HOW TO GET AWAY WITH TAX EVASION ?

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316 billion dollars. This is how much the so-called GAFA (Google, Apple, Facebook, Amazon) made in 2013. This is roughly equivalent to the GDP of Denmark, which ranked 35th in the world at that time. And yet in Europe Google benefits from an estimated corporate tax rate between 0,36 % and 0,82 %, and Facebook between 0,3 % and 0,01 %!

Behind these Big Four tech companies, to which can be added Microsoft, Starbucks… lie 4 companies with different business model and fiscal strategies. Today, one is led to an inevitable conclusion: a simple tax plan is not compatible with this multiplicity of situations. Someone should go and tell that to the European Union. For this reason, how is it remotely possible to pay almost no taxes? We have a few things to learn from tech giants…

Tax legislation in Europe, not much to be afraid of

Had the European Union built itself around a comprehensive tax plan, things would certainly be different. While the average corporate tax rate is around 19,5% throughout Europe, France goes up to 33,33% and Ireland down to 12,5%. Plus, there are some specific tax rulings for several states such as the Netherlands. Yet, Finance Ministers in the eurozone cannot reach an agreement on this issue. Despite their will to strengthen the Union, two sides clearly stand out: countries like Ireland or Luxembourg want the tech moguls they attracted to stay within their soil, whereas Germany and France would go for a harmonized tax plan. What better way for the Big Four to put their plan into action?

In these instances, more difficulties stack up for Eurozone members. On top of classic fiscal evasion, there are also strategies of tax avoidance which are not peculiar to the digital technology industry. But with these companies the quintessence of what is possible regarding legal fiscal optimization is reached. Furthermore, the intangible nature of these activities gives GAFA more freedom to avoid the tax system of a territory. Indeed, they can choose the billing location for their services. What it means is that they confine their income to where the tax system is more accommodating – either because of laws or because of other tax ruling agreements. Google, Apple and Facebook send large fractions of their income to Ireland, as well as Airbnb and Microsoft, while Amazon declares its revenue in Luxembourg. Why is it easier than in other activities? Because the notion of permanent establishment, meaning men and machines on a territory, is ineffective in the digital technology industry. What a good time to be a multi-billion-dollar internet pioneer!

When it comes to avoiding paying taxes, two words come to mind: transfer prices. Nobody cannot do anything about it and it is perfectly legal. They are the property rights (brands, permits…), the price of which is set in an arbitrary way, allowing the company to move the costs and the profit where it wishes to do so. According to Reuters, Starbucks charges its international subsidiaries royalties, of up to 6 % the amount of the bulk sales of every store, and in addition to that, a 25,000-euro fixed price the opening year of the shop. Since 2011, German and French Starbucks shops have been declaring losses, although its former CEO Howard Schultz guaranteed they were profitable. Where did the money go then? One thing is for sure: neither the governments nor the EU can battle against dematerialized flows. Amazon can provide a service without physical presence on the territory. Facebook exploits personal data for free, whereas in all other sectors the intermediate phases are going to generate taxes where they are realized. Airbnb and Uber produce services alongside the consumers – rents, fares… GAFA's advice to you: be immaterial.

The winner takes all, except taxes

Imagine: making $11 billion and keeping 99,8% of them. Wonderful, isn't it? This is the lesson Google taught Europe. But the American group is just another example among well-refined fiscal strategies from the giant tech companies. They involve two fiscal mechanisms, that I will be explaining for informational purposes only: the double Irish arrangement and the Dutch sandwich scheme.

The double Irish arrangement, as the name suggests, relies on the fact that an Ireland-based company is exonerated from Irish taxes on profits if its executive holding company is not on Irish soil. Google for instance set up its holding company, Google Holdings Ireland, as contingent to the fiscal legislation of Bermuda. And therefore, exonerating it from paying any taxes on profits at all, since Bermuda does not apply such legislation. On the grounds of intellectual property rights, all profitable activities that took place in Europe are balanced with the payment of fees to Google Holdings Ireland. The Mountain View firm accounts them for a cost, consequently deductible from its profit tax. For the sake of information, those fees were estimated at $5,4 billion in 2014. Imagine how much that represents in terms of views on YouTube…

On top of this, Google takes advantage of a right from Irish law according to which fees bound to the exploitation of a property right are totally exempted from imposition if they are transferred inside the European Union. A transfer outside of Ireland would result in a small taxation. As a result of which the American group decided to insert between its Irish company a Dutch company, Netherlands Holdings BV, through which transits the payment of fees. In the Netherlands, the tax is non-existent on the intellectual property royalties. For historic reasons the intellectual property has always been exempted there. This is the cornerstone for the so-called Dutch sandwich. Whichever GAFA is considered the European Commission has estimated at between €500 million and €1 billion the tax revenue losses due to those fiscal schemes. When it comes to the internet, "the winner takes all". Since gains in digital productivity are enormous, it is the biggest player who hits the jackpot. In this context the tax system should take it into account. But as of today, in the EU, it does not.

What to expect from the European Union?

While mechanisms of fiscal optimization used by the large companies of the digital technology industry are more and more slandered, the EU struggles to find a suitable solution. Every year, millions of dollars are not collected from potentially taxable revenue from GAFA – or even from you now. The fiscal decrease is such that we may wonder if refinement is adapted to this problem. At this stage, is the quicker, the better?

To solve this issue, two solutions are open. The first one comes from the European Commission. It advocates a wide access of the subject. The goal would be to standardize corporate taxes at a European level. It rekindles the idea of a common and strengthened basis for profit taxes on companies in Europe, to catch up GAFA. Thus, it offers to tax the whole of European profits, therefore removing the temptation for the companies to optimize this aggregate according to their digital presence – and not just physical presence anymore. Although this could be an effective plan, the European Commission only tackles the tax on profits and the fate of GAFA is bound to a unanimous agreement between European states. Given the current state the EU is, this would likely leave the Big Four a few years break. That should not bother them very much: after all, time is money.

The more creative answer to tax evasion could also be what Germany, Italy, Spain and France enforced: a tax on turnover generated in a country and not on profits anymore. This project aims at the digital technology majors, aka GAFA, Microsoft and co. First European states would have to establish criteria for a digital company. Besides, there would likely be a risk of double taxation. What is positive is that the following countries have joined this initiative: Bulgaria, Austria, Slovenia and Greece – and not Ireland obviously… Some suggest that the EU should lower the rates and get back the taxation of all these profits which leave abroad. Inherently the question of an European fiscal legislation goes far beyond a meek change of rate.

Ultimately getting away with tax evasion is not that hard, as long as you make over billions of dollars… for now. The fact that GAFA pay very few taxes in Europe, if not none, exposes the flaws of the European Union in common legislation. Then again, the Big Four (Microsoft, Uber, Airbnb, Starbucks… included) pays on average 22 times less taxes than regular companies in the EU. That amounts for lots of pints of Guinness!

If the progressive taxation of income in specific sectors seems fit, it must not put off the economy: the tax system ought to be rational. As for GAFA's fiscal strategies, they will perhaps change their mind after having to pay billion-dollar fines to the EU…