Oxfam Ireland Briefing Paper

HARD TO SWALLOW

Facilitating tax avoidance by Big Pharma in Ireland

EMBARGOED UNTIL 00:01 HRS GMT 18 September 2018

New research by Oxfam indicates that Ireland's corporate tax rules are allowing four of the world's largest pharmaceutical companies - Abbott, Johnson & Johnson, Merck and Pfizer - to avoid large amounts of tax by shifting profits to and through Ireland. In just seven developing countries, these four US pharma companies appear to be avoiding an estimated €96.6[1] million in taxes every year, undermining these governments' efforts to provide essential health services to address poverty and inequality. Our research also indicates that despite declaring significant profits in Ireland, these companies are paying very little tax on profits in Ireland. From the data we have accessed it appears that Abbott paid no tax on profits of €1.2 billion declared in Ireland in 2015. The Irish tax payer ultimately lost out on an estimated €155 million from this one company for just one year – this is the level of tax that would be due if Abbott was charged at Ireland's corporate tax rate of 12.5%. This undermines the Irish government's claims that it is implementing appropriate measures to tackle corporate tax avoidance[2].

[1] The tax filling data for the companies was originally recorded in dollars and has been converted into Euros based on the conversion rate of 1 US to 0.86250 EUR on 12.09.2018

[2] This country report focuses on 4 pharma companies' practices in Ireland. To see analysis for other countries, and methodology see global report: M. Fried (2018), Prescription for Poverty: Drug companies as tax dodgers, price gougers, and influence peddlers. Oxfam. http://policy-practice.oxfam.org.uk/publications/prescription-for-poverty-drug-companies-as-tax-dodgers-price-gougers-and-influe-620548

* Photo caption: Oanh (27) is a dialysis patient who lives in Hanoi, Vietnam. Oanh had to leave her family home in rural Me Linh District to move to the city for the hospital treatment she needs three times a week. She can't afford a kidney transplant and has campaigned with other dialysis patients for an increase in health cover. Photo: Adam Patterson/Oxfam

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WHAT'S THIS REPORT ABOUT?

Oxfam has reviewed available financial and tax data of Pfizer, Merck, Johnson & Johnson and Abbott, four of the largest US multinational pharmaceutical companies, all with large operations in Ireland, for the period that includes tax years 2013 through 2015. Our research suggests that these four companies are structuring their operations in a manner which allocates profits based on variables that are not always necessarily related to business activities, in a strategy to avoid tax.

Tax avoidance by the 4 companies led to an estimated loss of over €96.6 million in 7 developing countries.

We have uncovered a trend that indicates that these companies are recording very high levels of profit in countries like Ireland which have a low corporate tax rate, while recording much lower levels in developing countries in which they operate. For example, Johnson & Johnson's Thai subsidiaries posted eight percent profit, while its Irish subsidiaries posted 38 percent profit for the years 2013-15. During the same period Abbott made only eight percent profit in Thailand and four percent in Chile, which have tax rates of 20 and 21 percent respectively, while posting a six percent loss in Ecuador and a 36 percent loss in India (average tax rate 34.2 percent). In Ireland they earned 75 percent profit.

Our research estimates that globally such practices by these four companies have deprived the United States of an estimated €1.98 billion annually and other advanced economies of at least €1.21 billion. And they appear to have deprived the cash-strapped governments of the seven developing countries[3] covered in this report of more than €96.6 million every year, money that could be spent on vaccines, midwives or rural clinics.

What's more, despite declaring huge profits in Ireland, these companies are paying very little tax on these profits in Ireland. Based on the data we were able to access, our analysis of just one of these companies' operations in Ireland, Abbott, showed the company paid no tax on profits of €1.2 billion declared in Ireland in 2015. The Irish tax payer ultimately lost out on an estimated €155 million from this one company for just one year – this is the level of tax that would be due if Abbott was charged at Ireland's corporate tax rate of 12.5%.

Oxfam has undertaken this research to demonstrate that corporate tax avoidance continues to be a driver of inequality and acts as a barrier in the fight against poverty. Corporate tax dodging reduces the funds available to poorer countries to invest in public services that give people the means to lift themselves out of poverty. This is especially the case for the girls and women, who make up the

[3] Chile, Columbia, Ecuador, India, Pakistan, Peru and Thailand.

majority of people living in poverty - and who are more likely to rely on publicly-funded services like healthcare and less likely to be able to pay out-of-pocket for care.

When public services are inadequate or unavailable, it places an inordinate burden on women as care-givers, often compromising their health and their opportunities for education and employment. Conversely, quality public systems increase women's economic opportunities and their decision-making power within the household and can make a key difference in spreading care responsibilities more equitably. Besides draining money from social services, tax dodging also negatively impacts poor people because it requires governments to raise a greater proportion of their revenue from other sources. Most developing countries raise two thirds or more of their tax revenue through consumption taxes, which eat up a larger proportion of income the poorer you are. Developing countries bear some responsibility for facilitating this state of affairs, as do richer countries, like Ireland. Nothing these companies are doing is illegal. They are taking advantage of corporate tax rules that allows them to transfer profits from poorer countries, where tax revenue on such profits could provide resources for essential public services to address poverty.

BIG PHARMA IN IRELAND

The pharmaceutical industry has become one of the biggest industries in Ireland, with nine of the world's top 10 pharma companies having operations here. Pharma-chemical products make up half the total goods exported from Ireland every year. All four companies in this study have been active in Ireland for a number of decades, with large operations employing a combined total of approximately 10,000 people. However, in parallel to this is a shadow world of holding companies and multiple subsidiaries that use Ireland as a conduit to avoid tax on profits from their global operations. These practices undermine Ireland's reputation and increase the likelihood of Ireland continuing to be labelled a tax haven.

For example, Abbott declared a profit of €1.2 billion in Ireland in 2015 but paid absolutely no tax on these profits, based on the data we were able to access. The Irish tax payer ultimately lost out on an estimated €155 million from this one company for just one year – this is the level of tax for 2015 that would be due if Abbott was charged at Ireland's corporate tax rate of 12.5%. There was less information available for the other three companies, as entities not tax resident in Ireland are not required to file accounts in Ireland and no tax is withheld. We were able to determine that Johnson & Johnson recorded profits of €4.31 billion in Ireland in 2015, but as it only paid an effective tax rate of six percent, the Irish

Filings show that the Irish taxpayer lost out on €405 m in revenue from just two Pharma companies in 2015 taxpayer lost out on €250 million[4]. Thus, for just these two companies Ireland lost out on €405 million in tax revenue for just one year – money that could fund public services and reduce inequality levels in Ireland.

While the data we accessed on Abbott doesn't reveal the mechanisms used by the company to avoid taxes, there are a number of ways it could have done so. The first is by using the "Double Irish" structure. It is clear from previous filings from 2011 that Abbott has used this structure to avoid tax, as it declared that none of the income generated here was subject to Irish tax because its subsidiary was incorporated in Bermuda, though it operated in Ireland. Johnson & Johnson and Pfizer have also been known to have benefited from Double Irish arrangements in the past[5]. Interest payments collected by these entities would not be subject to Irish tax. Companies like Abbott can continue to use the Double Irish until the start of 2021.[6]

Alternatively, Abbott may have taken advantage of new rules introduced in 2015 that allow companies to offset up to 100 percent of profits against the cost of purchasing intellectual property (IP) rights[7]. Finally, Abbott may have used Ireland's double taxation treaty network to avoid tax. Oxfam Ireland[8] identified this approach as a possible replacement for the Double Irish in February 2017. It has been documented that several companies, including Pharma companies[9], have used this method, known as the 'Single Malt', to avoid tax. Multi-national companies (MNCs) have a suite of perfectly legal options to choose from if they wish to avoid tax in Ireland.

These findings correspond with the EU's recent assessment of Ireland's economy as part of the EU's Semester Review, which stated "some indicators suggest that Ireland's corporate tax rules are used in aggressive tax planning structures." This review found that royalties sent out of Ireland were equivalent to 26% of Ireland's GDP in 2015 - more royalties than were sent out of the rest of the EU combined,

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4 This is the extra tax that would have been due if they paid the tax on their profits at the full 12.5% rate.

5 Jonathan Berr, '*What Us investors need to know about the 'Double Irish'*, Money Watch, October 2014. https://www.cbsnews.com/news/what-u-s-investors-need-to-know-about-the-double-irish/ Financial Times, 'Axing of Double Irish plan greeted calmly by Wall Street, October 2014. https://www.ft.com/content/be0b232e-544b-11e4-84c6-00144feab7de

6 The 2014 Finance Act closed off the "Double Irish" for companies not already availing of this structure; companies which already used such a structure can continue to use it until January 2021.

7 There was a sharp uptake in companies availing of this measure in 2015 - the use of such allowances for intangible assets went up by 989%- Tancrad, Paul (2017), *An Analysis of 2015 Corporation Tax Returns and 2016 Payments,* Revenue, Dublin, page 8. Although this write-off was reduced to 80% in 2017, it was not imposed retrospectively, and the full amount of the qualifying expenditure will continue to be deductible, as the cap only limits how much can be claimed in a year.

8 Oxfam Ireland (2017), *Myths and Mantras,* Dublin, page 13.

9 Christian Aid Ireland, (2017), '*Impossible' Structures: tax outcomes overlooked by the 2015 tax Spillover analysis,* Dublin, page 20-21.

making Ireland the world's number one royalties' provider[10]. High levels of these payments far above normal economic activity indicate that the jurisdiction is facilitating tax avoidance.

TAX AVOIDANCE IS NOT A VICTIMLESS CRIME

The €96.6 million we estimate is lost annually to the seven developing countries in this study is just pocket change to these corporate behemoths. But it represents significant losses to low- and middle-income countries. Developing countries could use the money to address the yawning gaps in public health services that keeps many of the poorest people in the world from lifting themselves out of poverty.

India is among the biggest losers globally from corporate tax avoidance. Ireland's tax code has been implicated in facilitating some of this revenue loss - in 2017 Google was ordered to pay taxes on €194 million of profit to the Indian government which were found to have been illegally booked in Ireland.[11]

The Baba Raghav Das Memorial Medical College and Hospital (BRD) tragedy at Gorakhpur offers a glimpse of the human cost of inequality caused by corporate tax avoidance. In 2017, 1,317 children died at BRD Hospital. A leading cause of death is acute encephalitis syndrome, a mosquito-borne disease most often contracted because of poor sanitation, proximity to livestock and lack of preventative public health services. Encephalitis can be prevented through proper measures, but not easily cured. Sanitation and primary health facilities in the area surrounding BRD hospital are abysmal due to underinvestment.

"Out of these 1,300 children, maybe some would have died even in the best of circumstances, but 95 percent of deaths could have been prevented if only we had a health system functioning," says K Sujatha Rao, former Health Secretary of India. Pharma corporations are not responsible for the tragedy at Gorakhpur. The Indian government must do much more to invest in the health of its citizens. Nonetheless, stopping corporate tax dodging is critical to ensuring governments have the necessary resources to invest in their citizens. Had the Indian government received the estimated €63.8 million the four US drug companies may have underpaid in taxes annually, it could have allocated these funds to fighting encephalitis and still have had enough money left to buy Japanese encephalitis vaccines and bed nets for every child born each year in the whole of India.

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[10] EC, *'Country Report Ireland'* 2018, March 2018. https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-report-ireland-en_1.pdf

[11] Kevin McCarthy, *'Google India must pay back-taxes on $225m after cheekily funneling cash through Ireland'* The Register, October 2017 https://www.theregister.co.uk/2017/10/25/google_india_back_taxes/

The burdens of diseases like encephalitis are financial as well as physical and emotional. “Almost three to four percent of the population [of India] every year gets pushed below the poverty line on account of the unaffordability of health services,” says Rao. Medical costs, time spent traveling to treatment and caring for sick loved ones instead of working, lost education and earning potential, are costs borne by families that could have been avoided with adequate public services and prevention measures. Most often, it is women and girls who lose out on work and school to care for a sick child or sibling. When companies fail to pay their share of taxes and governments fail to invest in adequate public services, it is girls and women who pay the heaviest price.

MORE REFORM NEEDED

Ireland’s proposals to address corporate tax avoidance, outlined in the recently published report ‘Ireland’s Corporation Tax Roadmap,’[12] and US tax reforms will impact some current mechanisms for corporate tax avoidance. However, these plans do not go far enough to address all the tax avoidance mechanisms used by MNCs. Most worryingly, the proposals by the Irish government contain few, if any, mechanisms to address corporate tax avoidance that impacts developing countries, as outlined in this report. Moreover, though the Irish government recognises that additional reforms are required to take account of the highly digitalized global economy “to ensure that tax is paid by companies where value is actually created”[13], it does not support any role for developing countries in this process.

Most importantly, there is also a need for greater transparency if we are to really tackle corporate tax avoidance. Because the companies studied in this paper reveal little about their subsidiaries’ finances, Oxfam’s investigation and attempts to quantify their tax avoidance barely scratch the surface. We limited our inquiry to countries where we could find a critical mass of data, and even for those countries we located data for only 358 out of 687 subsidiaries - 56 in seven developing countries, 218 in eight advanced economies, and 84 in four tax havens. Oxfam cannot prove that the companies are engaged in profit shifting or tax avoidance. Such proof would require access to the companies’ tax returns. However, increasing transparency such as through public Country by Country Reporting would provide decision-makers, investors, journalists and civil society actors, especially in developing countries, with data to help review and, if necessary, reform aspects of the tax system that are being used purely for tax avoidance purposes.

[12] Department of Finance, *Ireland’s Corporation Tax Roadmap*, 2018, p. 29-30.
[13] Department of Finance, *Ireland’s Corporation Tax Roadmap*, 2018, p. ii.

RECOMMENDATIONS

Ireland has a well-earned reputation of acting fairly and being a champion of the rights of poorer countries. To ensure this reputation is maintained Ireland needs to:

- Require that all large MNCs adhere to **full and effective transparency** by supporting efforts at EU level to agree meaningful legislation on *public Country by Country Reporting.* This would ensure that MNCs publicly report on a country by country basis where they make their profits and pay their taxes.
- Advocate at relevant global forums for a consensus to be reached on a **minimum effective tax rate.** This would ensure that large MNCs would be obligated to pay a minimum level of tax on their profits in every country where they operate.
- Address profit-shifting by:
  A.) Mandating **strong controlled foreign company rules (CFC)** that use the option A approach as set out in the EU's Anti-Tax Avoidance Directive (ATAD) and ensure that CFC income to be assessed as part of these rules is as broad as possible to ensure its effectiveness.
  B.) Legislating for **'Two way' transfer pricing** to give Irish Revenue officials the power to investigate instances where profits are shifted into Ireland. Currently officials don't have the power to identify potential abuses which could lead to revenue losses in other countries, especially developing countries.
  C.) Applying more **stringent transfer pricing rules in relation to the valuation of IP**, and of returns to IP. This would reduce the opportunities for MNCs to use 'Double Irish' or 'Single Malt' type structures to avoid tax, by ensuring that company subsidiaries in tax havens receive royalties that are fairly priced, properly reflecting the future income stream related to that IP.
  D.) Undertake assessments of options to impose **withholding taxes on royalty payments** in certain cases - particularly to low or no-tax jurisdictions.
  E.) **Signing up to Article 12 of the OECD'S Multilateral Instrument.** This article makes it harder for MNCs to claim that they don't have a permanent establishment/taxable presence in a third country, a key way they avoid tax in developing countries.
- **Review and reform Ireland's Double Taxation Treaties**: Ireland should adopt the UN Model Double Taxation Convention between developed and developing countries (the UN model) as the minimum standard.
- **Strengthen Ireland's existing Exit Tax regime** and **subject all new tax incentives to rigorous economic and risk assessments.**
- Contribute to a **second generation of international tax reforms** to address the use of highly mobile value, including IP and other intangible assets. These reforms should propose new paradigms for a highly digitalized and global economy, including considering proposals to tax companies on their global profits and then apportion tax revenue according to value creation and economic activity. **Developing countries should participate in these discussions on an equal basis**.

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This paper was written by Michael McCarthy Flynn based on the Oxfam report, 'Prescription for Poverty: Drug companies as tax dodgers, price gougers, and influence peddlers'. Oxfam acknowledges the assistance of Didier Jacobs and Johan Longerock in its production. It is part of a series of papers written to inform public debate on development and humanitarian policy issues. For further information on the issues raised in this paper please email Michaelmccarthy.flynn@oxfam.org

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