A GLOBAL TOBACCO INDUSTRY WATCHDOG

Issue Brief

Global

Big Tobacco, Big Tax Avoidance

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Background

The COVID-19 pandemic has put significant pressure on public finances. The amount of money many governments have committed to address the pandemic thus far is staggering. Just months into the pandemic, the United States of America (U.S.) Congress approved $2.4 trillion to combat the crisis,[1] and the United Kingdom (U.K.) government had already spent an additional £210 billion by August 2020.[2] Recently, the EU approved a €670 billion COVID-19 recovery fund.[3]

This money has to come from somewhere, and many governments face a brutal choice: cut public spending (which, in many cases, has already been cut to the bone), or raise taxes, either on companies or on the wider population.

An alternative option that would boost governments' abilities to fund their pandemic recovery plans is for companies to pay their fair share of taxes (which, in theory, they should already be doing) and to tax excessive profits.[4] A good place to start is with the tobacco industry. It has few equals when it comes to making excessive profits—profits that have been made selling deadly products that kill up to two-thirds of users.

Further, smoking has been established as a risk factor for severe illness from COVID-19.[5,6,7,8] STOP argues, as part of its Tobacco Pay Up campaign, that: "Governments have the power to hold the tobacco industry financially accountable for the harms it's inflicted leading up to and during the COVID-19 crisis. They should use that power."

The Big Four are not paying their fair share of taxes

Cracking down on tax avoidance is one of many ways governments can hold the industry accountable. A new analysis by The Investigative Desk, written in collaboration with the University of Bath, a partner in STOP, has found that the industry's Big Four (British American Tobacco [BAT], Imperial Brands [IB], Japan Tobacco International [JTI], and Philip Morris International [PMI]) all make extensive use of almost all common tax avoidance methods in order to pay as little profit-related tax as possible.

While tax avoidance is not illegal, it is not morally right, especially during a respiratory health pandemic and at a time when public finances are stretched.

The disparity in revenues vs. taxes paid is shocking. The Big Four have revenues in excess of €80 billion, but they pay relatively little in taxes. For example, in the U.K., previous work by researchers at the University of Bath confirms that the Big Four—two of which are located in the U.K.—are paying minimal corporation tax in the country.[9] The industry is essentially gaming the current international financial system, using sophisticated methods of tax avoidance to move billions to jurisdictions with low tax rates.

Six European countries are playing a role

The investigation found that the tax structures of Belgium, Ireland, Luxembourg, the Netherlands, Switzerland and the U.K. enabled the industry's tax avoidance strategies. Of these, the Netherlands and the U.K. play a key role in facilitating conduit subsidiaries. The role of Switzerland may be similarly important, especially in the case of PMI, but this cannot be confirmed because of the country's financial secrecy.

Some highlights of the report include:

The Netherlands: On average, the Big Four shift around €7.5 billion of worldwide profits through the Netherlands annually. BAT and IB move these profits on to holding companies in the U.K., and PMI to a holding company in Switzerland. JTI seems to send them via the Netherlands straight to its parent company in Japan.

The U.K.: Using group relief (the ability to offset losses made by one subsidiary against profits made by another) the U.K. subsidiaries of IB and BAT—both headquartered in the U.K—lowered their U.K. corporate tax burden by a joint total of £2.5 billion between 2010 and 2019. As a result, BAT paid close to zero corporation tax. IB's annual reports are so untransparent that their actual UK tax burden is virtually impossible to determine.

Belgium: BAT shifts around €1 billion in dividends via Belgium each year. Tax paid on these profits is less than 1%.

Switzerland: Indications were found that a large part of PMI's annual profits is shifted toward Swiss entities, mainly from holding companies in the Netherlands. In addition, several billion euros in dividends seem to end up in Switzerland via the Netherlands every year. As Switzerland has highly secretive banking laws, this money is difficult to trace and can legitimately "disappear," making it very difficult to hold the industry to account.

Ireland: The country's low corporation tax rate and the favorable way that intellectual property profits and dividends within the EU are taxed, means Ireland is a very attractive environment for large companies. PMI makes extensive use of the Irish route as large dividends and interest payments flow through PMI Insurance Ireland Ltd., to, among others, Switzerland.

Luxembourg: The country has a broad network of income tax treaties (double taxation treaties). Indications were found that IB may make use of the exemption of withholding tax on incoming royalty and interest payments via its subsidiary company Altadis Luxembourg SA.

The Big Four are utilizing five main avoidance methods

How is the tobacco industry gaming the system? The Investigative Desk and the University of Bath found that Big Tobacco is using five main avoidance methods:

Shifting dividends

The €7.5 billion the Big Four shifts through the Netherlands annually mainly consists of dividends from subsidiaries. This is done via countries that allow dividends to be received and paid without tax being owed. BAT shifts around €1 billion in dividends via Belgium each year. Tax paid on these profits is less than 1%.

Notional (fictitious) interest deduction

The investigation found that BAT deposited around €3.5 billion in assets in three holding companies in Belgium, which helped it deduct several millions in notional (fictitious) interest each year from 2010-2017.

Profit shifting via intra-firm transactions

We found several examples of profit shifting via intra-firm transactions. One is the sale—on paper—of all BAT cigarettes produced by BAT Korea Manufacturing Ltd., (South Korea) to Rothmans Far East BV in the Netherlands. They are immediately re-sold to another South Korean company, BAT Korea Ltd., at a much higher price. This means that every year, on average, €98 million in Korean profits are shifted, tax-free, to the Netherlands.

Royalty payments

Royalty payments are payments for the right to, for example, use a particular tobacco brand that is paid by one group subsidiary to another which is likely located in a low-tax environment. There are clear indicators that PMI and JTI use royalty payments (through the Netherlands) as a tax planning tool:

Philip Morris Holland BV pays between €25 and 29 million annually in royalties to a foreign entity. For the Dutch subsidiary, these are considered costs, so the taxable profit is lowered considerably.

Japan Tobacco International Group Holding BV shifted about €250 million through the Netherlands every year between 2010-2013 as royalties.

Group relief, partly based on internal loans

The two British tobacco giants in particular use group relief (loss compensation) as a major method to reduce their corporate taxes. IB lowered their UK corporate tax bill by an estimated £ 1.8 billion over the last ten years. BAT lowered its corporate tax bill by an estimated £ 760 million. At both IB and BAT, the losses involved regularly stem from interest paid on internal loans, resulting in eligibility for group relief. There are indications these loans, at least in part, serve to lower their corporate tax bills. As a result, both BAT and IB pay close to 0% corporate tax in the U.K.

Tax disputes and investigations

Some countries are trying to make the industry pay. The Big Four have been involved in tax disputes in at least eleven countries over the last ten years, leading to claims by tax authorities ranging from €45 million to €1.2 billion. In the majority of cases so far, the courts' decisions have been in favor of the companies. This shows these tobacco companies are not necessarily breaking the law, but the pattern of disputes and investigations reveals that they are trying to circumvent tax obligations wherever possible:

- PMI has been/is under examination by foreign tax authorities in Germany, Indonesia, Russia, South Korea, Thailand, Switzerland and Turkey.
- BAT has been/is involved in disputes in the Netherlands (a record claim of €1.2 billion), Brazil, South Korea and Egypt. In September 2019, the European Commission announced an in-depth investigation into tax avoidance by multinationals. BAT is one of the 39 companies under investigation.
- IB is involved in three large ongoing tax-related legal procedures in France, Russia and the EU, involving tax claims totaling £672 million.
- JTI was involved in three specifications of tax disputes, in Turkey, Russia and the U.K.

The tobacco industry must pay its fair share of taxes

The six countries listed in this brief should crack down on tax avoidance measures that, while likely legal in those six countries, enable tobacco companies to circumvent their tax obligations in others.[10]

In the case of the U.K., the country's exit from the EU (i.e. Brexit) might allow the country greater freedom to act. Such action should be politically attractive for a government that wants to present Brexit as a positive development and is currently borrowing record sums.

Endnotes

1. https://www.usatoday.com/in-depth/news/2020/05/08/national-debt-how-much-could-coronavirus-cost-america/3051559001/
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STOP. A GLOBAL TOBACCO INDUSTRY WATCHDOG

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GGTC Global Center for Good Governance in Tobacco Control

The Union International Union Against Tuberculosis and Lung Disease Health solutions for the poor

Vital Strategies

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