A Legitimate Tax Plan for Minimization of Taxes for Multinational Technology Companies.

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Abstract- This paper constructs a legitimate tax plan that could be used by a multinational technology company to minimize its corporate taxes. Multinational technology companies minimize their corporate taxes by using a number of strategies such as taking advantage of the loopholes in the tax codes where they earn cross border incomes, using intellectual property arrangements to locate subsidiary companies in low tax jurisdictions and using techniques such as "Double the Irish with a Double Dutch Sandwich". Historically the international taxation of multinational companies has evolved over the last 100 years and organizations such as the G.8 and the OECD have worked tirelessly to harmonize the international taxation issues among nations. The environmental aspects of international taxation indicate that multinationals have greatly benefited from illegitimate tax minimization schemes. It is recommended that multinational technology companies use legitimate strategies to minimize their corporate taxes. Such strategies include the creation of subsidiary companies in various countries with no tax residency status, use of tax consultants to legally exploit the discrepancies in tax residency regulations and lobbying their governments or use bilateral treaties for tax credits of foreign corporate taxes paid by subsidiary companies.

Index Terms- International taxation, Multinational technology company, Tax minimization, Taxation plan,

I. Introduction

International taxation is a major component of the global business and for a long time multinational companies[1] have been minimizing their tax obligations by using offshore tax strategies which have enabled them to maximize earnings and safe guard the capital of their companies (Holtzblatt, Geekie & Tschakert, 2016). International companies engaged in technology, healthcare and financial services are some of the volatile industries where tax avoidance, evasion and financial fraud statement instances have been common due to schemes by these industries to minimize their tax payment obligations (Beasley, Carcello, Hermanson & Lapides, 2006). As observed by Devereux, Griffith and Klemm (2002) and OECD (2014) tax revenue is important because it enables countries to finance their national budgets and these budgets provide a vehicle for implementing national programs and infrastructural development. The nature of multinational companies allows them to engage in international business operations within multiple tax jurisdictions (Gross & Kujawa, 1992) where they minimize their tax payments. Several authorities such as Holtzblatt, Geekie and Tschakert (2016) as well as OECD (2014) have argued that multinational companies minimize their tax payments by taking advantage of the loopholes in the tax codes of the countries where they have established business interests or locating in low tax jurisdictions. Although some of the tax minimization strategies employed by multinational companies are legitimate, it is important to note the illegitimate tax minimization strategies deny countries tax revenue in billions of dollars annually (Taylor, Richardson & Lanis, 2015). For instance, such tax minimization strategies have led to studies such as Melnitzer (2006) and Smith (2000) where multinational corporations such as Apple Inc., Hewlett-Packard, Microsoft Corporation and Starbucks have all come under scrutiny due to tax avoidance schemes such as transfer pricing[2], creation of non-tax resident companies[3] anywhere, and taking advantages of discrepancies between the various country tax residency regulations.

Therefore, the purpose of this paper is to present a theoretical argument as how to construct a legitimate tax plan that minimizes taxes for a multinational technology company. The rest of the paper is organized as follows: In section 1.1, a Historical Perspective of International Taxation is presented after which the Current State and Environmental Statements are discussed in sections 1.2 and 1.3. In section 2.0, a Discussion of the Facts and Issues Related to International Taxation is presented. Section 3.0 of the paper presents the Analysis Facts and Issues raised in the previous section whereas the last two sections 4.0 and 5.0 of the paper present the Conclusions and Recommendations of the study.

1.1 HISTORICAL PERSPECTIVE OF INTERNATIONAL TAXATION

International taxation has evolved over the last 100 years and during this period there have been efforts by various parties to ensure harmonization of residence[4] and source[5] taxes paid by multinational companies so as to prevent double taxation and double non-taxation (Avi-Yonah, 2005). According to Avi-Yonah

[1] Multinational companies operate simultaneously in several countries.
[2] Transfer price is the price paid by the affiliate for an intrafirm sale of some product or service.
[3] In countries such as Ireland it is possible to set up non-tax resident companies.
[4] Residence tax relates to where the company is based.
[5] Source tax relates to where the income is earned.

(2005) the international taxation system in the United States (US) has gone through four stages of development. In United Kingdom (UK) during the 20th century competition for taxable income among nations emerged which led to a rise in taxation levels which resulted into international double taxation on the same income for multinational companies (Mollan &Tennet, 2005). The double taxation issue created a challenge to multinational companies and triggered the use of tax minimization strategies and relocation of corporate domicile (Mollan &Tennet, 2005). Furthermore, Voget (2011) posits that during the period 1997-2007, 6% of the multinational companies relocated their headquarters to other countries due to international taxation issues.

1.2 CURRENT STATE OF INTERNATIONAL TAXATION

Multinational companies have become major players in the global business such that their international taxation and tax minimization schemes are continuously an ongoing hot debate for tax policy makers and academics (Eggert & Kolmer, 2004). For instance Holtzblatt, Geekie and Tschakert (2016) as well as Duhigg and Kocieniewski (2012) have extensively argued that many technology multinational companies are utilizing intellectual property[6] arrangements to shift their businesses to low tax jurisdictions with aim of minimizing their tax burdens. Intellectual property arrangements create transfer pricing issues and recent evidence shows that there is a positive association between multinationality, tax haven utilization and intangible assets with transfer price aggressiveness (Taylor, Richardson & Lanis, 2015).

Furthermore, Devereux, Griffith and Klemm (2002) have provided evidence that statutory corporate income tax rates within the European Union have been undergoing reforms and have fallen from 48% in the early 1980s to 25% currently in countries like Germany in order to encourage compliance and investments by multinational companies. In 2013 the G.8[7] Summit in Lough Erne-UK advocated for information sharing by tax authorities worldwide with the aim of eliminating tax minimization strategies employed by multinational companies (International Monetary Fund, 2013). The OECD[8] member countries have also been working tirelessly on the international tax policy for many years (Avi-Yonah, 2003).

1.3 ENVIRONMENTAL STATEMENT FOR INTERNATIONAL TAXATION

Tax avoidance and evasion by multinationals is a serious issue in international taxation due reduced revenue earnings by many countries and the need for tax accountability (OECD, 2014). Furthermore, reduced barriers to international capital flows and integrated capital markets have created opportunities for multinational companies to widen their operations (Desai, Foley & Hines Jr, 2006). At the same time Duhigg and Kocieniewski (2012) have argued that today one of the most important industries in world is technology which faces taxation systems that are different across countries. Tax incentives such as tax holidays or liberal policies are useful in attracting multinational firms to various investment destinations. For instance, Ireland has tax policies which attract multinational companies to her jurisdiction in return for provision of local employment (Duhigg & Kocieniewski, 2012).

Extensive research has been done on international taxation of the US multinational companies. For instance, Beasley, Carcello, Hermanson and Lapides (2006) investigated financial fraud statement instances for the period 1987-1997 in technology, healthcare and financial services of 200 multinational companies and reported that all the three industries had weak corporate governance systems which exacerbated financial fraud statement instances leading to tax evasion. The tax and incentive tradeoffs in multinational transfer pricing study by Smith (2000) revealed that multinational companies use transfer pricing for tax minimization and managerial incentives. Furthermore, empirical findings by Taylor, Richardson and Lanis (2015) from 286 publicly listed US multinational companies over the period 2006-2012 demonstrate that through aggressive transfer pricing firms can obtain tax benefits by utilizing tax heavens and intangible assets. Furthermore, the Holtzblatt, Geekie and Tschakert (2016) study emphasizes the numerous international taxation minimization and reporting strategies used by technology companies and about US dollars 1.2 trillion was in 2012 reported to have been held abroad by the 100 largest companies in the US.

From the foregoing discussion it is evident that technology companies along with other volatile industries have benefited from tax minimization and reporting strategies by exploiting the weaknesses in the tax codes of the countries where they operate.

II. DISCUSSION OF FACTS AND ISSUES OF INTERNATIONAL TAXATION

2.1 International Taxation Framework

The international taxation is based on a framework which traditionally guides the taxation process worldwide. The OECD (2014) designed a comprehensive framework for international taxation which is based on the following principles: i) International Equity Principle which ensures equitable share of tax revenues across borders. The international taxation system is based on the source and residence concepts which are guided by the international equity principle. The place of incorporation or place of effective management or a combination of the two systems are used to determine the residence of a company for cross border taxation of income while income from domestic sources is taxed worldwide tax[9] and territorial tax[10] systems (OECD, 2014). ii) Flexibility Principle whose aim is to have a tax system that has capacity to embrace the technological and commercial advancements. iii) Effectiveness and fair principle which is aimed at avoiding double taxation and non-taxation. iv) Efficiency principle which emphasizes minimum tax compliance costs for governments. v) Certainty and simplicity principle which

[6] Intellectual property is an intangible corporate asset which includes patents, trade secrets, copyrights and trademarks.
[7] G.8 is a group eight most industrialized countries in the world
[8] OECD is Organization for Economic Co-operation and Development.
[9] Worldwide tax system subjects the country residents to taxes on income derived from sources in or outside the country.
[10] Territorial tax collects taxes only on the income earned within the territory.

advocates for simple and clear tax rules for the tax payers. iv) Neutrality principle which supports uniformity in tax principles for all types of businesses whether electronic commerce or conventional forms.

2.2 TAX PLANNING BY MULTINATIONAL TECHNOLOGY COMPANIES

Several researchers such as Holtzblatt, Geekie and Tschakert (2016), Melnitzer (2006), OECD (2014), Smith (2002) and Taylor, Richardson and Lanis (2015) have argued that, multinational technology companies have been over the years planning their tax payments by taking advantage of the loopholes in the tax codes of countries where they have business interests and shifting their business operations to low tax jurisdictions to minimize taxes. Tax code loopholes and tax havens have enabled the parent multinational technology companies to sell rights of their intellectual properties to controlled foreign companies[11] at artificially low prices which create transfer pricing problems (Holtzblatt, Geekie & Tschakert, 2016). Furthermore, Gross and Kujawa (1992) identified the following as the motivating factors for using transfer prices by multinational technology companies: i) The taxes in each country ii) Government imposed price restrictions iii) The risks of holding funds in a given currency and country. Multinational technology companies have been using the above methods to earn a big percentage of their profits from overseas subsidiaries (Holtzblatt, Geekie & Tschakert, 2016). The digital nature of some of the multinational technology companies enables them to transact business activities without their presence in foreign countries (Jacobs, Spengel, & Schäfer, 2003). Other multinational technology companies for example Apple Inc. have employed the "Double Irish with a Double Sandwich" strategy to decrease her tax obligations (Holtzblatt, Geekie & Tschakert, 2016).

III. ANALYSIS OF FACTS AND ISSUES IN INTERNATIONAL TAXATION

3.1 International Taxation Framework

Duhigg and Kocieniewski (2012) along with OECD (2014) have asserted that, the virtual nature of multinational technology companies poses a serious challenge for international taxation of these companies due to inability of the tax policy makers to apply the source and residence concepts of taxation to such companies. Additionally, OECD (2014) posits that multinational technology companies possess intangible assets and it is not clear how they add value and where the value creation occurs. Furthermore, the virtual nature of the multinational technology companies implies that while most of the key personnel can be located in the country of incorporation of the parent company, the parent companies can make or provide most of their goods and services by using foreign subsidiary companies (Holtzblatt, Geekie & Tschakert, 2016).

3.2 Tax Planning by Multinational Technology Companies

As advanced by Duhigg and Kocieniewski (2012) as well as Holtzblatt, Geekie and Tschakert (2016), the transfer pricing rules allow multinational technology companies to transfer intellectual properties to low tax jurisdictions and has enabled these companies to exploit the weak home country transfer pricing rules and amass billions of dollars in tax savings. One strategy which is widely used by multinational technology companies to minimize their tax obligations is the Double Irish with a Dutch Sandwich strategy (Holtzblatt, Geekie & Tschakert, 2016). Ireland is one of the countries where favorable international taxation arrangements have been given to multinational technology companies in return for creation of employment opportunities for the local population in Ireland (Holtzblatt, Geekie & Tschakert, 2016). The Double Irish with a Double Dutch Sandwich tax minimization strategy has been used by a number of multinational technology companies such as Apple Inc. and according to Holtzblatt, Geekie and Tschakert (2016) it is applied in the following way: 1) The parent multinational company transfers earnings into Irish and Dutch subsidiaries 2) The Irish and Dutch subsidiaries transfer the same earnings to the Caribbean tax haven corporations. The application of the Double the Irish with a Double Dutch Sandwich tax minimization strategy is illustrated in Figure 1. In this figure arrow A represents license to use intellectual property, while arrow B represents royalty payments for the use of the intellectual property. Arrow C represents the intellectual property sub license and arrow D designates royalty payments.

[11] Controlled foreign companies are companies with 50% or more owned by the parent company shareholders.

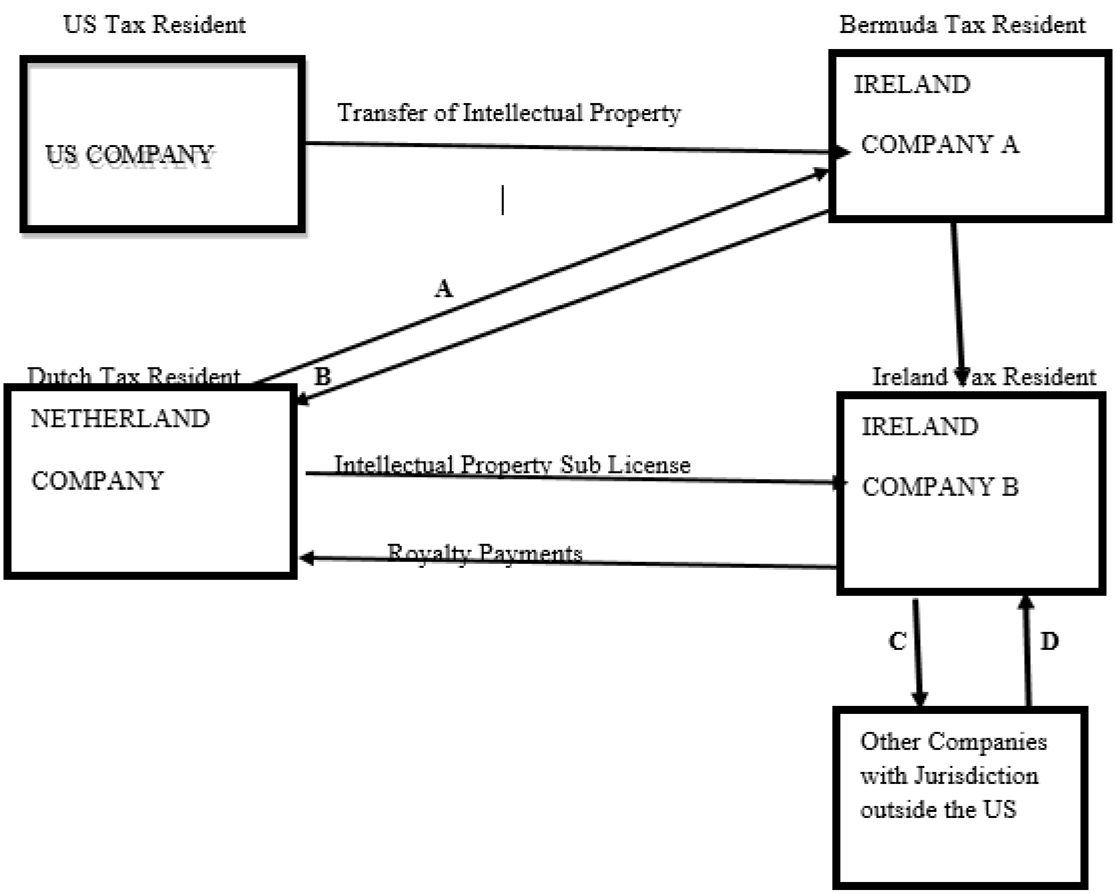

Figure 1: The Double Dutch Sandwich Tax Minimization Strategy (Holtzblatt, Geekie & Tschakert, 2016)

IV. CONCLUSIONS

Multinational technology companies can minimize taxes by exploiting the loopholes in the tax codes in the jurisdictions where they have investment interests. They can also deliberately transfer intellectual properties to their subsidiaries in low tax jurisdictions so as to minimize their tax obligations. Some multinational technology companies have employed the Double the Irish with a Double Dutch Sandwich strategy to minimize taxes.

V. RECOMMENDATIONS

Multinational technology companies can minimize corporate tax by adopting any of the following strategies:

1. Multinational technology companies could create subsidiary companies in locations such as Ireland without management or control from that country and qualify for the no tax residency status in Ireland. In such a situation the multinational technology companies could benefit from the tax incentives in Ireland and minimize their taxes. The assumption here is that tax incentives exist in Ireland.
2. Multinational technology companies could use tax consultants to legally exploit the discrepancies between the tax residency regulations of the home country and the other countries where they have business interests. This strategy could enable the multinationals to allocate a big percentage of their profits where the tax rates are much lower.
3. Multinational technology companies could lobby the respective governments for tax credit on foreign incomes Alternatively, bilateral tax treaties between the home country where the parent company is located and other countries where the parent company has direct investments could be used with the aim of allowing the parent company tax credit for the foreign corporate taxes paid by the subsidiaries.

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