February 8, 2013

Dear clients and colleagues,

Offshore tax havens are back in the limelight. The global economic slump has reduced tax revenues for many governments. Cash-strapped governments are looking for ways to balance their budgets and would like to get their hands on all the offshore wealth that has gone off their radar screens.

According to a report commissioned by the Tax Justice Network, a British organization, the super-rich elite have more than $21 trillion hidden in tax havens around the world; an amount roughly equivalent to the combined GDP of the US and Japan.

Even larger corporations such as Amazon, Apple, Google and Starbucks are being scrutinized for corporate structures that evade taxes by moving profits to low tax countries. Companies claim they are only playing by the rules; however, the rules of the game could change, bringing the game of musical chairs to a stop.

Countries such as Britain, Germany and France have requested an urgent review of the international tax standards at the Group of 20 meeting next month. Even emerging economies are unhappy and would like a change to the tax standards. In 2012 the Indian government told the UN "about the frustration over multinationals' ability to siphon off profits through royalties and management fees and deposit them in tax-friendlier locales". China and Brazil are also pressing the issue of tax evasion.

Multinationals are doing tax planning as a response to an outmoded tax system. Changes in regulations also helped. In 1997, Washington passed a new regulation which allowed multinationals to reduce their tax bill.

Governments have also made the business tax systems friendlier since 1980 where rates were reduced from 50% to 30% in industrial countries. Investors and the general public are demanding more transparency. Tax avoidance after all is just playing the technical rules over social responsibility.

The average tax rate for companies in the MSCI World Small Cap Index is 38%. On other hand the effective tax rate for Google is 19.4% and for Apple at 25.2%. Small cap companies tend to pay higher taxes, primarily due to the domestic nature of their revenue streams. As a whole, one could come to a conclusion that any change in the global tax structure would impact larger companies more that smaller ones.

Have a nice weekend.

The Global Alpha Team