Does Starbucks Pay Enough Tax?

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In 2012 Starbucks became a target for public protests

Starbucks tax bill in the UK

- Starbucks had paid very little corporate income tax since it entered the UK market in 1998
  - The Economist, "Wake up and smell the coffee", Dec. 15th 2012
- Starbucks declared zero profits (and therefore zero tax payments) in most years in the UK

It’s not just Starbucks

OH YES, THEY'RE THE GREAT AVOIDERS

Company	Revenues*	Tax Paid	Rate
Starbucks	£398m	Zero	Zero
Amazon	£3.3bn	£1.8m	0.0545pc
Apple	£10bn (est)	£11.4m	0.114pc
Facebook	£175m (est)	£238,000	0.136pc
Google	£2.6bn	£6m	0.23pc
EADS	£3bn	£10.5m	0.35pc
IBM	£3.8bn	£21.7m	0.57pc

UK Tax Gap: £32bn

Corporation Tax Gap: £4.1bn

*latest figures available

Sources: HMRC, company accounts, analyst estimates and forecasts.

Wider concern that corporations aren't paying a "fair share" of tax

- The media in the US and UK has called for companies to pay more tax and has reported heavily on the strategies that companies employee to avoid tax
  - Bloomberg "The Great Corporate Tax Dodge"
  - The New York Times "But Nobody Pays That" (for which the author received the Pulitzer prize)
  - The Times "Secrets of Tax Avoiders"
  - The Guardian "Tax Gap"
- It's not only the media, the OECD has formed a committee to consider *Base Erosion and Profit Shifting (BEPS)*

This talk

- Corporate income taxes
  - What are they?
  - Who bears the burden of the corporate income tax?
  - How much tax revenue do they raise?
- If firms do pay corporate income taxes, where should they pay them?

What are corporate income tax?

- Corporate income taxes are taxes on the profit a firm earns
- In the UK we tax profits earned in the UK
  - a shareholder invests in a firm
  - the manager buys equipment, materials and hires workers
  - the firm produces something that it sells to consumers
  - the profits of the firm are the revenue earned from selling the product minus the costs of equipment, materials and pay to workers and the manager
  - these profits are owned by the shareholders

Who bears the burden of the corporate income tax?

- **Legal incidence**
  - legally "the firm" pays the tax
- **Economic incidence**:
  - who is made worse off because of the tax
  - firms can not bear the economic incidence of a tax, they can not be made worse off, only people can
- Who is potentially made worse off by the corporate tax?
  - Shareholders, if the impact of tax is to reduced dividend or reduce capital gains
  - Workers, if the impact of tax is to reduce wages
  - Consumers, if the impact of tax is to increase prices
- Economic incidence can be very different from legal incidence

What is a corporation?

- Why have a corporate income tax
  - shareholders pay income tax on dividends
  - if we want to tax this income higher, raise income taxes
  - or increase consumption taxes
- In 2002 the government reduced the rate of corporate income tax on small firms from 10% to 0%
  - they lost something like £1bn in tax revenue a very short time
  - taxi drivers and other self-employed people incorporated and become firms
- Corporate income taxes might play an important role as a backstop to labour income taxes

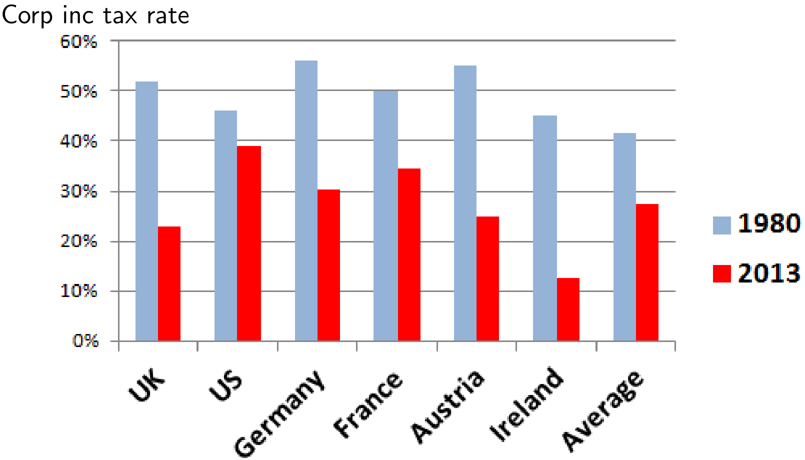
Who bears the burden of the corporate income tax?

- Academics and policy makers have argued that shareholders might not bear the full economic incidence of corporate incomes taxes
- One reason - capital is more mobile than workers
  - a firms can move it's investment to another country, most people won't move to another country to work
  - if corporate income taxes are high in one country then a firm will move to a country with lower taxes
  - this means workers have less capital to work with
  - this reduces their marginal product (they produce less in each hour that they work)
  - this lowers their wages
  - meaning that some of the economic incidence of the tax has been shifted to workers

Competition for capital

- The idea that capital is mobile leads to the prediction that governments should compete for firms to invest in their country by lowering their corporate income tax rates
- Over the past 30 years governments have reduced corporate income taxes

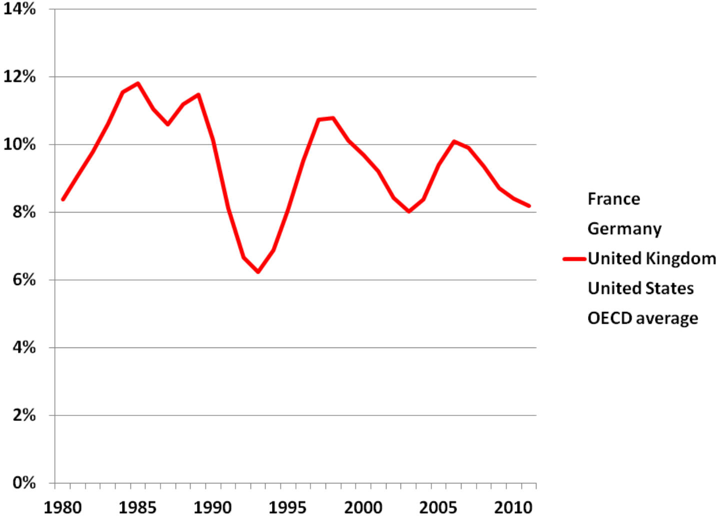
Governments have reduced corporate income tax rates



- Has the amount of corporate income taxes that firms pay declined?

Corporate income taxes as a share of total tax revenue

% total tax revenue



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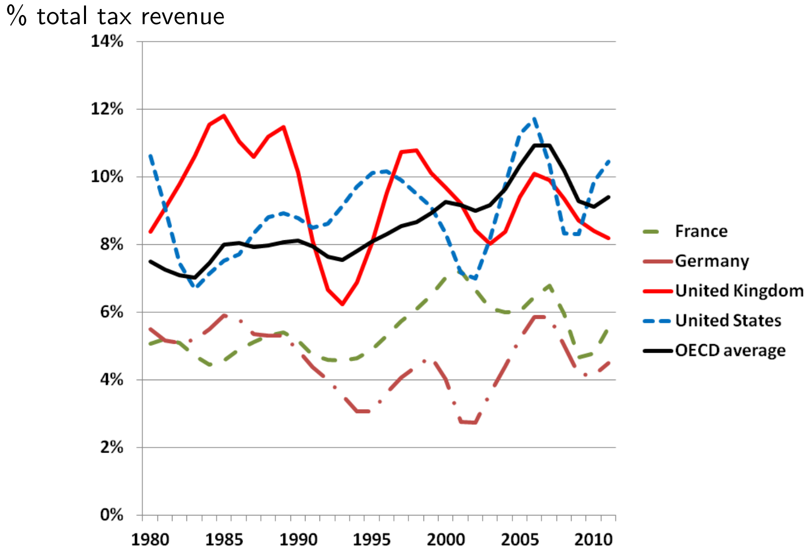


Why have revenues from corporate income taxes increased when tax rates have fallen?

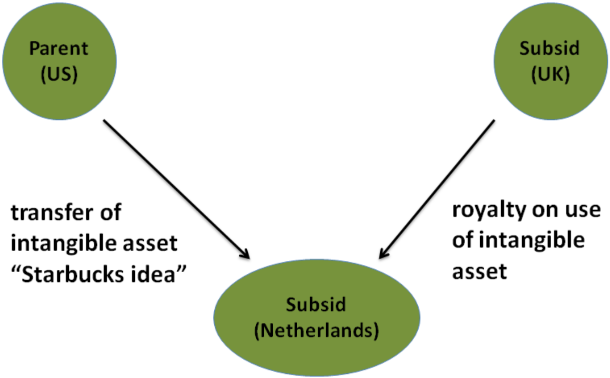
- Despite the long running concerns and the claims that companies do not pay enough tax, revenues from corporate income taxes have been surprisingly buoyant
- This is mainly because corporate profits have increased as a share of GDP
  - share of activity that is in corporations has increased
  - profitability of corporations has increased

Where should a firm pay tax?

- Lots of corporate activity takes place across many different countries (tax jurisdictions)
- In the 1980s governments were concerned that large corporations paid **too much tax**, because they faced tax on their activities in several countries
- International agreement at the OECD that
  - firms should pay tax in the location that the profit arose
  - individuals should pay tax in the location that they resided

Why doesn't Starbucks pay tax in the UK?

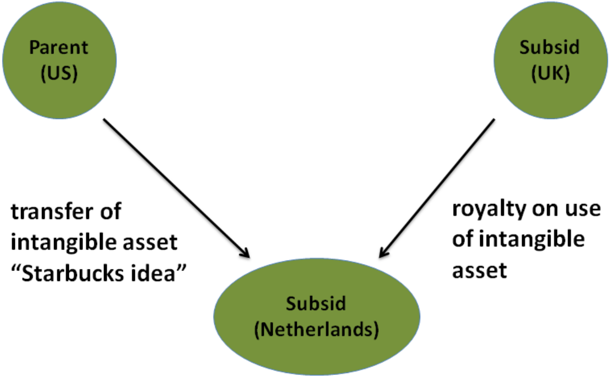
- Starbucks doesn't pay tax in the UK because it pays it in other countries
  - the UK subsidiary makes royalty payments to another Starbucks subsidiary in the Netherlands
  - the payment is for use of the brand and other intellectual property
  - the subsidiary in the Netherlands pays tax


Parent
(US)
Subsid
(UK)
transfer of
intangible asset
“Starbucks idea”
royalty on use
of intangible
asset
Subsid
(Netherlands)

How much tax does Starbucks pay?

- In 2011 Starbucks paid 31% tax rate worldwide
  - but paid 13% on it's overseas activities
- Is this fair?
  - given that we have international agreement that firms should pay tax in the location that the profit arose
- Where did the profits arise?
  - when I buy a cappuccino in Starbucks what am I paying for?
  - the machines?
  - the fact they ask my name and write it on the cup, the music they play, that they give me the free iTunes download?
  - those things were "created" at headquarters in the US, not in the UK branch

- It is difficult to know what is the price of these intangible assets, as they are not traded on the market



Other examples where firms can use international rules to avoid paying any tax

- Apple has an Irish subsidiary, no employees (until last year)
  - this subsidiary has rights to Apple's intellectual property outside of the US
  - it receives 60% of Apple's worldwide sales outside the US
- Ireland's tax rules means that that the firms should be taxed in the US
- The US tax rules mean that the firm should be taxed in Ireland
- So the firm is not taxed (on approx \$ 10bn a year)

Policy developments

- The OECD is currently considering these issues
  - BEPS report (Addressing Base Erosion and Profit Shifting)
  - international tax system originally set out to **avoid double taxation**
  - now the concern is that firms might pay too little tax
- It's not just firms that are using the rules to reduce tax
  - Governments want to:
    - ⋆ lower tax in their country to attract real investment
    - ⋆ lower tax on "their" firms to generate competitive advantage when they compete abroad
  - Yet they also want to raise tax revenue
- For fairness we want to ensure that profits are taxed somewhere
  - though this might be through other parts of the tax system, such as income taxes or consumption taxes