Multinational enterprises must stop profit shifting and pay their corporate income taxes

Emmanuel Budu Addo – HoF, ActionAid Ghana

Many developing countries such as Ghana hosts multinational enterprises (MNEs) to support their development agenda, hoping these enterprises will honour their tax obligations and meet the expectations of all stakeholders. In contrast, many MNEs take advantage of the power in their size and the complexity of their structure to deny many developing nations tax revenues that could be used to advance their development agenda of fighting poverty and the injustices that cause it. The 2009 Christian Aid report *"False profits: robbing the poor to keep the rich tax-free"* indicated that Ghana lost GBP 74 million between 2005 and 2007 to multinationals of EU and US residence. Another report by ActionAid UK alleged that SABMiller, the majority shareholder of Accra Brewery Limited has established complex structures that enable the company to avoid paying taxes, estimated at Ghs 2.2million per annum. The developing complexity of MNEs' quest to maximise their shareholder value against meeting their tax obligations have assumed a phenomenal trend and have now become a major aspect of development discourse which Ghana cannot ignore.

MNEs defined

A multinational enterprise (MNE) is defined by the Organisation for Economic Co-operation and Development (OECD) as "a company or group of companies with business establishments in two or more countries". MNE's, also known as multinational corporations, establish subsidiaries in countries other than their home countries with several motives – one of which is to expand their market access to increase their revenue and return on investment. MNEs contribute significantly to global production of goods and services. It is estimated that over 60% of international trade is handled by MNEs.

In Ghana, many MNEs have registered to operate in various industries including, banking, breweries, textiles, oil and gas, and mining. The government has the responsibility for providing an enabling environment including security, infrastructure, and human capital to facilitate the smooth operations of these businesses. In addition, government grants these businesses several years of tax holiday to enable them to overcome the restraints of business start-up, among other reasons. In return, MNEs are also statutorily obliged to pay income tax to government to enable government mobilise revenue to provide state services which are critical for the smooth operations of their businesses. Unfortunately, most MNEs use various schemes to aggressively avoid paying taxes. One of the commonest schemes used is to shift profits from Ghana to other countries through transfer mispricing of goods and services.

Transfer pricing as a management tool

Transfer pricing is an advanced management accounting tool used to determine the price at which a decentralised company transfers intermediate products or services from one sub-unit of the company to another. For example, when a company in Nigeria transfers goods or services to a related company in Ghana, the price charged by the Nigerian company is referred to as the “transfer price”. One of the main objectives for using transfer pricing is to determine the amount of profit or loss that is attributable to the activities of a decentralised sub-unit of a company. Various methods used to price output products or services of one sub-unit used as input products or services for another sub-unit helps to determine the amount of profit each sub-unit is contributing to the total profitability of the organisation.

The use of transfer pricing also helps management to make several decisions including the decision to buy inputs from external sources or produce them internally, depending on which strategy will effectively and efficiently enable achievement of corporate objectives. Where a sub-unit is making losses, a management decision could be made to determine whether the output of this sub-unit could be procured from external sources at a more competitive price, to optimise returns. Otherwise, for certain strategic advantages, the sub-unit’s loss could be tolerated.

Transfer pricing abuse

Unfortunately, many MNEs have predicated their profit-making, and their ability to meet their shareholders’ expectation through the misuse of the transfer pricing tool. Transfer mispricing is used to shift profit from one jurisdiction to another - usually from tax jurisdictions where the effective tax rates are higher to tax jurisdiction where the effective tax rates are significantly lower. Tax jurisdictions with significantly low effective tax rates are referred to as “tax havens”, and many MNEs have subsidiaries in these tax havens for the purposes of profit shifting. For instance it is reported that one building in the Cayman Islands is the registered office of 18,853 companies, including some of the biggest MNEs in the world. In fact the number of registered companies in the Cayman Islands is about double the size of the population.

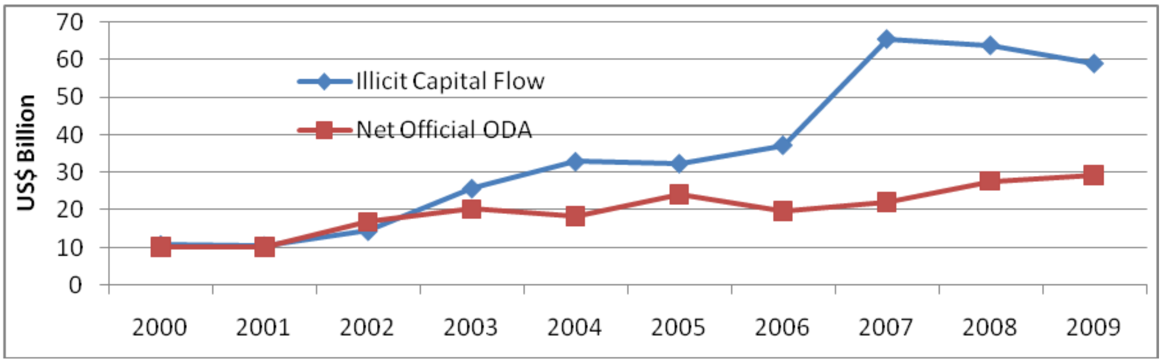
In most cases the establishments in the tax havens do not carry out any significant business activities, yet they record huge profits from which negligible or no corporate income taxes are levied. On the contrary, the subsidiaries where most of the business activities take place also misleadingly report low or no profits, and thereby pay negligible or no taxes. So through transfer mispricing, the MNEs are able to avoid payment of tax. These tax avoidance schemes of multinationals significantly affect the fiscal base of affected economies, both developed and developing. But developing countries such as Ghana bear the severest burden.

Tax revenue loss from transfer pricing abuse – a global perspective

A University of Essex report in 2010 indicated that the GDP of Russia declined by 14% in 2004 as a result of tax losses from transfer pricing malpractices. The Chinese government also reported that about 60% of company losses recorded in the country were false, thereby causing a tax loss of over 30 billion Yuen (US$4.39 billion) per annum. In 2009, Christian Aid reported that between 2005 and 2007, MNEs siphoned significant amounts of tax revenue to the 27 EU countries, UK, Ireland and the United States of America. In Africa, Algeria, Cote d'Ivoire, Egypt, Morocco, and South Africa, lost Euros 386 million, 225 million, 272 million, 376 million and 962 million respectively to the 27 EU countries alone.

A critical analysis of illicit transfer of capital from Africa and the lost revenue thereon comparative to Official Development Assistance (ODA) indicates that, the former is increasing at a rate three times higher than the rate at which the later is increasing.

Illicit capital outflow compared with ODA to Africa between 2000 and 2009



Source: Global Financial Integrity 2010&2011, and OECD

The 2010 and 2011 reports from Global Financial Integrity indicated that illicit financial flows from Africa between 2000 and 2009 amounted to more than US$ 352 billion. Within the same period, the OECD recorded that net ODA to Africa totalled $198.52 billion. The chart above has been used to compare the average rate of growth of illicit transfers of capital from Africa against the net ODA Africa has received from its developing partners within the period 2000 to 2009. The chart indicates that illicit transfer of capital grew at US$ 6.6 billion annually, a rate three times higher than the rate of growth of net ODA. Between 2005 and 2009 the rate of increase deteriorated to US $8 billion per annum, which is more than four times the growth rate of net ODA for the same period. This clearly underscores the urgent need for African countries to collectively address the issues involved head-on to discourage transfer mispricing and allied practices that deny the continent the revenue critical for economic development and poverty alleviation. Developed countries such as the US have made significant progress in curbing transfer mispricing and profit shifting. These countries have improved tax regulations, enhanced tax audit systems, and an apprised public that support enforcement of tax regulations.

The United States Treasury report to Congress in November 2007 which reported on earnings stripping, transfer pricing and U.S. income tax treaties stated that the US had made significant progress towards curbing transfer pricing malpractices. The effect of which was an enhanced revenue collection and increased recovery. The report further stated that an amount of US $ 3.4 billion was recovered from GlaxoSmithKline plc, a recovery that was considered the largest single payment ever made to the US revenue services.

Unfortunately, Ghana our beloved country, has not made such significant recoveries yet, nor prosecuted any company for profit shifting through transfer pricing. This notwithstanding, the practice is commonplace among many MNEs. Recently Ghana benefited from a five-country research by ActionAid which alleged that SABMiller, the company that holds majority shares in Accra Brewery has squirreled millions of Great British Pounds to tax havens through aggressive tax dodging schemes. The report identified four main schemes that SABMiller used to avoid taxes.

Transfer pricing abuse in Ghana

SABMiller has taken possession of iconic African beer brands and registered them in the name of its subsidiary in Rotterdam. In 2009, Accra Brewery paid about 2.1% of its turnover as royalties to this company. Secondly, SABMiller has another subsidiary in Zug which supposedly provides management services. The ActionAid report *"Calling time, why SABMiller should stop dodging taxes in Africa"* noted that Accra Breweries paid precisely 4.6% of its turnover annually as management fees to the Zug-based Bevman Services – a subsidiary of SABMiller Plc. SABMiller has also established another subsidiary in Mauritius where corporate tax rate is 3% to be in charge of procurement. This company in Mauritius which has 15 staff, mostly on on-the-job training, makes £150 million per annum in revenue, all by courtesy of transfer mispricing. About 50% of Accra Brewery's procurement, including items originating from South Africa and Brazil, goes through this company. Additionally, this Mauritius company granted a loan to Accra Brewery. The loan amount was more than seven times the capital of the Accra Brewery, and huge amounts of interest are charged on this loan. Accra Brewery has denied using aggressive tax avoidance schemes to avoid taxes, yet it could not explain why it failed to pay corporate tax for three years between 2007 and 2010.

Working together to end transfer pricing and poverty

The report about SABMiller's tax practices and that of many other companies across the globe have brought to the fore the need for thorough discussions about ethical business practices in Ghana and the need for MNEs to reconsider the reputational risk of tax dodging and use acceptable cost management methods (including eco-friendly practices) to optimise their stakeholder expectations. It is important to acknowledge that discussions condemning tax dodging practices have assumed wider dimensions globally, prompting more investigations into operations of MNEs. Similarly, corporate stakeholders are now aware of their rights and the responsibilities of corporate entities. Many civil society organisations are also supporting these stakeholders to demand their due rights from the rights-holders, and corporate income tax dodging is one of the areas of concern because of its multiplier effect to causing extreme poverty. MNEs need to appreciate these developments and position themselves appropriately to ensure that they respond adequately and fairly to the expectations of all stakeholders. Just as those who act honourably get a "pat on their shoulder", unethical practices that act to perpetuate poverty must be condemned. Ghana has come a long way in reforming its tax administration to ensure effective tax revenue mobilisation. And the government, recognising the challenges of tax dodging through transfer mispricing, is working fervidly to introduce a regulation to curb the current challenges. This provides a great opportunity for stakeholders – especially MNEs who are prone to transfer mispricing accusations – to be keenly involved in discussions leading to the introduction of the regulations. Civil society organisations such as ActionAid are also doing their part to apprise the public to appreciate the negative effects of tax dodging with the view to creating deeper public understanding of the effects of tax dodging. This will catalyse a positive response to the enforcement of the transfer pricing regulation. So the time to report the right profit is now, and MNEs, who genuinely pay their taxes, must support the call to end tax dodging in Ghana.

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For more information contact the following
Washington Nuworkpor, 0208170286 or Washington.Nuworkpor@actionaid.org
Emmanuel Budu Addo, 0202012683 or Emmanuel.Baddo@actionaid.org
Adwoa Kluvitse, 0244317560 or Adwoa.kluvitse@actionaid.org