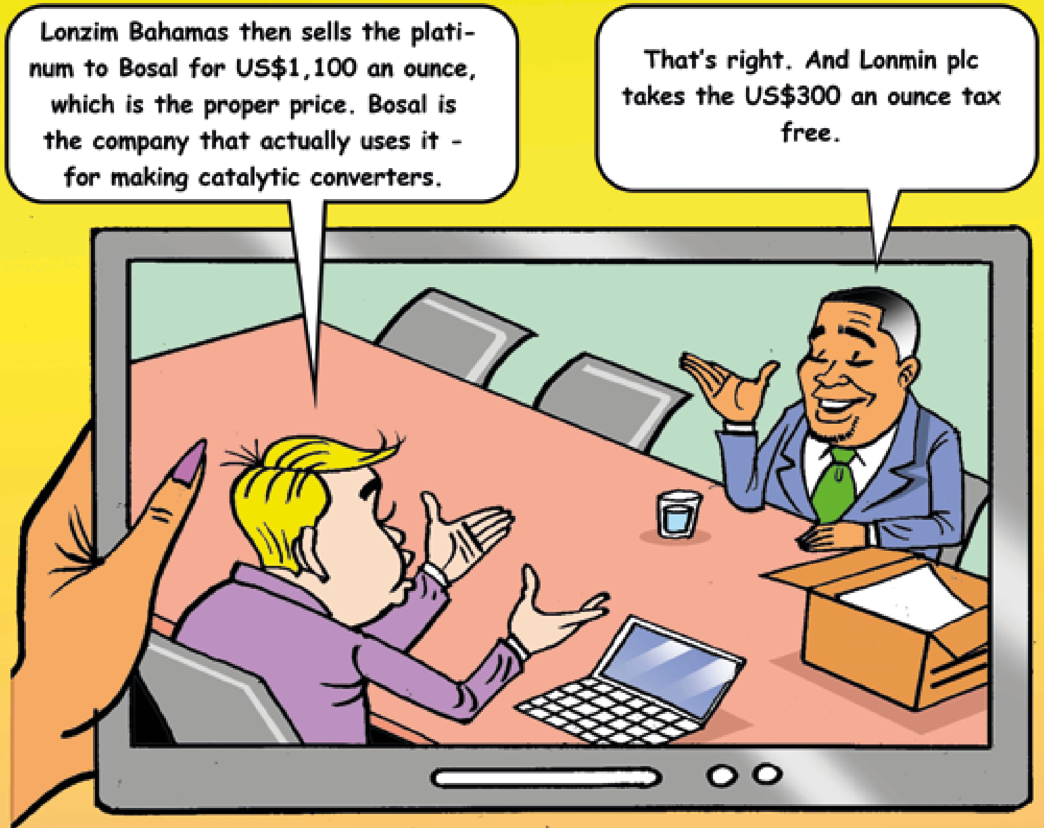


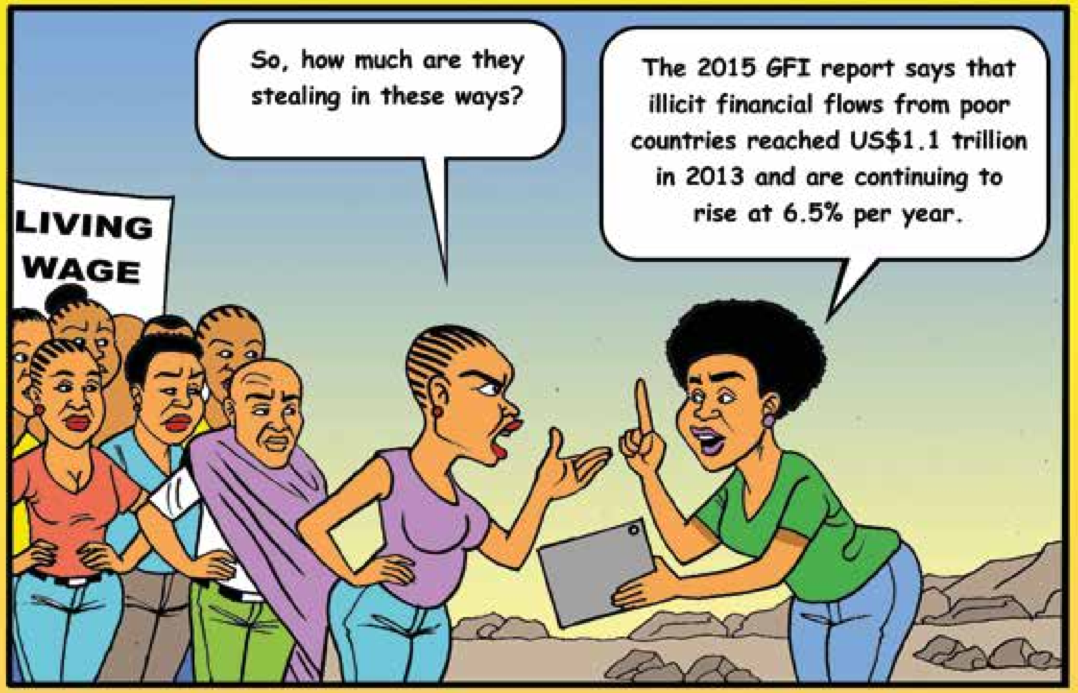
A Canadian business magazine wrote in 2013:

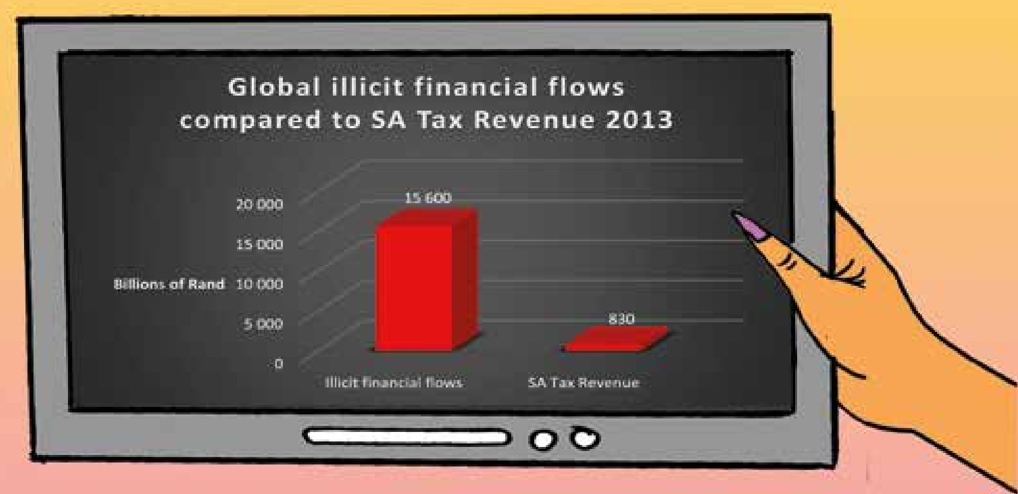
For decades, Canadian companies have flocked to Barbados with their cash in order to legally avoid paying Canadian taxes. If a Canadian company wants to expand its business outside of Canada, it can create a subsidiary in Barbados where it can park its international profits. This way, it legally doesn't have to pay Canadian taxes on those profits.



Companies also do this inside the same country. So, for example, Robertson Winery (RW) transfers its profits to another company in the same group - Roberston Kooperatiewe Wynmakery Beperk (RKWB). RKWB comprises about 30 farms which sell the grapes to RKWB. Each of those farms pays a lower tax than RW because they are small businesses. So when the Group transfers its profits to the farms, it pays less tax. And it claims to have no money for "unrealistic" wage demands.



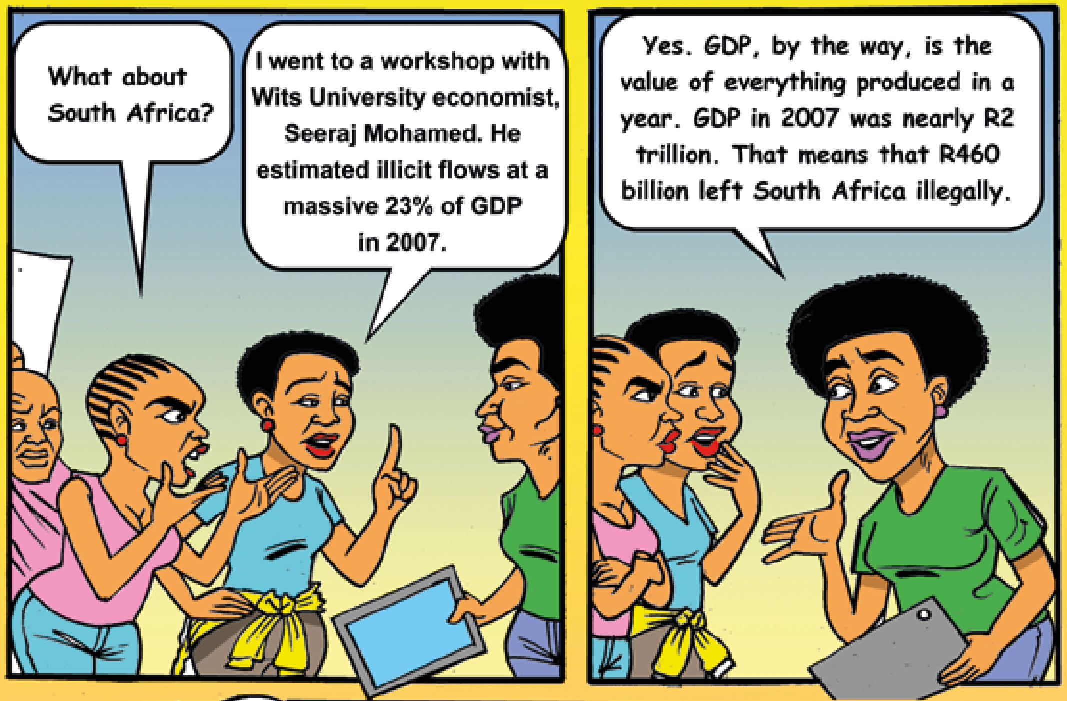


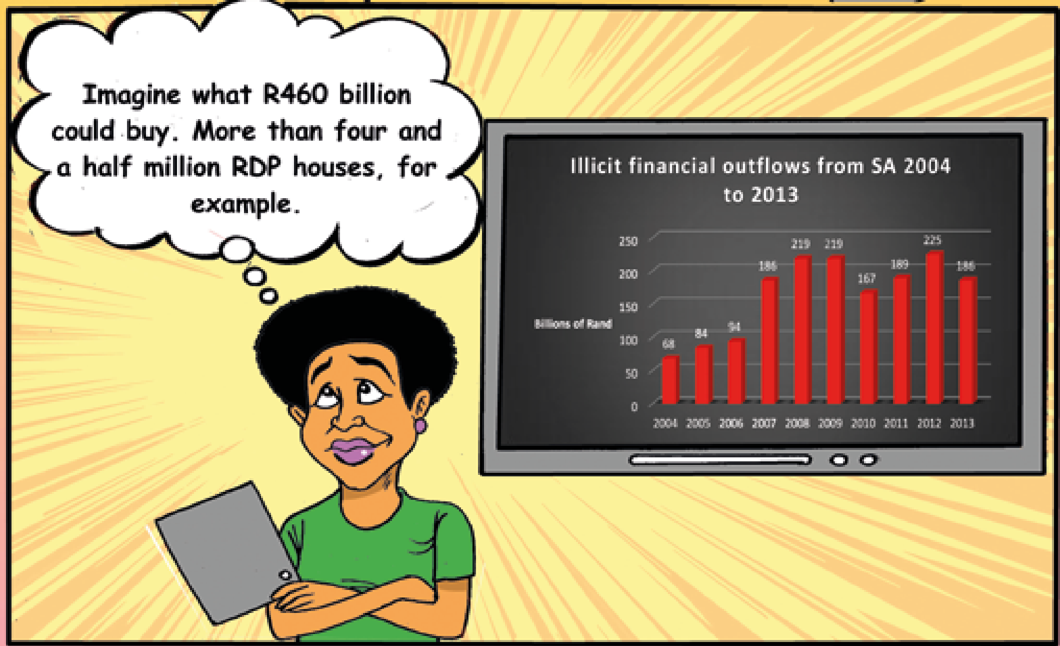


Take the example of De Beers, the diamond mining company. Research by the University of Manchester strongly suggests that De Beers used transfer pricing and misinvoicing worth US$2.83 billion from 2004-12 in order to minimize its tax liability.

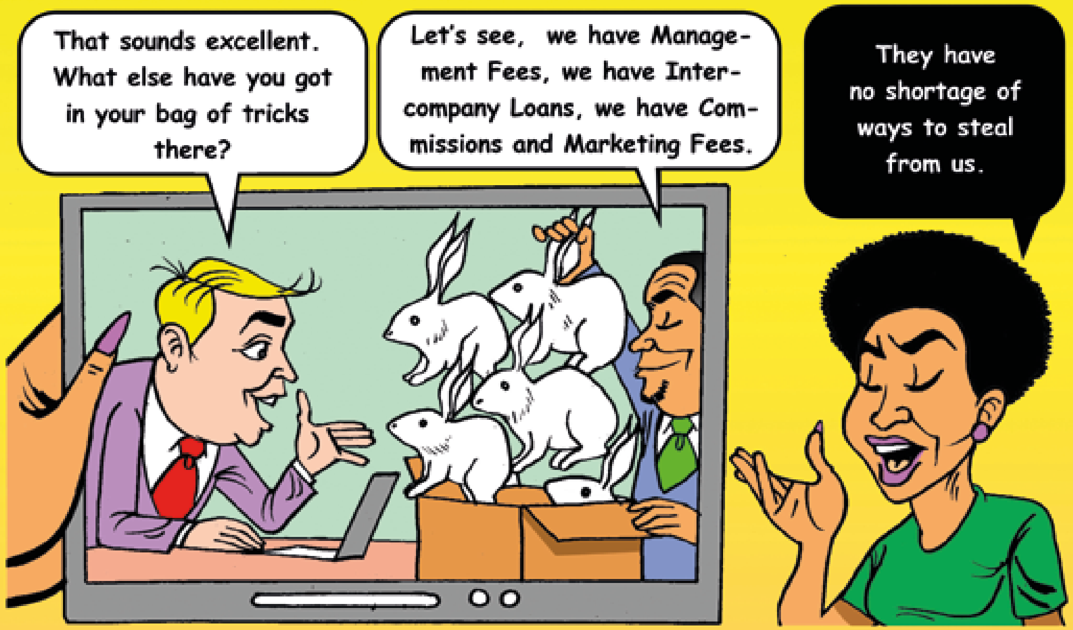
At R15 to the dollar, US$1.1 trillion is about R16.5 trillion. To give an idea of scale, in 2011 South Africa collected R830 billion in tax from all sources. So illicit financial flows from poor countries were 18 times all the taxes collected in South Africa.

These figures do not include vast amounts of money shifted out of the reach of national authorities through all the "legal" methods.

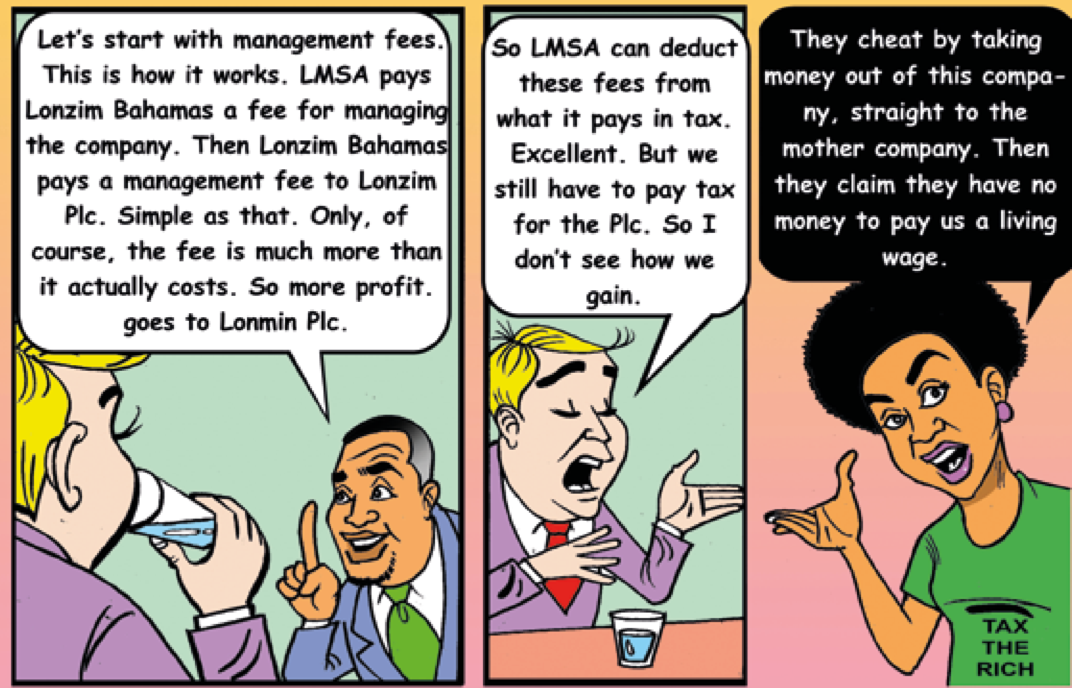


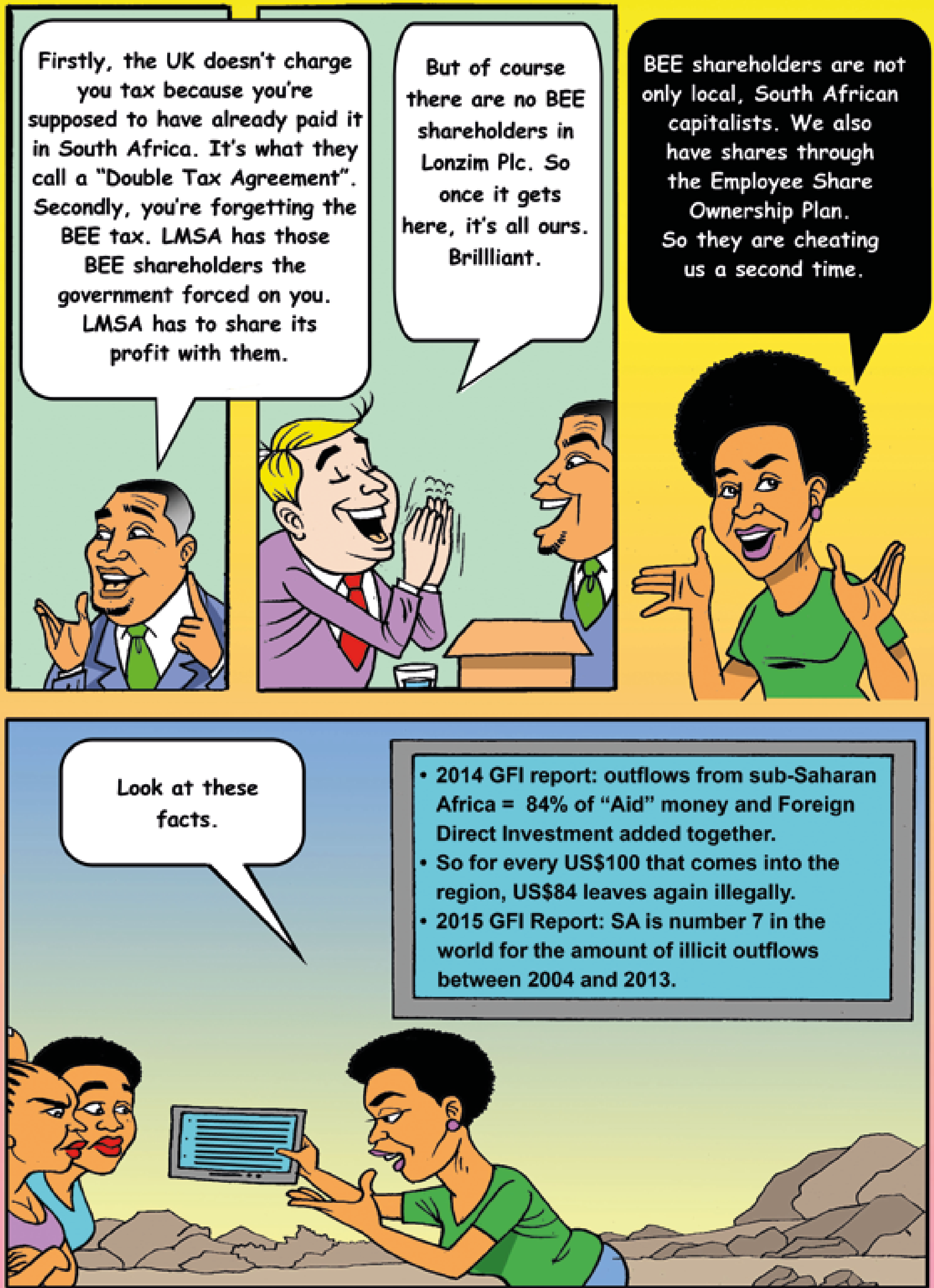


Company tax in 2007 was 29%. If that R460 billion had stayed in South Africa and been taxed, SARS would have received an extra R133 billion, on top of the R580 billion it actually collected. That's 23% more.



If a poor person steals, they go to prison. These companies are stealing more than we can imagine, but their executives and shareholders freely parade the results of their crimes. The more they succeed in stealing by "shifting the profits", the bigger their bonuses.




Firstly, the UK doesn't charge you tax because you're supposed to have already paid it in South Africa. It's what they call a "Double Tax Agreement". Secondly, you're forgetting the BEE tax. LMSA has those BEE shareholders the government forced on you. LMSA has to share its profit with them.
But of course there are no BEE shareholders in Lonzim Plc. So once it gets here, it's all ours. Brillliant.
BEE shareholders are not only local, South African capitalists. We also have shares through the Employee Share Ownership Plan. So they are cheating us a second time.
Look at these facts.
• 2014 GFI report: outflows from sub-Saharan Africa = 84% of "Aid" money and Foreign Direct Investment added together.
• So for every US$100 that comes into the region, US$84 leaves again illegally.
• 2015 GFI Report: SA is number 7 in the world for the amount of illicit outflows between 2004 and 2013.


And then there's the "intercompany loans". Let's say Lonzim Bermuda lends LMSA R100 million. LMSA pays interest on the loan.
Since all your profit is paid back in loan repayments you are able to show zero profit in SA. That means zero taxes and zero wage increases.
And of course LMSA can deduct the interest charges from its profits when it declares for tax. Lovely.
They sometimes call this "thin capitalisa-tion" because the com-pany raises money through loans instead of through selling shares.
TAX THE RICH

Eastplats International Incorporated (EII) is a company in Barbados. Barbados is a well-known tax haven. While its tax rate for "regular companies" is 25%, it has a special rate for "international companies" – between 0.25% and 2.5%.

EII is owned 100% by Eastern Platinum Ltd in Canada. EII loaned R2.9 billion to Barplats Mining, also owned by EPL Canada. The loan (on 31 December 2011) helped a lot to make Barplats Mining Ltd perform badly.

- **In 2010 Barplats deducted R208 million for the loan from its taxable earnings. The result was it claimed a loss of R46.5 million instead of a profit of R162.7 million!**
- **In 2011, Barplats deducted another R226 million in interest paid. That's more than half of its R390 million loss before tax in 2011.**

- **In 2006 Western Platinum Ltd (WPL), a subsidiary of Lonmin, paid R248 million in "commission" to a company called WMSL in Bermuda. In 2007 it paid R276 million. Bermuda is a tax haven.**
- **WPL paid over US$330 million in "sales commissions" between 2002 and 2012. This is equivalent to R2.5 billion at the average exchange rates for these 11 years.**
- **WMSL is 18% owned by the BEE partner Incwala, and 82% by Lonmin Plc.**

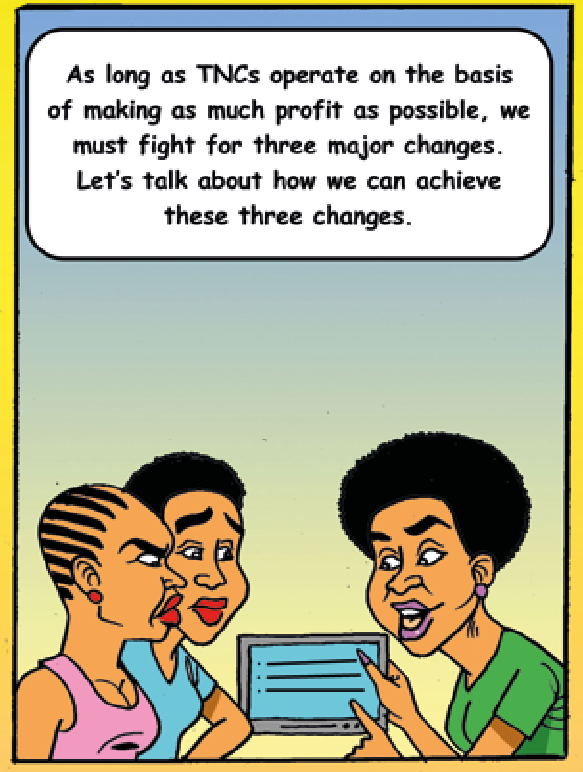
Between 2008 and 2012, the Lonmin Group in South Africa paid US$162 million (more than R1.2 billion at R15 to the dollar) in "commissions" to a Lonmin Plc subsidiary in Bermuda. That would have been enough, for example, to give Rock Drill Operators (RDOs) an increase of between R3,500 and R4,000 in 2012. In 2012, the Lonmin RDOs demanded R12,500. The company could have paid the R12,500, if it had not paid the "commissions".

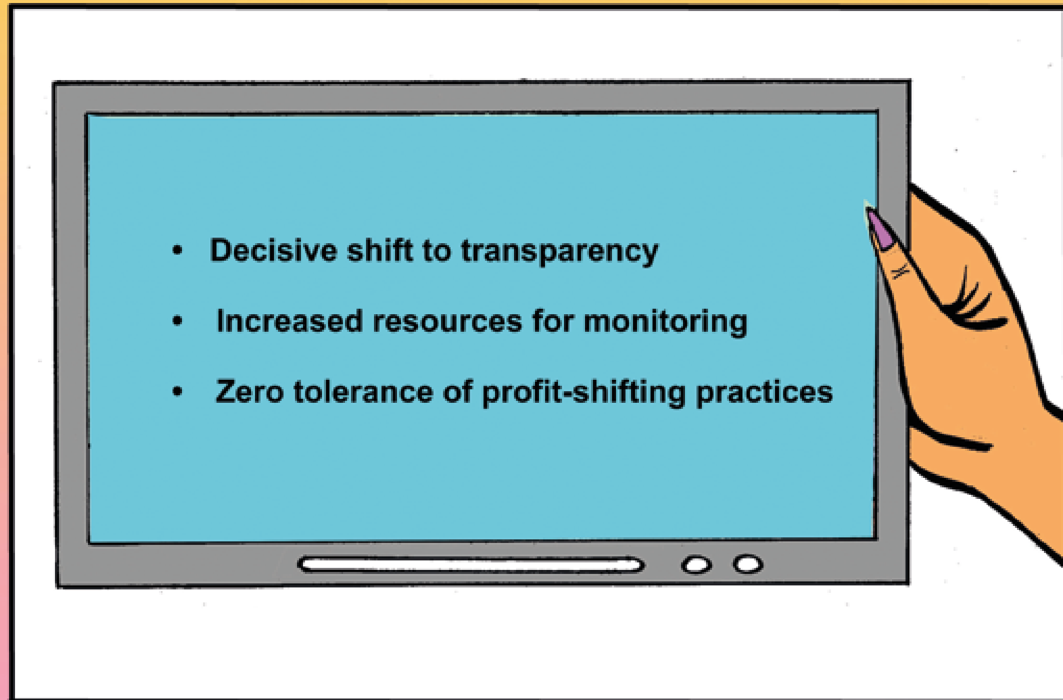
In fact, the effect on wage levels is much bigger than the effect on tax revenues. If a company moves US$100m out of the country, that entire amount is removed from the pot for wage negotiations. But with a tax rate of 28%, the loss in tax is US$28m not US$100m.

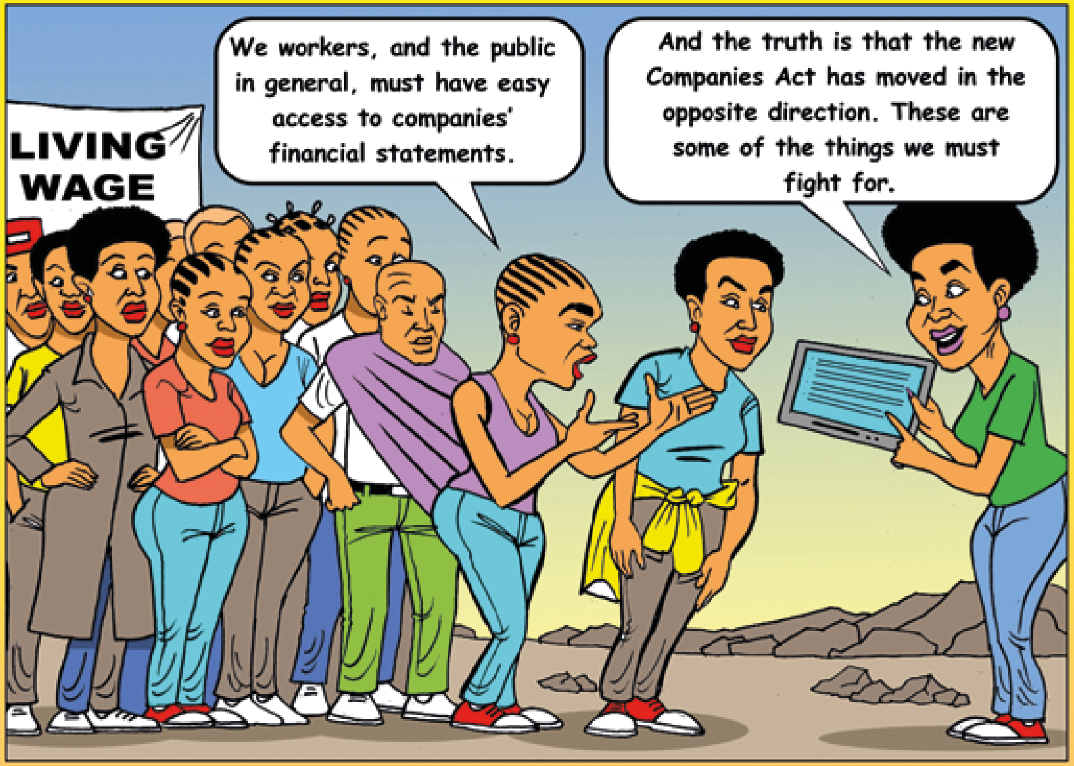
In 2012, Lonmin Plc chose to continue implementing these profit-shifting arrangements. They cost the local subsidiaries well over R400 million per year. At the same time, they failed to meet their SLP obligations. For example, they committed themselves to building 6,000 houses. In fact they built three.

If the company had made different decisions, the Marikana disaster could have been avoided.

This problem is not going away. It is a growing problem. It poses a great danger to the future of South African democracy.







- Amend Companies Act: all companies TNC-owned must publish annual financial statements.
- Only truly small companies (not TNC subsidiaries) exempted.
- Must cover "external" companies (SA companies set up by foreign companies)
- Must also include foreign companies which receive regular income from fellow company in SA.
- Responsibility must lie with parent company.

- More resources for the CIPC.
- CIPC must be given resources to oversee compliance and report on violations.
- SARS must have resources to defeat power of corporations and large auditing firms.

- CIPC is the Companies and Intellectual Property Commission. It is responsible for registering companies.
- SARS is the South African Revenue Service.

There has been research into a number of individual cases and it is clear that this will make a big difference. And it should not damage the "investment climate".


We must have research which gives concrete examples and details. Companies must be named.
We must be able to quote numbers.
We must mobilise the power of independent research, investigative journalism and pressure from the public against the power of the corporations.
LIVING WAGE
We must mobilise the power of organised workers. And we should link up with workers in other parts of the world. We must be like these TNCs and operate as a unified workforce across the world.
TAX THE RICH


Trade unions should insist on seeing the financial statements of the subsidiaries where their members are employed.
This strike will continue until Lonzim opens the books - all the books, of the whole corporation not just this South African piece.
TAX THE RICH

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