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Debating Taxation of MNEs – On the use of Legal Facts in the current Debate and Non-legal Obligations

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The taxation of MNEs is widely debated. This is even more so with respect to MNE's tax planning arrangements. Increasingly, however, it seems that politicians and the media are not paying enough attention to facts in the debate. Recently we have witnessed examples in my home country of this tendency. These examples are the reason for this blog. I believe that the example serves perfectly as an illustration of todays' environment. Businesses not only face the challenges of increasingly complex and unclear legislation (including BEPS initiatives) but are now also facing the risk of public ban.

The specific case in mind is a very recent media case regarding the international mobile operating company "3". This case serves well as an illustration of the current climate and the level in the debate. The case has revealed that politicians and media are willing to present to the public what they see as revelations and that the same politicians and the media are willing to make some wide reaching conclusions on the basis hereof. At best, however, the "revelations" bring about no news. Moreover, several misunderstandings are brought forward by the media. It seems that the only objective is the creation of a good news story.

The news story was initiated by the so-called Luxleaks documents, where private rulings from the Luxembourg tax authorities have been stolen and subsequently revealed in the media. One such private ruling concerned the owner of the mobile operating company "3", a company resident in Hong Kong, which owned its European subsidiaries through its regional headquarters in Luxembourg. The European subsidiaries were financed through loan advanced from Hong Kong through Luxembourg. The Luxembourg ruling created certainty with respect to the tax treatment of the financing arrangement. Moreover, the effective taxation of interest received in Luxembourg was limited to 5.2 %.

Evidently, the consequence from obtaining a loan is the payment of interest from the Danish debtor company to its creditor in Luxembourg. Despite severe restrictions on the deductibility of interest payments in recent years such payments are still deductible as a starting point. Combined with massive investments in network and marketing a tax loss was generated in Denmark

Basically, the above facts are all that have been revealed to the public. The reaction has been overwhelming in terms of massive condemnation and indignation. Leading left wing politicians are quoted for the following [my translation]: "3 is cheating its customers for taxes, which could have financed welfare, childcare and eldercare". Another politician (previously a minister in the current

government) expressed to find herself in a state of shock and indignation and encouraged consumers to reconsider using the company's services. The most far reaching reaction has been the claim from two socialist parties to ban the company and its big 4 advisors as a service provider to the public sector.

Obviously, there is a political dimension to the debate. However, facts should not be left entirely out of the discussion as currently seems to be the case. From a legal perspective the criticism is based on certain technical misunderstandings which are commented in the following.

The special feature concerning carry forward of tax losses seems to cause great understanding difficulties by politicians and the media. Expressed in a popular way businesses may save their losses for better times, where the activities are once again profitable, and can set off such profits. As a consequence businesses are not punished by incurring costs in one fiscal year while making money in another. This principle is very well known in many countries. It does not require any form of tax planning to benefit from this principle and as a consequence not pay any corporate income tax as long as the amount of losses carried forward exceeds the profits of any subsequent fiscal year.

When attacking this simple and well known mechanism politicians are demonstrating an enormous lack of knowledge of the tax system which is almost inexplicable.

The interest payments between related parties should be arm's length. In the 3-case it was made publicly known that the tax authorities in 2010 actually did carry out a transfer pricing audit but that this did not result in an increase of the taxable income or in a change of the terms of the loans. Presumably, 3 was in fact in compliance with the applicable legislation.

Moreover, it was made known, that the interest payments were not subject to interest withholding tax in Denmark (ie. the beneficial ownership requirement was fulfilled).

The debate becomes genuinely derailed when politicians and media claims that Denmark loses tax revenues as a consequence of the company being subject to an effective low tax rate on the interest payments in Luxembourg. This is a misunderstanding and inappropriate criticism. Denmark did not lose any tax revenue as a consequence of the tax ruling between Luxembourg and the Hong Kong company. If the income generated in Luxembourg would have been subject to an effective corporate income tax of say 25% for the fiscal years in question, this would not have resulted in a single euro in increased tax revenue in Denmark.

As a consequence of the complexity of todays' tax legislation it often involves quite an effort to conclude on the correct tax position of an internationally operating group of companies. In light of this, it may be considered whether it is reasonable to present the companies with further requirements not stated in any hard legislation. Is it not a fair assumption for the company to make, that once all laws of any country where the company operates are fulfilled, nothing more can be required by the company? Would it be fair to expect that a company on its own will seek a worse tax position as compared to the position that directly follows from the applicable laws of any given country?

Should we all recall the learned statements by several courts around the globe, according to which tax payers are free to choose the alternative which does not result in the highest tax payments. Taxpayers are actually allowed to choose the alternative which triggers the least taxes.

Politicians who want to bring about a change in the activities of companies should promote changes in the legislation if there is any room left for such changes. It seems to contravene the basic idea of the EU if any member state unilaterally should prevent companies from conducting business through other member states (including Luxembourg), simply because the latter has chosen another design for its fiscal system.

When politicians belonging to parties in office argue publicly for a ban of concrete companies and their advisors this is a kind of abuse of power (here used in a non-legal sense). This is especially so, when the company in question has complied with all tax provision of the country in question.

The dimension of morality in the tax debate seems to be anchored in the thought of solidarity. However, no business can be conducted on the basis of loose concepts as this. Companies are primarily a tool for serving the interest of their owners – the shareholders, which i.a. includes generating after tax profits.

Arguing that companies should pay more taxes than follows from the tax laws, is similar to criticizing drivers on a freeway staying below the speed limits. Could we agree that this lacks meaning?

The solution to all tax planning (including aggressive tax planning) is to level the playing field by eliminating structural differences between the tax systems and or tax rates of the states of the world. Once it is realized that this is only possible to a limited extent a single state can either choose to enact all types of anti-abuse and anti-arbitrage rules that are theoretically available or enter the battlefield for investment, employment and capital through the design of an attractive tax system.

The observed attempt to put a ban on the MNE's advisors also seems too far reaching. Who could ever want to engage an advisor who would have as an objective of her advice to recommend the more expensive solution (think of an investment advisor)? In some countries the advisor might even have to compensate a client that has been taxed harder than the client could have expected, if the advisor has overlooked or failed to mention a more favorable solution.

While the criticism of the MNEs in the current debate tends to be increased this does not seem to be based on a correct technical analysis. A meaningful debate definitely deserves a more knowledgeable technical basis.

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