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ScienceDirect

Accounting Forum 32 (2008) 199–212

ACCOUNTING FORUM

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Financial flows and treasury management firms in Ireland

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Abstract

The use of tax havens is a pervasive part of modern economic activity. Treasury management subsidiaries who are key conduits in the global intra-firm movement of funds are often located in tax havens or in countries with tax haven type features. This paper shows how two recent European Court of Justice cases dealing with treasury management firms located in Ireland, have helped secure the legal and tax benefits of such operations. The paper examines financial flows and other financial characteristics of 46 treasury management firms based in Ireland for the period 1998–05. While financial flows are large, they are highly variable from period to period. These firms are highly profitable, but median employment is zero. The paper concludes that while recent court cases have supported the existence of both low tax regimes and treasury management type operations within the EU, their continued existence is opposed by many EU and non EU countries as being at variance with legislation to counteract tax avoidance.
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Keywords: Tax havens; Treasury management; Financial flows

1. Introduction

Tax avoidance and the use of tax havens, is a pervasive part of modern economic activity.[1] The international tax avoidance industry and an increased use of tax havens and low tax countries have developed in parallel with the growth of international business (Picciotto, 1992, p. 95). Some have argued that these developments, sometimes discussed in terms of tax competition, are beneficial. Hines and Rice (1994) for example, argue that the low tax policy of tax havens may have increased the ability of the US Treasury to collect corporate tax revenue. This is because under the US tax system zero foreign tax rates result in zero US tax credits. Hence when dividends which have not been subject to tax or have been taxed at a low rate, are remitted to the US, US corporate taxes must be paid on these dividends. However this argument assumes that profits not already subject to tax will be remitted to the US. O'Sullivan (2004) shows that the absolute amount of foreign retained earnings by US corporations rose from $49 billion in 1993 to $169 billion in 2003 so that the proportion retained abroad rose to 67% of total foreign earnings for the year 2003. A substantial proportion of US profits earned abroad are in low tax jurisdictions. For 2005, six low tax countries (Bermuda, Luxembourg, Ireland, Netherlands, Netherlands Antilles, and Switzerland) accounted for 45% of the net income and for just 5% of total tax paid abroad of US majority owned affiliates abroad.[2] The American Jobs Creation Act (AJCA) (2004) allowed

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[1] Palan (2002) argues that the existence of tax havens is unavoidable as they are a direct outcome of the principle of national sovereignty and mobile capital (financial assets and intellectual capital – patents, trademarks). They provide the essential requirement for international tax planning, that is the choice of location of all or part of a corporations activities (Palan, p. 172).

[2] *Source*: US Bureau of Economic Analysis, Selected financial data on non-bank US parents for 2005, and USDIAp, Table III.k.1. Taxes paid for the Netherlands Antilles were not published but are likely to be minimal. Data available at http://www.bea.gov/.

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doi:10.1016/j.accfor.2008.03.001

US corporations to repatriate profits at a tax rate of 5.25%, compared with a normal tax rate of 35% for the year 2005. As a direct result there was an estimated profit inflow into the US of $300 billion in the year 2005.[3] Desai, Foley, and Hines (2006) argue that low tax rates in tax havens may have increased the level of foreign direct investment in higher tax neighbouring countries. Others have taken a far less benign view of the effects of low tax rates and tax havens. In 1998 the OECD was required by its members to "develop measures to counter the distorting effects of harmful tax competition" on investment, financing and national tax bases. This decision was subsequently endorsed by a meeting of the G7 heads of State, and a meeting of the Council of Europe adopted a voluntary code on harmful tax practices (Council of the European Union, 1997). The EU has advocated much closer tax coordination to combat tax fraud and tax avoidance.[4] An OECD report (1998, par. 31) states 'harmful tax competition' may result in countries using tax policies to attract financial and mobile capital and can result in one country effectively 'poaching' the tax base of other countries (OECD, 1998, par. 31). This can also have the effect of discouraging compliance by all tax payers and may erode the tax base of both countries (par. 28). It is also likely, although not identified in the OECD Report, that firms who use tax havens derive benefits and hence a competitive advantage in comparison with those firms that do not use tax havens. Subsequently the OECD in a progress Report in 2004 (OECD, 2004, par. 12), claimed that of 47 harmful tax regimes identified amongst OECD members in 2000, 45 have either been eliminated, modified or found not to harmful. It is likely though, that the influence of tax havens has increased, rather than reduced since the 1998 OECD report (Christensen, 2007; Mitchell, Sikka, Christensen, Morris, & Filling, 2002).

Many tax havens are well known and widely discussed for example Cayman Islands, Bermuda and the Netherlands Antilles. What is less widely recognised is that developed economies may also have features that enable tax haven type activities to take place. Van Dijk et al. (2006) identify several tax haven type features of the Netherlands, while recognising that the Netherlands is not a 'pure tax haven'. It cannot be a 'pure tax haven' because the Netherlands Government needs to raise tax from a large commercial base to finance government expenditures (Van Dijk et al., 2006, p. 14). The UK also has tax haven type features (Christensen, p. 221), for example rules which give non-domiciles preferential tax treatment (H.M. Treasury, 2007, par. 5.80); and extensive allowances so that for the year 2005–06 31% of all large firms paid zero corporation tax (National Audit Office, 2007, p. 10). Ireland is in a similar category. Even though the nominal rate of corporation tax is low at 12.5%, effective tax rates are likely to be even lower.[5] As in the case of the UK 'light touch regulation' is seen as an advantage in attracting financial firms to locate in Ireland, in particular in relation to firms in the international financial services sector.[6]

As a result certain tax haven type activities have located in Ireland, for example treasury management firms. Treasury management firms are the conduits for the global movement of intra-firm financial flows. A key point of their operation is that intra-firm flows of funds should not be subject to taxation or regulatory restrictions. This type of firm has also been identified as an important feature of tax haven type activities in the Netherlands (Van Dijk, Weyzig, & Murphy, 2006, p. 33 and 38). In Ireland treasury management firms are generally legally organised as a wholly owned subsidiary, but may also be organised as a branch of a foreign parent. They often form part of a complex organisational structure whose immediate parent may be located in a tax haven such as the Cayman Islands (Stewart, 2005). They are large in

[3] New York Times editorial 25 July, 2007. In particular drug companies repatriated $100 billion. Rather than creating jobs in the US, many of these companies shed jobs. *Source*: Alex Berenson, New York Times, 24 July, 2007. Other data shows that foreign net corporate dividends by industry, paid to US residents rose from $121 billion in 2004 to $348 billion in 2005 and then fell to $167 billion in 2006. The share of foreign retained corporate earnings by industry, owned by US residents fell from $195 billion in 2004 to $10 billion in 2005, and then increased to $252 billion in 2006. *Source*: National Income and Product Accounts, Tables 6.20D and 6.21D. Available at http://www.bea.gov/national/.

[4] See L. Kovacs, taxation Commissioner, "Tax Harmonisation versus tax competition in Europe", speech by given 10 Oct 2005, available at http://europa.eu/rapid/press.

[5] One reason for this is exemption from- profits tax on income from royalties and patents held in Ireland. Because of this exemption several firms in 'hi-tech' sectors located in Ireland report low or zero corporate tax. For example, Symantic International Limited reported zero tax on profits of $252 m. for the year ending April 2004; Scandisk Ireland reported zero tax on profits of $106 million for the year ending January 2006, and Forest Laboratories reported paying tax of $15.5 million on profits before tax of $669 million for the year ending March 2007. Round Island One (Microsoft operations in Ireland) reported pre tax profits of $3.848 billion and tax of $324 million or approximately 8% of pre-tax profits, for the year ending June 2004.

[6] See Financial Times, 21 September, 2007 for the UK. Several commentators have emphasised the value to Ireland of a 'light touch regulation' in relation to financial services, for example Commissioner McCreevy in a speech to the European Affairs Institute, Dublin, 30 June, 2006. A report to the IDA recommended amongst other things a "speedy legislative developments in response to industry demand" (Deloitte, 2004, p. 58) and identified a current source of competitive advantage for the location of insurance companies in Ireland as a reputation for being the Bermuda of Europe" (Deloitte, 2004, p. 65).

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