Ending the Free Ride

Making multinationals pay their way

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Executive summary

The purpose of this report is to examine the anger at the perceived low levels of United Kingdom (UK) corporation tax which multinationals, such as Amazon, Google and Starbucks, pay and to discuss what the implications for their tax bills and the economy more widely would be if a system of unitary taxation were introduced.

Amazon, Google and Starbucks try to avoid paying their fair share of corporation tax in the UK. In 2009-2013, they paid a combined total of only £57.7 million despite revenues of nearly £32 billion over the same period, meaning only 0.18% of revenues were paid in corporation tax. They pay little corporation tax in the UK, yet benefit from the public services, such as a fair legal system and policing. This means other taxpayers have to pay more in order to make up the shortfall. There is growing anger about the lack of corporation tax paid which puts pressure on firms to contribute more. A more sustainable solution would be to change the system so that firms pay their share without public pressure.

It is difficult to tax the profits of multinational corporations like Amazon, Starbucks and Google as it is not obvious where they earn their profits. Multinationals try to make it appear like they earn low profits in high tax countries and high profits in low tax countries by shifting profit around parts of their corporate group in a system of so called transfer 'mispricing' (the charging of prices different from the market rate for inter-group sales). In order to combat this avoidance, the tax authorities use the 'arm's length principle' to work out the 'true' transfer price between parts of the firm in order to work out how much profit each subsidiary earns. It is often difficult or impossible to estimate the true transfer price as there are often no comparable prices. Additionally there is a declining number of staff in HMRC to do the investigations to find out the true transfer price. Consequentially multinationals get away with profit shifting to a large degree, leading to low profits being reported in the UK and a low corporation tax take from multinationals.

A unitary corporation tax system provides a solution to the current tax avoidance by multinationals. Instead of charging firms based on the reported profits of their UK subsidiary, it looks at the global group profits and apportions a share of them to the UK, based on the relative level of involvement the firm has in the UK in relation to its global activity. Formally the unitary tax is;

$$Unitary\ Tax = \%\ Involvement\ x\ Global\ Profits\ x\ Corporation\ Tax\ Rate$$

The level of involvement is determined by the sales made, people employed and non-current assets owned in the UK in comparison to the same factors on a global group level. It is harder to avoid a unitary tax than the current form of corporation tax as in order to reduce a tax bill multinationals would have to change their levels of sales, employment or non-current assets in the UK rather than just changing the internal transfer prices.

I apply unitary taxation to Amazon, Google and Starbucks to give an idea of how the system would influence tax receipts. There is a substantial difference between the current receipts and estimated receipts under unitary taxation, £74m for Amazon, £690m for Google and £35m for Starbucks.

Multinationals would have to pay more tax under the unitary taxation system, but this would not necessarily be a problem for business in the UK. The UK would still be able to attract multinational businesses to operate in the UK due to the low rate of corporation tax in comparison to other similar economies, which means that tax bills may still be smaller by locating to the UK. It would also provide fairer competition between multinationals and domestic firms, providing a boost to business. Under the current system multinationals effective corporation tax rates are much lower than comparable domestic competitors, for example 2009-2013 Starbucks paid 1.7% of the estimated UK share of global profits in tax, whereas Greggs pays 19.7% of UK profits in tax. This means currently multinationals have much lower costs and so can out-compete domestic firms. Under unitary taxation they would both pay much more similar rates and so could compete fairly.

Multinationals would want to get around the unitary tax system by making it appear they did little business in the UK and instead did all their business in tax haven countries. In order to do this, the UK subsidiary of the multinational may report fewer employees, sales and non-current assets in the UK than the multinational actually has in the country. There are some ad hoc checks that could use existing data to give an estimate if under reporting were happening. Employee numbers could be compared with how many employees the multinationals make National Insurance contributions for, sales could be compared with VAT returns and non-current assets could be checked against the properties that the firms pay business rates on. If these rough estimates were significantly different from what the UK subsidiary reports then more detailed investigation could be done.

Another approach to obtaining accurate data on UK activity would be to introduce a requirement for multinationals to produce combined global reports with information on their activity on a country by country basis. As this information would also be available to investors, multinationals would not want to manipulate the figures greatly. If they made it look as though all activity was concentrated in tax havens and none in the UK, then investors would be concerned that risk was not spread out enough and that there was not enough involvement in the profitable UK market. This investor concern would lead to a drop in the share price and since the shareholders of multinationals do not want the share price to go down, firms would have an incentive to reasonably accurately report where activity happens.

The weighting of the formula that is used to decide how much activity happens in each country may be difficult to agree upon between many nations, as they would each benefit from different types of formula. If a country has a high concentration of non-current assets then it may prefer a formula giving more weight to non-current assets whereas if a country has a high concentration of employees then it would want a formula giving more weight to employees. There does not need to be agreement between nations on the formula used. In the United States, individual states apply a unitary corporation tax system which uses varying formulas, and the same principle could be applied to different nations.

Unitary tax provides a feasible solution to the corporation tax avoidance by multinationals such as Amazon, Google and Starbucks. If it had been used from 2009-2013, I estimate that it would have generated additional revenues of £799m for Amazon, Starbucks and Google, representing an increase of over 1000% on revenues that were actually collected during that period. The UK would still be able to attract multinationals due to its competitive corporation tax rate. Domestic business would be better able to compete with multinationals as domestic firms would pay more similar rates of corporation tax under unitary taxation than under the current system. Although there may be some avoidance there are checks that can be done which would limit this and disagreement on the formula used to decide share of profits is not an obstacle as the system can work when different states use different formulas.

Introduction

The issue of corporation tax avoidance and ways to stop it is part of the broader debate about public finances and the need to balance the books which followed the 2010 general election. Public finances in 2010 were not in good shape, with the gap between government income and expenditure, the deficit, being the highest it has been in peacetime history, at 11.3% of GDP.[1] This deficit was partially due to the recession causing high government spending on things such as unemployment benefit and lower tax receipts, but even after adjusting for the effects of the recession, the remaining structural deficit was still significant. According to the International Monetary Fund, it was 8.6% of GDP in 2010 in the UK. In comparison, this was the fourth highest level in a group of 30 similar advanced economies.[2] This high level of structural deficit is not sustainable in the long term as the UK will have to pay back its creditors. This will be much harder to do if there is high borrowing adding to the national debt. Indeed, the coalition government were particularly convinced by the need to reduce the deficit and so, in the 2010 spending review, they set out to 'carry out Britain's unavoidable deficit reduction plan.'[3] The plan was to reduce the deficit with 80% of the reduction coming from spending cuts and 20% coming from tax rises.[4] Despite these efforts to reduce the deficit and a recent return to growth boosting government revenues, the deficit is still significant at 5.8% of GDP for 2013-2014.[5]

Some action therefore still needs to be taken to make the UK's financial position more secure. There has already been a lot of focus on spending cuts and it may be hard for government departments to still deliver the services we expect with yet further cuts in their budgets. Tax rises also seem to be a difficult option and they are never particularly popular. Indeed, the Chancellor, George Osborne, has ruled them out for after the 2015 election.[6] More feasible is to try and cut down on tax avoidance so that the tax that is owed is actually collected. A major component of tax avoidance comes from multinational corporations dodging corporation tax. This issue was highlighted by the Public Accounts Committee (PAC) and its chair Margaret Hodge when they addressed the issue in 2013. Certain multinationals, such as Amazon, Google and Starbucks, were highlighted as tax dodgers and even ‘evil,’ as Margaret Hodge branded Google in a jibe at Google’s corporate motto of ‘do no evil.’[7]

There have been calls to improve the current system to stop the corporation tax avoidance by multinationals. In 2013 the government introduced the General Anti-Abuse Rule (GAAR) which gave powers to impose a tax adjustment that is ‘just and reasonable’[8] if it thought that abusive avoidance of taxation has occurred. In 2014, Lord Digby Jones, former head of the UK’s leading employers organisation, the CBI, suggested that there should a ‘business covenant’ in which businesses agreed to pay their fair share of taxes in return for the government providing public services for them.[9] These attempts to improve the system do not provide a good solution to corporation tax avoidance. GAAR is problematic as it relies too heavily on subjective judgements of what is ‘just and reasonable’ and whether abusive avoidance has even occurred. A business covenant may provide a good image boost for firms, but they are far more likely to pay more attention to their shareholders wish of maximising profits, partially through minimising their tax bills, than a loose agreement with the government.

Instead of the age old approach of trying to patch up the broken system by which corporation tax is calculated, it is interesting to consider the effects of adopting in the UK a new approach of calculating how much corporation tax is due, based on firms’ level of economic activity in the UK – so called unitary taxation. Unitary taxation apportions a share of the multinational’s global profits to the UK based on its amount of involvement in the UK. This solves the problem of multinationals ‘profit shifting’ from the UK to low tax countries to make it look as though they earn low profits in the UK and so pay low taxes in the UK. In order to reduce their tax bill they would have to change real economic activity in the UK, which is a lot harder to do than just shifting profits. Unitary tax is not an untested or extreme idea. It has been used for state corporation tax in the United States for many decades and a version of it is currently under consideration within the European Union (EU).

Much of the debate around unitary taxation is abstract and does not directly address the impact it would have on the biggest abusers of the current system. An exception to this is in an interesting paper by Richard Murphy and Meesha Nehru which did look at the application of unitary taxation to HSBC and Barclays.[10]

Drawing on their work I consider what the effects would be of using the unitary taxation system to work out how much corporation tax is owed for some of the worst perceived offenders of corporation tax avoidance; Amazon, Google and Starbucks. This examination is meant as an accessible insight into the estimated effects of adopting unitary taxation in the UK.

The report has four main sections which each draw upon examples from Amazon, Google and Starbucks to illustrate corporation tax avoidance and the effects of a unitary tax. In the first section I consider how much corporation tax is being paid by Amazon, Google and Starbucks and what drives anger about these low levels. In the second section, the workings and abuse of the current corporation tax system are explained. In the third section, the concept and background of a unitary tax are explained in the third section and the unitary tax is applied to Amazon, Google and Starbucks. Finally, in the fourth section, the objections to unitary taxation, including its effect on business, ability to be avoided and disagreement on the formula used by it, are discussed.

Corporation tax avoidance

How much UK corporation tax do they pay?

Figure 1.1: UK corporation tax paid by Amazon, Google and Starbucks 2009-2013

Year	Amazon (£m)	Google (£m)	Starbucks (£m)
2009	-1.3	-1.8	0.1
2010	0.5	4.9	0.0
2011	1.8	3.4	0.0
2012	3.2	30.8	0.0
2013	4.2	21.6	2.3
Totals	8.4	58.9	2.4

Sources: Amazon.co.uk Limited, Starbucks Coffee Company (UK) Limited and Google UK Limited annual reports[11]

People are amazed when they see these household names, many of whom they patronise on a daily basis, pay very little or no corporation tax. Indeed as can be seen in figure 1.1 between 2009 and 2013, Amazon paid £8.4m, Google £58.9m and Starbucks £2.4m. Corporation tax is a charge on the profit of firms, which itself is a residual of economic activity. As a result, proxies of economic activity are often compared to corporation tax paid to see if companies are paying their perceived fair share. The most common way that this is done is a comparison between revenues and corporation tax paid. The UK revenues of the firms are shown in figure 1.2 below. The levels of corporation tax in relation to revenues are indeed small. Amazon paid just 0.05% of its revenue in corporation tax, Google 0.45% and Starbucks 0.12%.

Figure 1.2: UK revenue for Amazon, Google and Starbucks 2009-2013

Year	Amazon (£m)	Google (£m)	Starbucks (£m)
2009	2355.1	1912.8	388.0
2010	2516.9	2132.6	396.0
2011	3445.2	2613.5	398.0
2012	3984.0	2996.3	413.0
2013	4398.7	3401.4	399.0
Totals	16699.9	13056.6	1994.0

Sources: Amazon.com Incorporated, Starbucks Coffee Company (UK) Limited and Google Incorporated annual reports[12]

Who cares about it?

Anger about low levels of corporation tax paid by multinationals comes from politicians and the public. On the left, Ken Livingstone complained earlier this year that 'the tax burden has become so unfair...you just need to make sure that the corporate sector pays its tax.'[13] On the right, David Cameron urged at the World Economic Forum in Davos in 2013 that 'businesses must pay their fair share' and that those who avoid tax need to 'wake up and smell the coffee,'[14] a reference to Starbucks. Michael Heseltine, former deputy leader of the Conservative party, exclaimed in a recent interview 'go after them! How many gunboats have Amazon got?'[15] Even US President Obama has entered the debate by publically criticising Google for 'simply changing your mailing address to avoid paying taxes'[16].

It is not just the politicians who are angry. The issue also matters to the general public. A YouGov poll in 2013[17] looked at whether people found it was acceptable or not for firms to legally avoid paying tax and found that 62% of the UK public thought it unacceptable. Public anger can also be seen by the rise of tax shaming, where the public protest or boycott firms which do not pay their perceived fair share. In 2011, Barclays Bank was subject to a 'raid' by protestors who shouted 'Dave and George do your sums'[18] (in reference to the Prime Minister and the Chancellor). There was a sit down protest in Fortnum and Mason and this June ten Vodafone stores were blockaded across the country.[19] Even the firms recognise the anger. According to an Ernst and Young survey of 830 tax and finance executives in 25 countries in 2014 almost 90% were concerned about the media coverage of taxes, in comparison with 60% in 2011.[20]

Why do they care?

There is anger at multinationals paying little tax as it seems unfair that a firm can be heavily involved in the UK and gain much from operating in the UK, yet contribute so little to the country. Firms rely on public services to help them succeed, such as a fair legal system to help enforce business contracts, highly educated workers to do the complex tasks that they require and the police and armed forces to preserve the peace which allows business to happen. These thoughts about business benefitting from public services were echoed in the Obama 2012 campaign, where there was an emphasis on how 'the American system'[21] helps business to thrive and as a result businesses should contribute to their funding. If they don't contribute, then in effect they are free riding on all the other tax payers and forcing everyone else to pay more.

It is this 'free ride' that multinationals enjoy that makes people particularly angry. Citizens directly contribute a substantial amount to the funding of public services via income taxes, national insurance contributions and capital gains taxes. These provided some £269 billion in 2014, 54% of total tax receipts.[22] We bear this burden as there are certain services that the private sector does not provide the right quantities of, such as education, and so there must be a government to provide the appropriate quantities of these goods. We feel some entitlement to the services that the government has provided as we have helped finance them. As the American President F.D. Roosevelt once remarked 'taxes, after all, are the dues that we pay for the privileges of membership in an organised society.'[23] In comparison the multinationals have the privileges of membership, but do not seem to be paying the membership fee.

So the current corporation tax system is not producing the desired result of making multinational corporations contribute proportionately to the finances of 'UK Plc'. We cannot expect multinationals to voluntarily pay more tax as they operate in the interests of the shareholders and so will try and maximise global profit by reducing corporation tax costs. The only reason that they might pay more than they legally have to do is if they are worried that paying minimal tax was bad for their reputation. For example after public outcry, a Starbucks spokeswoman commented in 2013 that 'we decided to forgo certain deductions which would make us liable to pay £10m in corporation tax this year'.[24] It is not however a sustainable system to rely on public pressure to make multinationals pay more tax. It may be easy to have pressure for consumer goods, where the public reputation is important, but a lot harder in other industries. Is anyone going to bother protesting against the makers of widgets or industrial detergents? Even if people can be bothered, it still requires a lot of their time and effort to do so. They should not have to do this. The system should consistently deliver the desired result of corporations contributing to the UK, without the need for protest. So let's review the system.

The current corporation tax system

What is corporation tax?

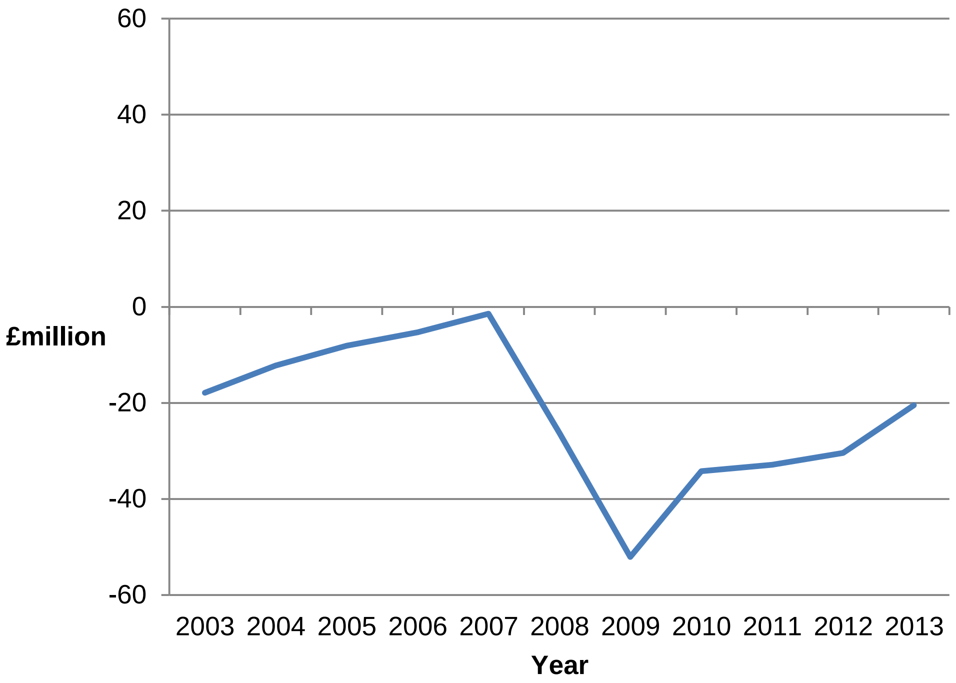
Corporation tax, introduced in 1965, is a direct tax which is made in relation to profits made by firms. It raised £39.5 billion in 2012-2013, 10% of total tax receipts.[25] The taxable profits include not only profits from taxable income, including trading profits and investment profits (excluding dividend income) but also capital gains. There is a lower rate of tax for small companies, where profits are below £1.5 million a year. Currently the main rate is at 21% whilst the small profits rate is 20%.[26]

Why is it hard to tax multinationals?

Firms who operate solely in the UK are charged corporation tax. This is relatively easy to do as you just take the profits reported, allow certain deductions and then tax what is left. To work out how much tax multinationals owe is however a lot harder. The problem with applying corporation tax to multinational firms is that each country where the firm operates has to work out how much profit is made in that country. It is often difficult to work out where the profits have been made, due to manipulation of internal transfer pricing distorting the reported profits. For example a multinational car firm may have a UK subsidiary which assembles cars using parts manufactured by subsidiaries in other countries which have lower levels of corporation tax. In order to try and reduce their tax bill, the firm will make the cost of the parts artificially high to the UK subsidiary so that the UK subsidiary consistently makes a loss and so has to pay no corporation tax. This inflated internal price of the parts makes the parts subsidiary have high profits since it is getting above the market price for parts. The parts subsidiary is in a low corporation tax country, so pays little corporation tax on these high profits. Thus the overall tax bill has been reduced by transfer 'mispricing.' The shareholders benefit at the expense of the UK Treasury.

Starbucks is a good example of the effects of this transfer mispricing on reported profits. The company entered the UK coffee retail market in 1998 with the purchase of the Seattle Coffee Company's chain of 56 coffee shops.[27] Today it is one of the largest coffee chains in the UK with 593 stores, representing over two thirds of the group's stores in the European Union.[28] This clear commitment to the UK over the last 16 years and the concentration of stores in the UK rather than in other European countries would suggest that the Starbucks group considers the UK a good, profitable market to be in; otherwise they would have withdrawn and relocated elsewhere. Despite this, the UK subsidiary has consistently reports losses, as shown in figure 2.1 below.

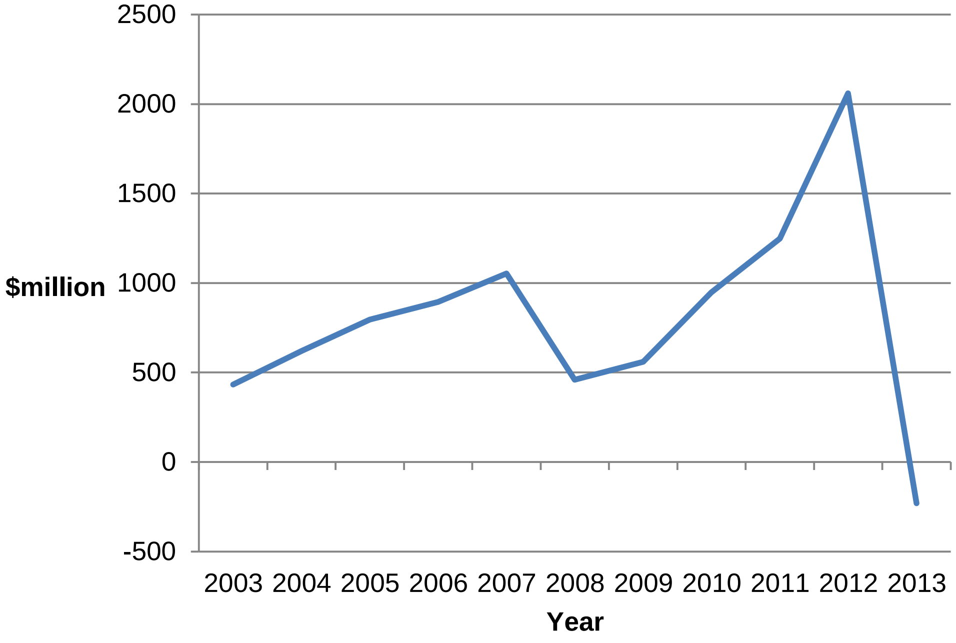
Figure 2.1 - Pre tax profits of Starbucks Coffee Company UK Limited 2003-2013



Source: Starbucks Coffee Company (UK) Limited annual reports 2003-2013[29]

One of the main reasons that there are losses reported every year is the transfer mispricing that goes on within the group. For example, the UK operation of Starbucks pays the parent company a royalty of 6% of sales for its use of intellectual property, such as brand and business processes.[30] This means that whilst the UK operation made a loss, overall the group still made substantial profits, in part thanks to its operations in the UK. The group profits are shown in figure 2.2 below. Profits were recorded in every year except 2013, in comparison to losses made every year by the UK subsidiary.

Figure 2.2 – Pre tax profits for Starbucks Corporation 2003-2013



Source: annual reports 2003-2013 Starbucks Corporation[31]

This profit shifting via transfer mispricing presents difficulties for governments as it can reduce their tax base substantially, especially given that around 60% of global trade takes place within multinational firms.[32] In order to combat internal transfer pricing, governments use the 'arm's length principle'.[33] This is where the transfer prices are replaced by the 'market price' – the price that would have been paid if the transaction had occurred between two firms who were not part of the same group. The two tax authorities between who the transfer pricing has occurred must agree on the transfer price adjustment and they can then both see how much profit there is to tax in each jurisdiction.

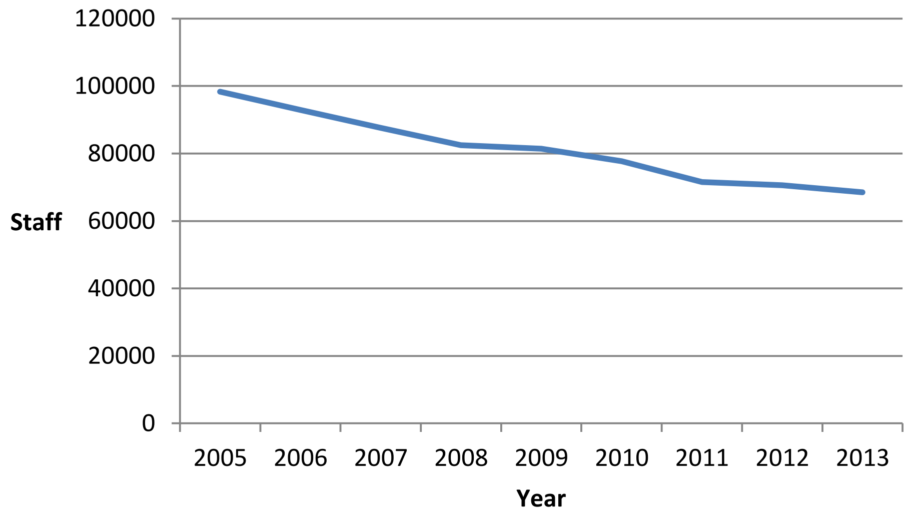
Why are they hardly taxed?

There are problems with transfer price adjustment.[34] Firstly there are often not equivalent market trades that can be used to calculate the 'correct' transfer price. Suppose that you were calculating the corporation tax for Starbucks Coffee Company (UK) Limited. It reports that the 'price' of the Starbucks brand and other intellectual property is 6% of its sales. However Starbucks Corporation doesn't sell its brand to anyone else in the UK, so no direct market trade comparison is available. It is also difficult to find something indirectly comparable. Other coffee chains could be used, but their brand may be less or more important to the business than for Starbucks so different rates may be charged.

If it is hard to find comparable market prices to use to correct for transfer mispricing, then the comparable profit margins can be used in the cost plus and resale price methods. These look at the costs of producing a product and the price sold at respectively and then add a profit margin that is similar to other products in the industry. There is still the problem that this uses 'comparable' profit margins but often there may be no firm to provide an accurate comparison. Given these difficulties in accurately calculating how much tax is owed to whom, multinationals can often in practice can avoid an equitable amount of tax by shifting profits around. The tax authorities find it difficult to prove under the arm's length principle that they have done so wrongly.

This problem is compounded by continued staff cuts at HMRC. This means that there is not enough experienced staff to successfully challenge transfer mispricing in the large multinationals. Full time equivalent staff numbers, a measure of both full and part time staff, were cut from 98337 in 2005 to 68520 by 2013, representing a cut of over 30%. The overall downwards trend from 2005-2013 is shown in figure 2.3.

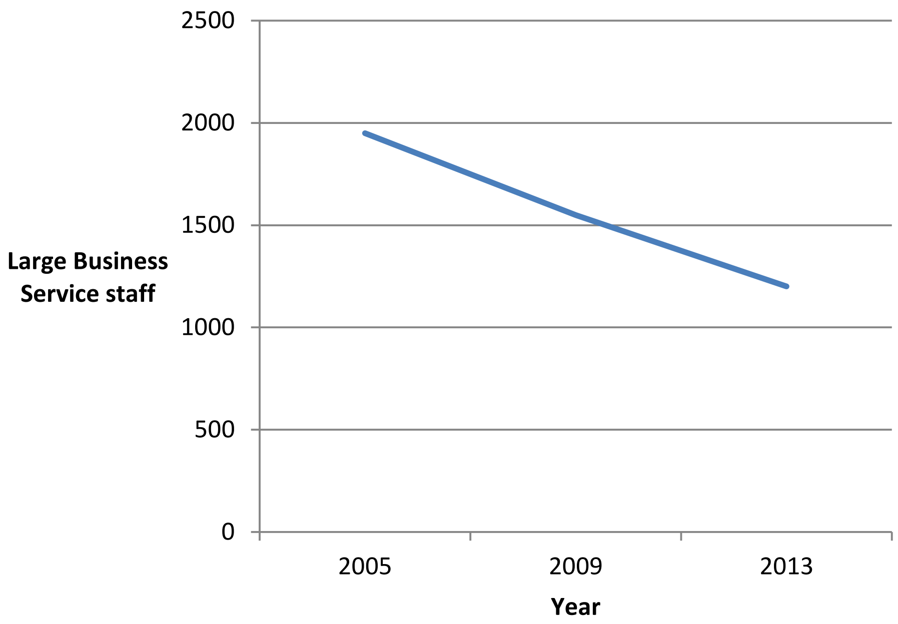
Figure 2.3 – Numbers of staff in HMRC 2005-2013



Source: HMRC annual reports[35]

This trend of declining staff numbers in HMRC as a whole is also reflected in declining employees of the Large Business Service, the part of HMRC that looks at the tax affairs of the 770 largest businesses in the UK,[36] which includes many multinationals. Staff numbers have fallen from 1950 in 2005 to 1200 in 2013, representing a cut of 38%. The overall trend is shown in figure 2.4. These declining numbers of staff available to investigate the complex transfer mispricing arrangements of the multinationals cannot help in trying to successfully stop tax avoidance by profit shifting.

Figure 2.4 – Numbers of staff in Large Business Service 2005-2013



Sources: Public Accounts Committee, Tax Research LLP[37]

Unitary tax as a solution to corporation tax avoidance

Unitary tax and its context

What is a unitary tax?

A unitary tax considers the involvement of a unitary firm in a country, relative to its global activities, and its global pre-tax profits. It then apportions a share of the global pre-tax profits in proportion to relative activity in the country that the country. The country can then apply corporation tax at its own level to this share of profits, as a unitary tax bill.

$$Unitary\ Tax = \%\ Involement\ x\ Global\ Profits\ x\ Corporation\ Tax\ Rate$$

What is a unitary firm?

A unitary firm is one that exists as several different legal entities, but in reality acts like a single united firm. It acts like a single firm due to common ownership and common business activities. Ownership in this context means having over 50% direct or indirect control of the shares in the firm with voting or other comparable rights. Therefore for a parent-subsidiary controlled group, which many multinationals are, unity of ownership means having a common parent firm that owns over 50% in each of the subsidiaries.[38]

Considering just ownership as a condition for a group of firms being unitary is not enough. It could be the case that there are a group of firms that are commonly owned, but have no interaction with each other so it would be strange to consider them a unitary group. Thus there also needs to be a test for common operations between the firms in the group that would give an indication of whether they really are a united group of firms.[39] Tests for common operations can include shared staff functions, such as personnel, purchasing, legal and financing, shared management, such as executives who sit on both parent and subsidiary boards and decisions that are taken by the group and not by individual subsidiaries, and shared image, by common advertising, product range and patents.[40]

Amazon, Google and Starbucks groups and their UK subsidiaries can be considered unitary firms. Firstly the UK subsidiaries meet the ownership requirements to be part of the unitary group. Amazon.co.uk Ltd is owned by Amazon EU Sarl, which in turn is owned by the Amazon.com group.[41] Starbucks Coffee Company (UK) Ltd is owned by Starbucks Coffee Holdings UK Ltd which is owned by Starbucks Corporation, the global group.[42] Google UK Ltd is owned by Google International LLC, which is owned by Google Inc, the global group.[43] There are also shared operations between the parents and subsidiaries. All three UK subsidiaries use the same branding and similar products ranges to the parent firms. Additionally there are shared staff functions. This is especially the case with the online firms, where much of the development of the website and search engine is done in the US and then tweaked slightly for the UK.

The UK subsidiaries of Amazon, Google and Starbucks would not be able to operate without assistance from their parent firms in the US. It seems odd that the tax system treats them as completely separate legal entities, when in reality they are a united firm. Instead the tax system should look at what each whole group does to calculate how much tax is owed as this would give a better reflection of economic reality. This can be achieved by a unitary tax.

How to measure involvement?

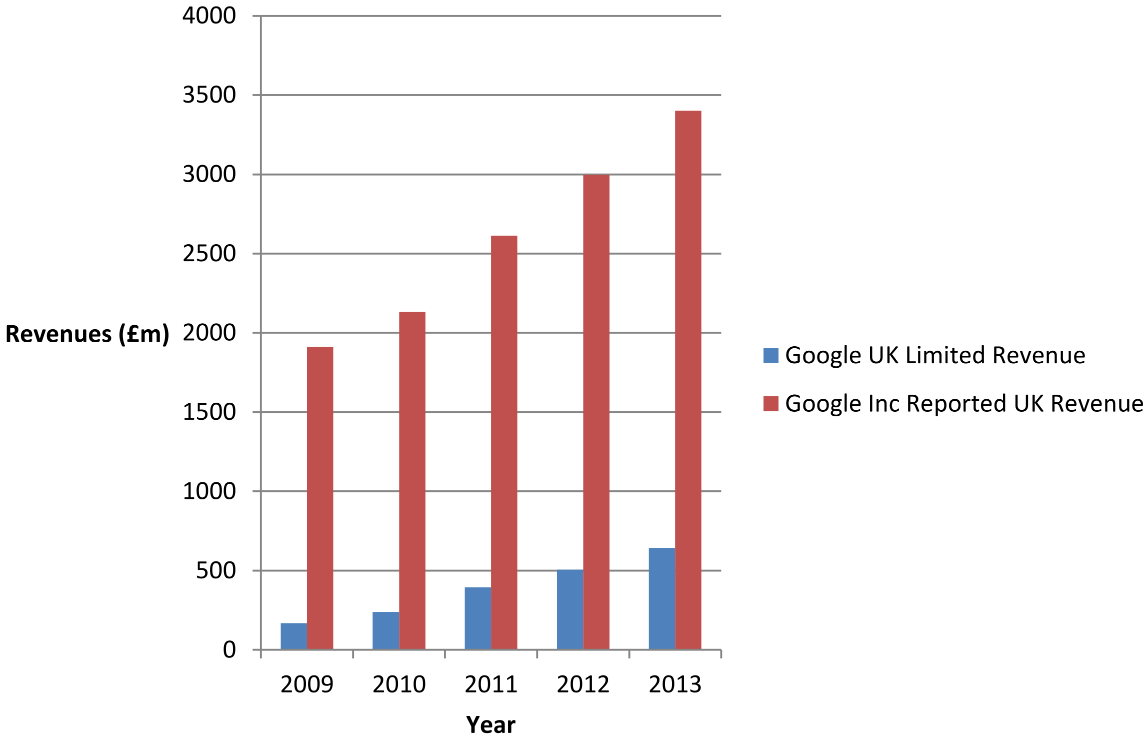
In order to do business, firms must have assets, such as buildings to operate from, employees, in order to carry out the business, and sales, to provide the revenue to keep the business going. Without any of these it is hard for a firm to operate, so they should all be included in the measure of economic involvement that a firm has in a country.[44] It must be carefully considered how to measure these factors so that not only do they accurately reflect economic activity but also that they cannot be easily manipulated so that pay less tax is paid.

Assets should only include those which are fixed and tangible. If one allows other assets, such as cash, intellectual property rights (IPRs) and inventories, then these can be easily moved around by firms from one country to another to suit their tax arrangements. It is much harder to move a business property or plant around at short notice to suit changing tax conditions. Consequentially the fixed, tangible assets of a firm provide a good indication of the level of investment which it has in a particular country and it is relatively hard to manipulate. In company accounts this class of assets is referred to as 'non-current' assets, so this is the term which I will use when considering such assets.

Labour should ideally be measured as all employees, including sub-contractors as they are involved in the firm's business. The location of labour should be calculated by place of employment, rather than location of employer, otherwise holding companies in tax havens could be set up to employ all the firm's staff and distort the employment numbers in the UK. To get around the problem of workers who spend time working in different countries, their inclusion in the employees for one country should be weighted in proportion to the amount of time which they have spent there. The central difficulty with trying to measure labour is whether to use headcount or a payroll. Payroll is useful if the firm operates in countries with similar wage rates as then it can show where the highest value employees are located and not just where the pure numbers are. It is not so useful if the firm operates in countries with vastly different wage rates as then it may overemphasise certain countries, usually the richer ones, over the involvement in countries with lower wage rates. Since multinationals by their nature operate in many diverse countries, I will use the headcount measure to overcome the wage disparity problem. Additionally global reports provide no information on salary costs, but do give employee numbers, so it is a lot easier methodologically to use headcount.

The way to calculate sales is to consider all revenue and then to allocate sales by where the location of the customer rather than the selling company. If it were done by company location, then firms could simply set up holding companies in tax havens and have all sales booked through there. There can be significant difference between measuring sales by destination of firm selling and destination of seller. For example in Google Inc's annual reports there is an indication of revenue in the UK and this is consistently much higher than the reported revenue of Google Inc's UK subsidiary, Google UK Limited, as some sales made in the UK are booked via Google's Irish subsidiary.[45] For example, in 2012 Google Inc reported the group made nearly £3000 million of revenue in the UK whilst Google UK Limited reported just over £500 million. A comparison between the revenues for 2009-2013 is shown in figure 3.1

Figure 3.1 - Comparison of revenues for Google in the UK reported in the combined global report and by local subsidiary



Source: Google UK Limited and Google Incorporated annual reports[46]

Where possible, I have used the level of sales in the UK indicated in the global reports, rather than the UK company's reported sales, as this provides a better representation of sales by location of client. Starbucks don't provide data on the level of sales in the UK in their global reports, so I have used the sales reported in the UK subsidiary report. This should be less of a problem than using the UK subsidiary data for Amazon and Google as Starbucks is a high street rather than online firm and therefore will find it harder to book sales offshore than Amazon and Google.

Given that there are three different factors that could be used to determine the involvement of a firm in a country, each one of these must have a weighting in its overall contribution to the measure of involvement. The traditional unitary tax, gives equal weights to assets, sales and labour.[47]

$$\% \, Involvement = \frac{1}{3}\%Assets + \frac{1}{3}\%Labour + \frac{1}{3}\%Sales$$

Are there any precedents?

United States

Wisconsin first adopted a state income tax over 100 years ago and was revolutionary in using a unitary tax (based on property, sales and cost of manufacture).[48] They adopted this as the manufacturing and railroad companies operating in Wisconsin were active in several states and so there needed to be a method to work out how much income should be taxed in each. The use of unitary taxation spread so that by the 1930s most states used it.[49] Whilst it was possible to vary how the apportionment was worked out in each state, most used the equally weighted 'Massachusetts' formula when adopting the system. The passing of the Uniform Division of Income for Tax Purposes Act (UDITPA) in 1957[50] provided uniform definitions of the factors used and treatment for the various types of income. Since the early 1980s, some states have moved away from the Massachusetts formula to one that gives more weight to sales.[51] There has also been a development of the water's edge system. This is where, due to pressure from foreign corporations, some states limit what they define as the combined group activity to just activity within the United States, rather than the previous worldwide system.

EU proposals

Recently the EU has been considering a system of unitary taxation within its borders, termed the Common Consolidated Corporate Tax Base (CCCTB), with the aim of reducing barriers to business for firms operating throughout the single market. Currently, if a firm operates in all EU member states, it would have to file 28 separate tax returns, generating large administrative costs. Consequentially small firms may be discouraged from doing business in more than one country due to the high costs. In the proposed system, firms would be required to submit one report for their EU activity. Profits would be divided up by formulary apportionment and each state would tax their share. This does not mean that there would be a harmonisation of tax rates in the EU, just a harmonised tax base. The proposed formula to apportion profits is similar to the traditional model, but measures labour by looking at both headcount and payroll and weighting these equally. Formally,

$$\%\,Invovlement = \frac{1}{3}\%Assets + \frac{1}{6}\%Headcount + \frac{1}{6}\%Payroll + \frac{1}{3}\%Sales$$

The European Commission estimate that the CCCTB would generate compliance cost savings of around €700m.[52] Due to these potential benefits there is considerable support for the proposal from business. According to Algirdas Semeta, European Commissioner for Taxation, Customs, Audit and Anti-Fraud, the CCCTB is an initiative which is keenly awaited by 80% of businesses.[53] There is however political disagreement about the proposals. Several countries, including Britain and Ireland[54], fear that creating a common tax base would be a step towards creating a common tax rate. They do not want this as they think it is an illegitimate infringement on their sovereignty. There is also disagreement among states about exactly which formula to use, as different formulae benefit different countries, dependent on the level of sales, labour and assets in each country.

How does it offer a solution to corporation tax avoidance?

Why should the unitary tax raise more revenue than the current corporation tax system?

A corporation tax based on the unitary assessment method should make it much harder for multinationals to avoid paying their fair contribution to the UK than the current system. Under the current system it is possible to use transfer mispricing to artificially reduce profits in the UK and so pay a reduced corporation tax. As transfer prices within the group only redirect profit from one subsidiary to another, they do not affect the global group pre-tax profits. As the unitary tax uses as it reference point global pre tax profits, not local reported pre-tax profit, the tax take is not artificially reduced by transfer mispricing. In order to give an idea of the effect on tax bills, I will apply unitary tax to Amazon, Starbucks and Google for 2009-2013.

Application of unitary tax to Amazon, Google and Starbucks

All information has been taken from the firms' global annual reports and where necessary the entity they operate through in the UK. Annual reports are audited by external auditors who have a duty to ensure that the data is correct. Where sales and non-current asset figures appear in foreign currencies the appropriate conversion rates have been applied. I will use the traditional ‘equal weightings’ for the apportionment formula for this analysis as a starting point to see what the differences in tax receipts will be. Later on I discuss the varying effects when different formula weightings are used.

Calculating involvement in the UK

$$Unitary\ Tax = \%\ \boldsymbol{Involement}\ x\ Global\ Profits\ x\ Corporation\ Tax\ Rate$$

$$\%\ \boldsymbol{Involvement} = \frac{1}{3}\%Assets + \frac{1}{3}\%Labour + \frac{1}{3}\%Sales$$

Figure 3.2 – Involvement of Amazon in the UK by sales, employees and non-current assets 2009-2013

Year	Global Sales (£m)	UK Sales (£m)	%Sales in UK	Global Employees	UK Employees	% Employees in UK	Global Non-current Assets (£m)	UK Non-current Assets (£m)	% Non-current Assets in UK
2009	15700.5	2355.1	15.0	24300	1872	7.7	2572.7	31	1.2
2010	21911.1	2516.9	11.5	33700	2265	6.7	3235.0	45	1.4
2011	30971.2	3445.2	11.1	56200	3023	5.4	5017.0	109	2.2
2012	37572.2	3984.0	10.6	88400	4191	4.7	6924.3	154.0	2.2
2013	44916.9	4398.7	9.8	117300	5912	5.0	9371.7	173	1.8
Mean			**11.6**			**5.9**			**1.8**

Sources: Amazon.co.uk Limited and Amazon.com Incorporated annual reports[55]

Figure 3.3 – Overall involvement of Amazon in the UK 2009-2013

Year	%Sales in UK	Sales Weight	% Employees in UK	Employment Weight	% Non-current Assets in UK	Non-current Asset Weight	% Involvement in UK
2009	15.0	1/3	7.7	1/3	1.2	1/3	8.0
2010	11.5	1/3	6.7	1/3	1.4	1/3	6.5
2011	11.1	1/3	5.4	1/3	2.2	1/3	6.2
2012	10.6	1/3	4.7	1/3	2.2	1/3	5.9
2013	9.8	1/3	5.0	1/3	1.8	1/3	5.6
Mean	**11.6**		**5.9**		**1.8**		**6.4**

Amazon shows varying levels of involvement with each one of the proxies for economic activity. It is most involved in terms of sales, with a mean of 11.6% of global sales in the UK. Its activity with regards to employment is less substantive, with a mean of only 5.9% of global employees working in the UK. It has very little involvement with non-current assets in the UK, with a mean of just 1.8% of global non-current assets in the UK. Overall there is a mean involvement of 6.4% in the UK. The reason for the strong sales involvement in contrast with the relatively low employment and asset involvement is due to the nature of Amazon as a multinational company. It is headquartered in Seattle, USA, and so much of the central staff and other non-current assets are based in the United States, reducing the relative size of employment and non-current assets in the UK.

Figure 3.4 – Involvement of Google in the UK by sales, employees and non-current assets 2009-2013

Year	Global Sales (£m)	UK Sales (£m)	%Sales in UK	Global Employees	UK Employees	% Employees in UK	Global Non-current Assets (£m)	UK Non-current Assets (£m)	% Non-current Assets in UK
2009	15093.2	1912.8	12.7	19835	848	4.3	7423.9	10.7	0.1
2010	18783.0	2132.6	11.4	24400	930	3.8	10434.7	12.0	0.1
2011	24418.4	2613.5	10.7	32467	1304	4.0	12765.5	45.7	0.4
2012	30857.6	2996.3	9.7	53861	1613	3.0	20506.6	91.6	0.4
2013	36092.4	3401.4	9.4	47756	1835	3.8	22945.9	413.1	1.1
Mean			**10.8**			**3.8**			**0.4**

Sources: Google UK Limited and Google Incorporated annual reports[56]

Figure 3.5 – Overall involvement of Google in the UK 2009-2013

Year	%Sales in UK	Sales Weight	% Employees in UK	Employment Weight	% Non-current Assets in UK	Non-current Asset Weight	% Involvement in UK
2009	12.7	1/3	4.3	1/3	0.1	1/3	5.7
2010	11.4	1/3	3.8	1/3	0.1	1/3	5.1
2011	10.7	1/3	4.0	1/3	0.4	1/3	5.0
2012	9.7	1/3	3.0	1/3	0.4	1/3	4.4
2013	9.4	1/3	3.8	1/3	1.1	1/3	4.8
Mean	**10.8**		**3.8**		**0.4**		**5.1**

Google has a similar structure to its level of involvement as Amazon, perhaps because they are both internet based firms. It is primarily involved with the UK in terms of sales, with 10.8% of global sales happening in the UK. It is less concentrated in the UK with regards to employment, with only 3.8% of its workforce in the UK, and even less involved with regards to non-current assets, holding only 0.4% of global non-current assets in the UK. Overall the mean involvement is 5.1%. In a similar way to Amazon, Google has headquarters in the US and so of the many of the staff and assets are concentrated there.

Figure 3.6 – Involvement of Starbucks in the UK by sales, employees and non-current assets 2009-2013

Year	Global Sales (£m)	UK Sales (£m)	% Sales in UK	Global Employees	UK Employees	% Employees in UK	Global Non-current Assets (£m)	UK Non-current Assets (£m)	% Non-current Assets in UK
2009	5669.1	388.0	6.8	142000	9623	6.8	2239.7	93.4	4.2
2010	6775.4	396.0	5.8	137000	8647	6.3	2297.1	80.4	3.5
2011	7462.3	398.0	5.3	149000	8763	5.9	2273.8	68.6	3.0
2012	8228.4	413.0	5.0	151000	8739	5.8	2487.2	66.6	2.7
2013	9224.1	399.0	4.3	182000	7726	4.2	3744.9	65.7	1.8
Mean			**5.5**			**5.8**			**3.0**

Sources: Starbucks Coffee Company (UK) Limited and Starbucks Corporation annual reports[57]

Figure 3.7 – Overall involvement of Starbucks in the UK 2009-2013

Year	% Sales in UK	Sales Weight	% Employees in UK	Employment Weight	% Assets in UK	Non-current Asset Weight	% Involvement in UK
2009	6.8	1/3	6.8	1/3	4.2	1/3	5.9
2010	5.8	1/3	6.3	1/3	3.5	1/3	5.2
2011	5.3	1/3	5.9	1/3	3.0	1/3	4.7
2012	5.0	1/3	5.8	1/3	2.7	1/3	4.5
2013	4.3	1/3	4.2	1/3	1.8	1/3	3.4
Mean	**5.5**		**5.8**		**3.0**		**4.8**

Starbucks highest level of involvement in the UK is for employment at 5.8%, closely followed by sales at 5.5% and non-current assets at 4.8% of the global total. The relatively high levels of non-current assets and employment compared to Amazon and Google are due to Starbucks being a high shop street, rather than an internet firm. Starbucks will need many shops as well as warehouses and distribution chains to supply the shops, whereas Amazon only needs warehouses. Starbucks therefore needs more employees and non-current assets in each country it operates in, as a proportion of total employees and non-current assets, whereas it is easier for Amazon to centralise. Overall Starbucks had a mean involvement in the UK of 4.8%.

Given activity, how much tax should be paid?

Now the level of involvement of each of the three firms has in the UK has been calculated, the level of unitary tax that would have been due in each year can be calculated. First the portion of pre-tax profits attributable to the UK is worked out by the multiplication of global pre-tax profits by relative involvement in the UK.

$$UK\ share\ of\ profits = \%\ Involement\ x\ Global\ Profits$$

This gives the amount of pre-tax profit that can be considered by HMRC. HMRC does give some allowances and reliefs which means that the pre-tax profits are not exactly the eventual level of profits to which corporation tax are applied to.[58] These include;

- Marginal relief – applicable to firms whose profits are in between the threshold for the lower rate of corporation tax (£0.3m) and main rate of corporation tax (£1.5m)

- Creative industry tax relief – applicable to firms directly involved in the production and development of certain films, 'high end' television programmes, animation programmes or video games

- The patent box – lower rate (10%) of corporation tax for profits from patented inventions or certain other innovations

- Capital allowances – designed to allow the cost of assets to be written off against taxable profits. Take the place of depreciation which is normally shown in company accounts, as this isn't allowable for corporation tax purposes

Marginal relief and creative industry relief do not apply to Amazon, Google and Starbucks as they don't meet the necessary criteria. The majority of the business done is also not based on patents, Although Amazon does have a few patented products, its main revenues come from selling other firm's goods on its websites. Google gets the majority of its revenues from advertising in its search engine, 87% in 2012[59], and a search engine does not fall under UK patent law. Starbucks sells coffee, which cannot be patented. They would get some capital allowances, but considering their small amount of UK non-current assets, these shouldn't be particularly large. Due to lack of allowances and reliefs applicable to Amazon, Google and Starbucks, there should be minimal difference between UK pre-tax profits and UK profits to which corporation tax can be applied.

Additionally there is corporation tax relief if a firm makes losses. It can choose to carry the loss forward or backwards to another accounting period to offset corporation tax obligations in those periods. The relief for losses under unitary tax would work in a similar way to that under the current system. If the unitary tax were negative then this would count as a relief which could be carried forward or backwards. In my calculations if a negative unitary tax is calculated then I will leave it so as I cannot know in what period the firm would want to use this relief.

Therefore the UK share of global pre tax profits provides a good estimation of the amount of profit that corporation tax can be applied to for Amazon, Google and Starbucks. Consequentially to estimate the unitary tax, the UK share of global pre tax profits are multiplied by corporation tax rate.

$$Unitary\ Tax = \%\ Involement\ x\ Global\ Profits\ x\ Corporation\ Tax\ Rate$$

Figure 3.8 – Calculation of unitary tax for Amazon 2009-2013

Year	Pre-tax global profits (£m)	% Involvement in UK	UK share of profits (£m)	UK Corporation Tax Rate (%)	Unitary Tax (£m)
2009	743.7	8.0	92.5	28.0	**25.9**
2010	959.0	6.5	97.8	28.0	**27.4**
2011	601.7	6.2	58.1	26.0	**15.1**
2012	334.6	5.9	31.9	24.0	**7.6**
2013	305.3	5.6	28.1	23.0	**6.5**
Totals					**82.5**

Source: Amazon Incorporated annual reports and previous tables [60]

Figure 3.9 – Calculation of unitary tax for Google 2009-2013

Year	Pre-tax global profits (£m)	% Involvement in UK	UK share of profits (£m)	UK Corporation Tax Rate (%)	Unitary Tax (£m)
2009	5368.9	5.7	477.5	28.0	**133.7**
2010	6915.9	5.1	549.9	28.0	**154.0**
2011	7940.4	5.0	619.5	26.0	**161.1**
2012	8232.4	4.4	586.8	24.0	**140.8**
2013	8745.4	4.8	693.5	23.0	**159.5**
Totals					**588.7**

Source: Google Incorporated annual reports and previous tables [61]

Figure 3.10 – Calculation of unitary tax for Starbucks 2009-2013

Year	Pre-tax global profits (£m)	% Involvement in UK	UK share of profits (£m)	Corporation Tax Rate (%)	Unitary Tax (£m)
2009	353.7	5.9	21.0	28.0	**5.9**
2010	599.9	5.2	31.3	28.0	**8.8**
2011	796.0	4.7	37.8	26.0	**9.8**
2012	1274.0	4.5	57.3	24.0	**13.7**
2013	-142.4	3.4	-4.9	23.0	**-1.1**
Totals					**37.1**

Source: Starbucks Corporation annual reports and previous tables[62]

What would be the changes in tax revenues?

Having calculated the unitary tax that would have been paid in the years 2009-2013, it is important to compare this to corporation tax that was actually paid in this period. The difference between the two is what I term the 'tax gap'. It is important to consider this as it would have be the change in tax revenue had the unitary system been in place at the time.

Figure 3.11: Tax gap for Amazon 2009-2013

Year	Unitary Tax (£m)	Corporation Tax Paid (£m)	'Tax gap' (£m)
2009	25.9	-1.3	27.2
2010	27.4	0.5	26.9
2011	15.1	1.8	13.3
2012	7.6	3.2	4.4
2013	6.5	4.2	2.0
Total	**82.5**	**8.4**	**74.1**

Sources: corporation tax paid from annual reports of Amazon.co.uk Limited.[63] ***Other data from previous tables***

Figure 3.12: Graphical representation of the tax gap for Amazon 2009-2013

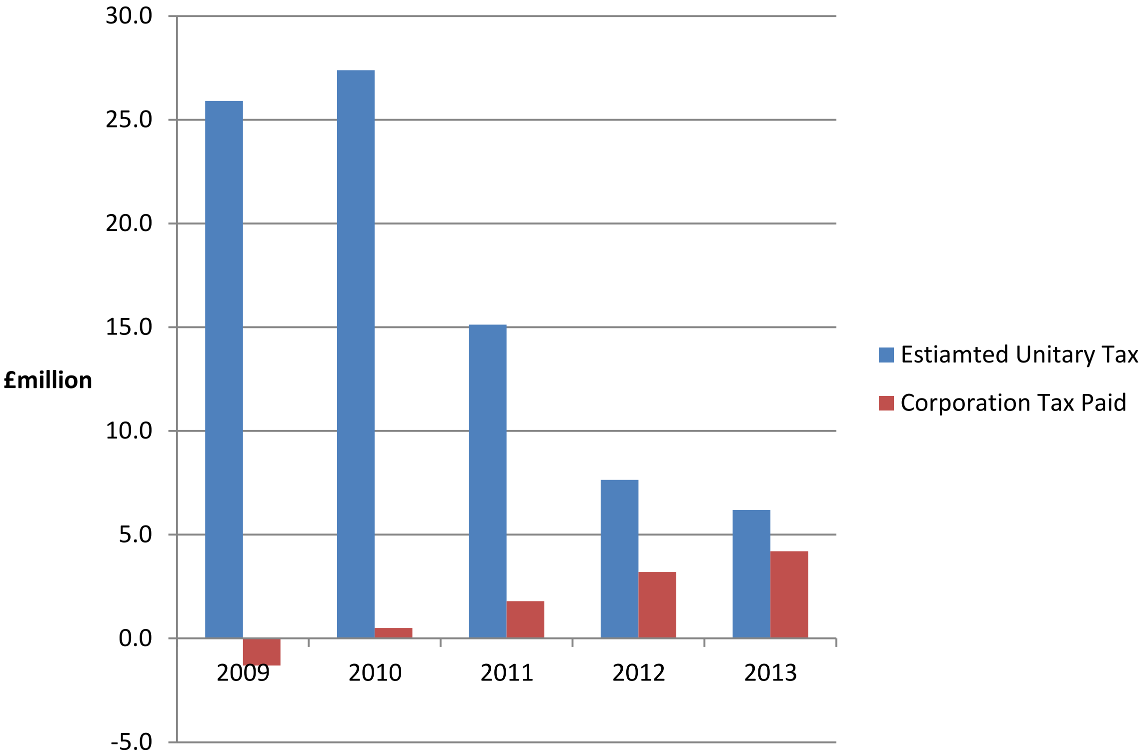


Figure 3.13 – Tax gap for Google 2009-2013

Year	Unitary Tax (£m)	Corporation Tax Paid (£m)	'Tax gap' (£m)
2009	133.7	-1.8	135.5
2010	154.0	4.9	149.1
2011	161.1	3.4	157.7
2012	140.8	30.8	110.0
2013	159.5	21.6	137.9
Total	**588.7**	**37.3**	**690.2**

Sources: corporation tax paid from annual reports of Google UK Limited.[64] Other data from previous tables

Figure 3.14: Graphical representation of the tax gap for Google 2009-2013

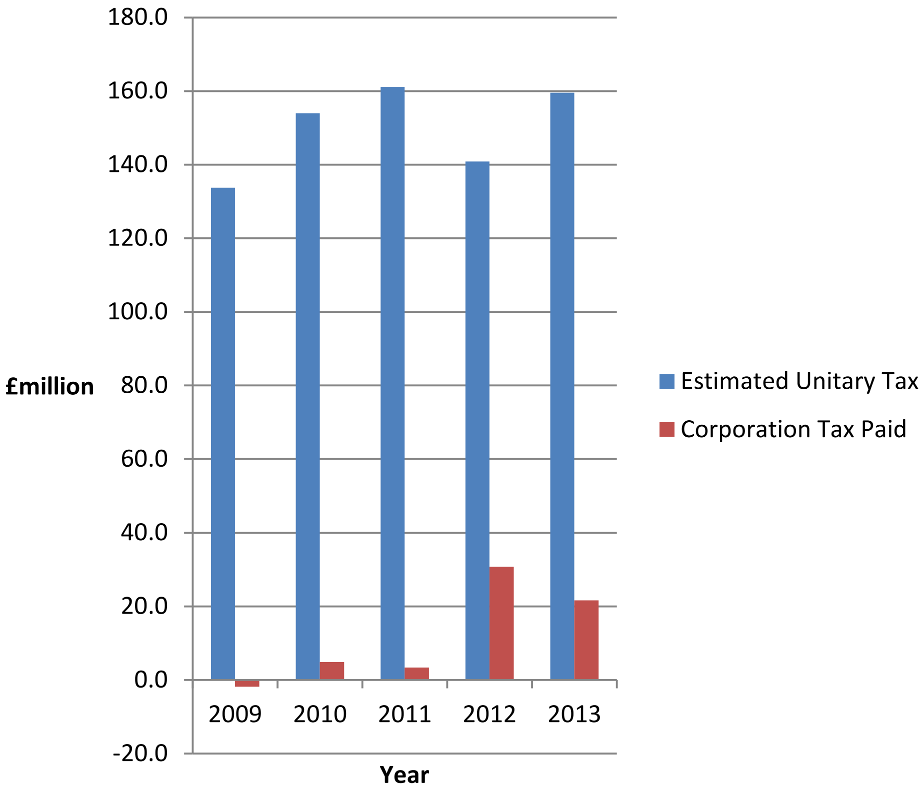
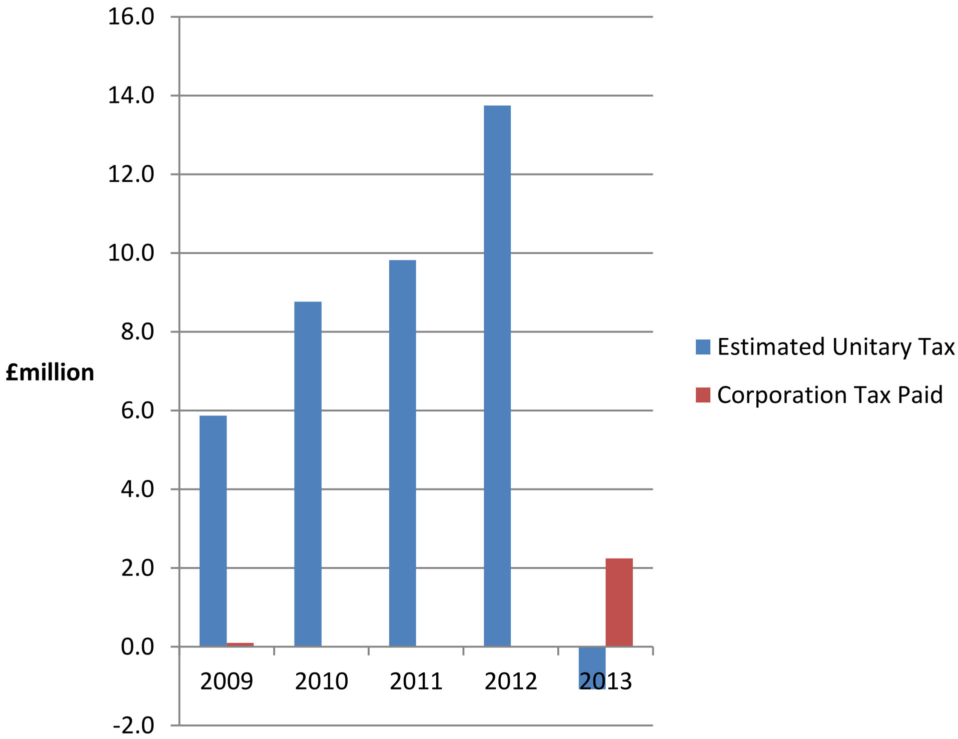


Figure 3.15 – Tax gap for Starbucks 2009-2013

Year	Unitary Tax (£m)	Corporation Tax Paid (£m)	'Tax gap' (£m)
2009	5.9	0.1	5.8
2010	8.8	0.0	8.8
2011	9.8	0.0	9.8
2012	13.7	0.0	13.7
2013	-1.1	2.3	-3.3
Total	**37.1**	**2.4**	**34.8**

Sources: corporation tax paid from annual reports of Starbucks Coffee Company (UK) Limited.[65] Other data from previous tables

Figure 3.16: Graphical representation of the tax gap for Starbucks 2009-2013



For the three multinationals considered, the unitary tax solves the problem of perceived low tax receipts as they all would be charged more under the unitary tax system than under the current corporation tax system. The biggest tax gap for Google, where the difference between the corporation tax paid 2009-2013 and the estimated unitary tax over that period was £690 million. Amazon had a tax gap of £74 million 2009-2013, this is lower than Google partially due to their low margins meaning that although Amazon have large revenues they also have low profits. Starbucks had the lowest tax gap with £35 million difference between what they paid in corporation tax and the estimated unitary tax. It is interesting that Starbucks has attracted so much public anger, when compared to Google and Amazon, the cost of its tax dodging seems to be a lot less. This is perhaps because there are many similar substitutes for Starbucks, such as Costa Coffee, Cafe Nero and Coffee Republic, meaning that the cost to boycotting Starbucks is relatively low for the consumer. In comparison Google and Amazon are much more dominant in their sectors, so the costs of a boycott of them is a lot higher as there is no easy alternative.

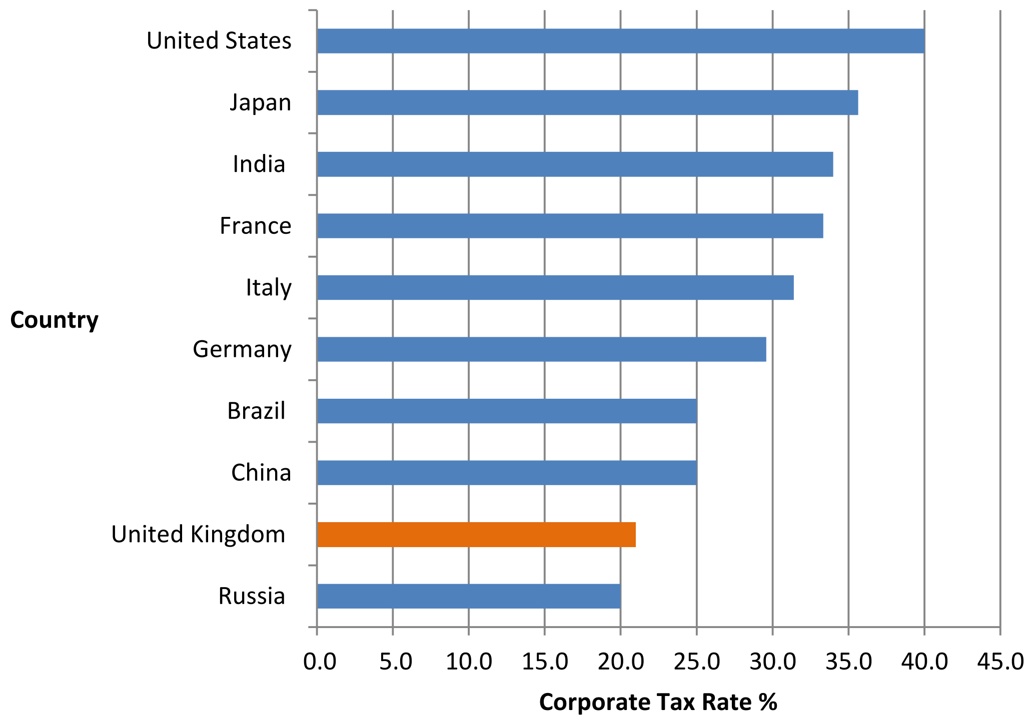
Overall the increase in revenues would be £799 million. To put this number in perspective with that amount of money it is possible to pay the salaries of either over 29000 teachers in inner London,[66] 37000 graduate nurses[67] or 44000 regular soldiers.[68] This is a relevant comparison as multinationals benefit from the teachers, healthcare and security that the country provides, yet does not contribute proportionately to fund it.

Objections to unitary tax

Would it be bad for business in the UK?

Moving from to a system where they have to pay tax based on how much activity they have in the UK, would mean that the multinational firms would have to pay more tax. Locating in the UK would still be attractive as the corporation tax rate is low compared to other similar economies, meaning that multinational firms may still pay less tax by locating in the UK instead of other countries. At 21% the UK has the lowest rate of corporation tax of the ten largest economies in the world in 2014, with the exception of Russia, at 20%. Most countries have significantly higher rates, from China at 25% to the United States at 40%. The complete comparison is shown in the figure 4.1.

Figure 4.1: Corporate tax rates in large economies in 2014



Source: KPMG Corporate Tax Tables[69]

As a result of this low rate of corporation tax, Britain is a preferred destination for firms to be located in. Indeed, in 2013, the UK Chairman of Ernst & Young, Steve Varley, said he knew of '40 multinational companies that have been looking to undertake global and regional headquarters relocations into Britain'.[70]More recently Pfzier had been attempting to takeover Astra Zeneca, as this would allow it to 'invert' its tax base to the UK, to take advantage of the much lower tax rate than the US.[71]

So the UK should still be able to attract multinationals if it adopted a unitary tax. An additional benefit for business in the UK would be that it would mean fairer competition between domestic and multinationals firms. Currently the problem is that multinationals pay a much smaller percentage of their profits in tax than domestic firms, as multinationals can shift profits overseas to avoid corporation tax whereas there is no opportunity for domestic firms to do this. This smaller percentage of tax paid by multinationals means that they have a lower 'effective tax rate'.

$$UK\ effective\ corporation\ tax\ rate\ (\%) = \frac{UK\ Corporation\ Tax\ Paid}{UK\ Profits} x100$$

The lower effective tax rate of multinationals means in effect that they have lower costs, as taxation is viewed as just another cost of doing business. These lower costs allow multinationals to outcompete firms that operate just in the UK. This distorts the competitive market and may push viable domestic firms out of the market just because they can't shift their profits overseas.

In order to illustrate the lower effective tax rate of multinationals I will compare the effective tax rates of Amazon and Starbucks with similar firms that just operate in the UK market; John Lewis and Greggs. The effective corporation tax rate of John Lewis and Greggs is lower than the corporation tax rate due to various allowances and reliefs. As these allowances and reliefs are different for each firm, the eventual effective rates are different.

Amazon vs. John Lewis Partnership

It is difficult to find an exact domestic comparison to Amazon as it dominates the online retail market. It sold 20% of the total electrical goods that were sold online in Europe in 2013, with the nearest competitor selling only 4%.[72] Additionally by their nature online retail firms tend to be multinational as the costs of operating in many countries are much lower than traditional retailers as fewer commercial premises have to be bought to expand. John Lewis does provide a relatively good approximation as they too have a large product range and compete with Amazon in areas such as electronics. John Lewis also has an important and growing online presence, with online sales over the Christmas period soaring by 28% compared to the previous year.[73] John Lewis were unable to shift their UK profits abroad so they paid 24.3% of their profits in corporation tax, whereas Amazon were able to shift their UK profits so they only paid 2.7% of their UK profits in corporation tax.

Figure 4.2: Effective tax rate for Amazon 2009-2013

Year	UK share of pre-tax profits (£m)	UK Corporation Tax Paid (£m)	Effective Tax Rate (%)
2009	92.5	-1.3	-1.4
2010	97.8	0.5	0.5
2011	58.1	1.8	3.1
2012	31.9	3.2	10.0
2013	28.1	4.2	14.9
Totals	**308.5**	**8.4**	**2.7**

Sources: previous tables

Figure 4.3: Effective tax rate for John Lewis 2009-2013

Year	UK pre-tax profits (£m)	UK Corporation Tax Paid (£m)	Effective tax rate (%)
2009	281.6	48.1	17.1
2010	155.3	48.8	31.4
2011	173.4	46.0	26.5
2012	188.6	52.4	27.8
2013	198.8	47.1	23.7
Totals	**997.7**	**242.4**	24.3

Source: John Lewis Partnership annual reports 2009-2013[74]

Starbucks v. Greggs

Starbucks and Greggs are similar in that they are both large nationwide retailers of food and drink, Starbucks with 593 stores and Greggs with 1671.[75] Starbucks paid an effective rate of corporation tax of only 1.7% for the period 2009-2013, whilst Greggs paid 19.7%. Greggs paid tax an effective lower rate than John Lewis as it had more allowances and deductions.

Figure 4.4: Effective tax rate for Starbucks 2009-2013

Year	UK share of pre tax profits (£m)	UK Corporation Tax Paid (£m)	Effective Tax Rate (%)
2009	21.0	0.1	0.5
2010	31.3	0.0	0.0
2011	37.8	0.0	0.0
2012	57.3	0.0	0.0
2013	-4.9	2.3	-45.9
Totals	**142.4**	**2.4**	**1.7**

Sources: previous tables

Figure 4.5: Effective tax rate for Greggs 2009-2013

Year	UK pre-tax profits (£m)	UK Corporation Tax Paid (£m)	Effective tax rate
2009	48.7	14.4	29.6
2010	52.4	14.6	27.9
2011	60.5	16.0	26.4
2012	52.4	12.6	24.0
2013	33.2	-8.9	-26.8
	247.1	**48.6**	**19.7**

Source: Greggs PLC's annual reports 2009-2013[76]

Would multinationals be able to get around it?

In order to accurately calculate what unitary tax to apply to each multinational firm, there must be information on their level of activity in the UK, as well as their total global activity. It is sometimes the case that if you look at the UK subsidiary's report of what business they have done, it can often be misleading, as not all the business in the UK is done by the UK subsidiary (recall the discussion about Google's UK sales). If a unitary tax were used, then firms may try to increase the degree to which they register business done in the UK with a non UK based subsidiary in order to make it look like they have less involvement in the UK.

There are a few ad hoc solutions that the government could use to estimate the level of business in the UK, instead of relying on the subsidiary's reported business. Firstly, with employees, it should be relatively clear how many employees a firm has in the UK by the number of separate National Insurance contributions that it makes, even if these are paid from a firm registered in a tax haven.

Secondly Value Added Tax (VAT) returns can provide a useful estimate of sales made in the UK. VAT is a sales tax that is charged when a VAT registered business (registration compulsory if annual turnover is over £81,000) sells to either another business or to a non business customer.[77] The majority of items have the standard rate (20%) of VAT applied to them, there are some reduced rate (5%), such as domestic fuel and power, children's car seats and sanitary hygiene products, and a few zero rated items, such as non restaurant and take away food, books/newspapers, children's clothes and shoes and public transport. In the quarterly VAT return, firms give both the VAT they charged on what they sold and the VAT they paid on what they bought. As the vast majority of items are charged at 20% VAT, the VAT charge on sold products can be multiplied by five in order to give an estimate of revenues.

Finally, a significant proportion of non-current assets are the buildings and warehouses which multinationals operate from. Business properties such as these are charged business rates on the basis of the value of the property. This value could be adjusted to give an indication of the level of non-current assets in the UK.

All of these ad hoc solutions have the advantage of using mostly pre-existing data to make estimations of activity. If the estimations are significantly different from the UK subsidiary's reports then more detailed investigation can be done.

Another solution to the problem of UK subsidiaries not reporting the total business done in the UK would be to compel multinationals to produce a combined global report which gives country by country details on activity. This concept was developed by Richard Murphy and the Tax Justice Network.[78] A country by country report would require that multinationals had to declare which countries they operate in, what they are called in each country, the financial performance in each country (including sales, labour and non-current assets) and how much tax and other benefits they pay to government. We could then see exactly where multinationals operate and what activity is carried out in each. There is also incentive for the multinationals not to 'cheat' on their global reports and underestimate activity in high tax jurisdictions. The global report with a breakdown of activity in each country would give investors a good idea of what risk the firm was exposed to by the degree to which it was doing business in each country. If it appears that all sales, employees and assets are held in a few tax havens, then the business looks significantly exposed to risk and also not involved in profitable markets. Consequentially if the figures are manipulated, this may lead to a drop in investor confidence in a firm and a drop in the share price. As it is the company's duty to look after the interests of its shareholders by maximising the share price it would not want to misreport figures to a substantial amount due to fears about appearing over exposed to risk.

There is some precedent for country by country reporting which indicates that it may be possible to implement it. In the financial sector, in the wake of accusations about the underpayment of corporation tax by some banks, such as Lloyds and HSBC,[79] and worries about where exactly risk was spread around the world after the financial crisis, there was a move towards country by country reporting in the EU. As a result under the Capital Requirements Directive IV (2013), Article 89, there is a requirement for all credit institutions and investment firms to report on a country by country basis from 1 July 2014.[80] This includes a requirement to disclose annually for each country: name of firms, the nature of activities, the number of employees and turnover. Certain 'globally systemically important institutions' will also have to disclose their pre tax profit/loss and any taxes paid or subsidies received.[81] This is very similar to the description of country-by-country reporting suggested above and is useful in that it allows the level of activity of the banks in each country to be calculated and also what exposure to risk they have, based on relative involvement in different countries.

Formula disagreement

The weightings in the apportionment formula are difficult to agree on, as seen with the CCCTB discussions. These arguments arise because different formulas would be beneficial to different types of country as different formulas can make it look like a multinational does more or less business in a particular country. For example if the country is a heavily labour based economy, then they will want to adopt a formula that gives extra weight to the number of employees. If however a country has a lot of wealthy consumers, then it may want more weight given to sales.

In order to see how using different formulas can affect the potential tax receipts, it is useful to consider again the case of Amazon, Google and Starbucks. I will consider the most common formulas in use in the unitary tax system in the United States.[82] These are the equally weighted formula, the double weight to sales formula and the 100% weight to sales formula. Formally;

$$Equal: \%\ Involvement = \frac{1}{3}\%Assets + \frac{1}{3}\%Labour + \frac{1}{3}\%Sales$$

$$Double\ Sales: \%\ Involvement = \frac{1}{4}\%Assets + \frac{1}{4}\%Labour + \frac{1}{2}\%Sales$$

$$100\%\ Sales: \%\ Involvement = \%Sales$$

Figure 4.6: Comparison of differently weighted unitary taxes for Amazon 2009-2013

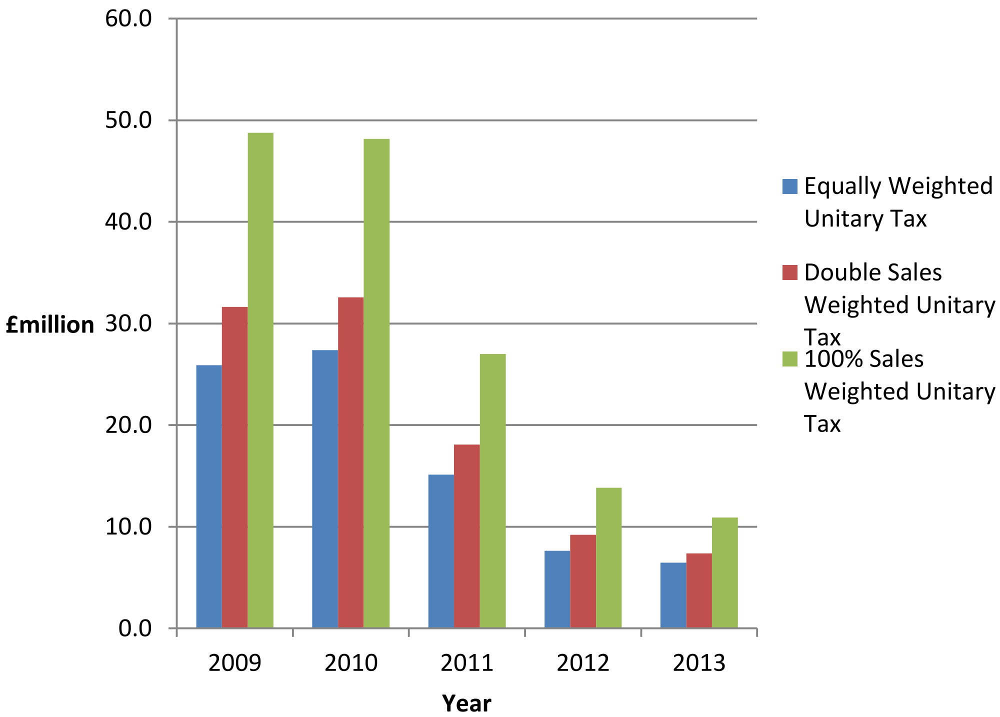


Figure 4.7: Comparison of differently weighted unitary taxes for Google 2009-2013

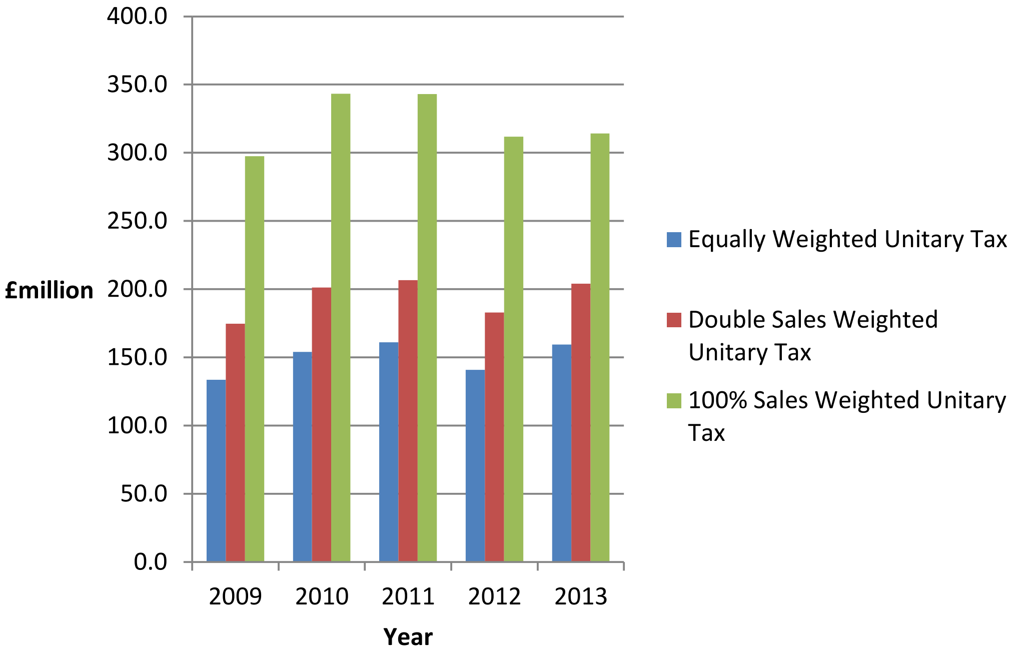
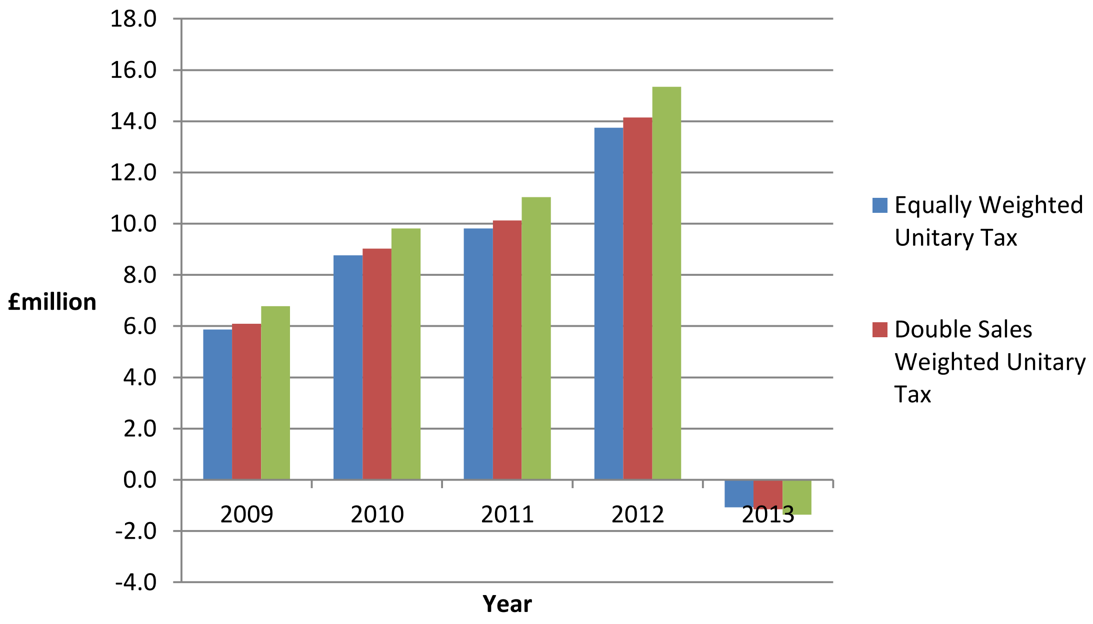


Figure 4.8: Comparison of differently weighted unitary taxes for Starbucks 2009-2013

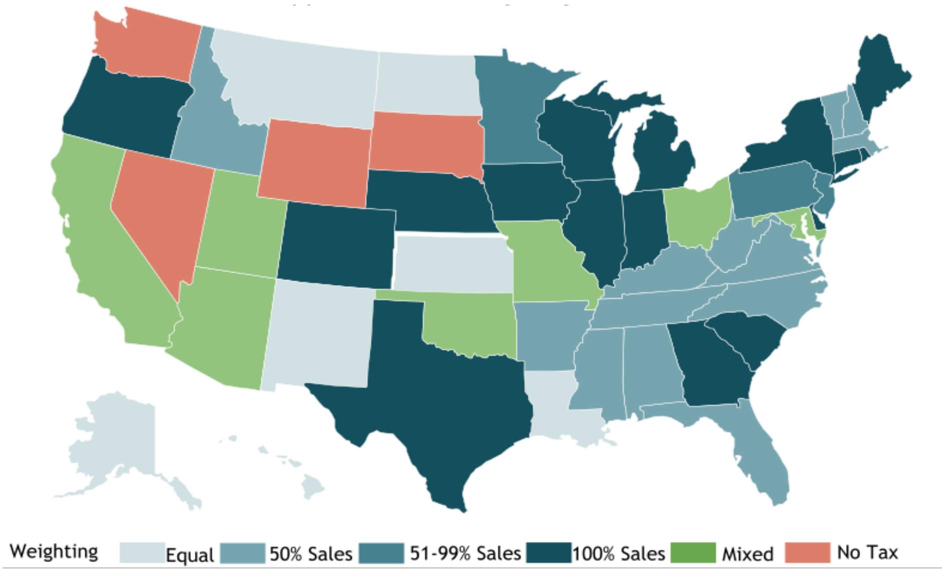


The amount of corporation tax due increases as more weight is put on the sales factor. Thus, if the UK aims to maximise corporation tax receipts then it may argue for the main weight to be placed upon the sales factor. Other countries may want a factor that favours assets and employment as they have a small consumer market but are substantial producers.

Is it really a constraint?

Although it would be helpful for accounting purposes to have a common formula in order to determine involvement, it isn't necessary to have a common formula to have a unitary tax system. For an example of how this would work, consider the state corporation tax system in the United States, where there is considerable variation in formulas used. The 46 states that use corporation tax include sales in the apportionment formula and 33 states also include factors which compare each firm's payroll and property in the state compared to total payroll and property. Of the 33 states which use the three factor formulas, 22 give extra weight to the sales factor. Seven states have more than one formula that can be used, some depending on what sort of business is being done. For example in California, a firm can elect to have either 50% weighting or 100% weighting on sales. This is summarised in the figure below

Figure 4.9: United States state corporation tax apportionment weighting in 2012



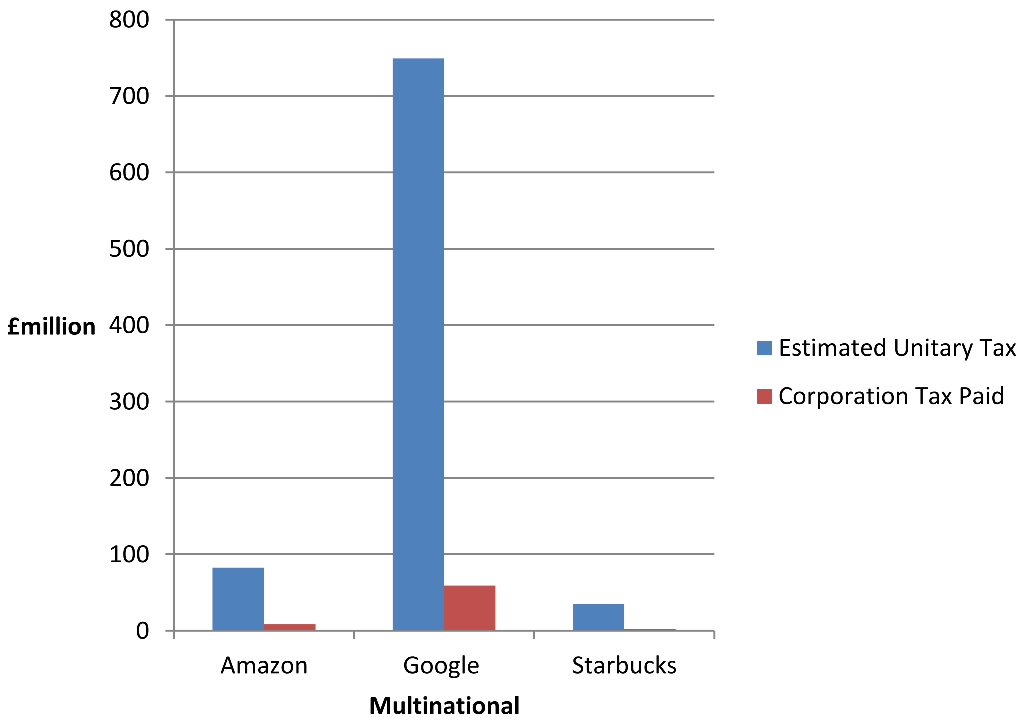
Data source: Lohman, J., Corporation Tax Income Apportionment Formulas (2012)[83]

Conclusion

Does unitary taxation provide a feasible solution to the low tax paid by Amazon, Google and Starbucks?

Unitary tax would generate more tax revenue from Amazon, Google and Starbucks than under the current system of corporation tax. Under my estimates if it had been used between 2009 and 2013 it would generate additional revenues of £799m (£690m from Google, £74m from Amazon and £35m from Starbucks), representing an increase of over 1000% on revenues that were actually collected during that period. The level of estimated unitary tax and corporation tax paid between 2009 and 2013 are shown on figure 5.1.

Figure 5.1 – Comparison of total revenues under estimated unitary tax and the current corporation tax system for Amazon, Google and Starbucks 2009-2013



Unitary tax may prove good for business in the UK. The UK would still be able to attract multinationals as although they would be paying higher taxes then they previously did in the UK, the taxes may still be lower than in other similar economies due to the UK's relatively low corporation tax rate of 21%. Unitary tax would also mean the difference between the effective rate of corporation tax between multinational and domestic firms would be substantially reduced. This would allow for fairer competition between domestic and multinational firms, giving a boost to British firms.

Multinationals might try to avoid unitary tax by disguising where their activity happens. However due to the ad hoc tests of National Insurance for employees, VAT for sales and business rates for non-current assets it would be possible to see where gross misreporting was happening and then focus resources on investigating those cases. Additionally country by country reporting could be introduced so that the level of involvement could be seen from the global group perspective. The group would be discouraged from cheating on the report as it may cause them to look over exposed to risk, leading to a drop in share price.

It may prove difficult to agree on a formula to calculate the unitary tax for multinationals as different formulas are beneficial for different countries. For example for the taxation of Amazon, Google and Starbucks the UK would most benefit from a formula that was weighted towards sales and least benefit from a system that was weighted towards non-current assets. Agreement on the formula is not needed for a unitary tax system to be used within an economic group, as the experience of the state corporation tax in the United States shows.

1. Introduce a unitary tax system to stop multinationals avoiding UK corporation tax

2. Lobby for others, such as the EU, to use similar unitary tax systems to help reduce administration costs for firms. Do not force the same formula upon others as this would lead to disagreement and non implementation

3. Use equal weightings for the apportionment formula. This would impose the smallest tax burden on multinationals of all the weightings considered, but still raise considerably more revenue than the current system does.

4. Introduce country by country reporting. This would provide another check on how much involvement multinationals have in the UK

Future avenues of research

In order to make the current analysis of Amazon, Starbucks and Google more informative it would be interesting to see how different labour involvement in the UK is when measured with payroll instead of with headcount. This would be relevant in the context of the CCCTB which proposes to use an equal split between headcount and payroll to work out labour involvement

The framework which I have used could also be expanded to consider other multinationals operating in the UK to give a more complete picture of how the unitary tax would affect their tax bills and whether there would be any significant variation dependent on sector or size of multinational.

Additionally the framework could be applied to countries other than the UK to see if there were differing effects for the different countries tax bills for multinationals. It may prove of particular interest to run this exercise for the federal corporation tax in the US. There has been a recent trend for US companies to 'inverted' their tax base overseas so they have to pay a much reduced corporation tax in the US.[84] Indeed inversion deals constituted over $200 billion of mergers and acquisitions for US firms in the year to 5 August 2014, which made up around 2/3 of total merger and acquisition business.[85] This tax avoidance has angered the federal government, with the White House threatening to use controversial presidential powers to stop tax inversion and the reduced tax revenues that result from it.[86] Unitary tax could provide a solution to this and some research can be done to see whether it is a good option for the United States federal government.

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