Tax-driven wealth chains: A multiple case study of tax avoidance in the Finnish mining sector

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A B S T R A C T

This paper contributes to recent discussions of corporate tax avoidance and global wealth chains. Drawing on multiple case studies, we outline the key strategies adopted by Finnish mining companies as they seek to lower their tax burden. After screening the accounts of the companies mining metallic ores in Finland, we provide an in-depth analysis of the tax avoidance arrangements at three of these mines. The mines were operated by two Canadian enterprises that utilized seven different tax avoidance arrangements. The multiple case study approach adopted in this paper is helpful in developing both quantitative and qualitative tax avoidance research, since our findings highlight major deficiencies of datasets commonly used in the dominant quantitative tax avoidance research. Our qualitative approach helps tackle some of the limitations imposed on tax researchers as a result of the considerable secrecy surrounding tax matters. In particular, we argue that the existing tax avoidance research has focused too much on statutory corporate income tax rates even though today, tax minimization relies mostly on specific tax incentives and other loopholes in tax laws. We argue that the arrangements we describe mirror a wider phenomenon where multinational enterprises exert societal power commonly associated with sovereign states. Crossing the disciplinary boundaries of accounting, political economy and tax law, we also contribute to the emerging research agenda on global wealth chains. We call for more attention to the intersections between accounting and tax law for understanding how enterprises can separate their value chains from the intra-firm flows of wealth.

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1. Introduction

The system of prices is like the system of words or the system of numbers. Words, prices and numbers are nominal and not real. They are signs and symbols needed for the operation of working rules. . . . Words are deceptive if they do not convey the meaning intended; numbers are liars if they do not indicate the actual quantities; prices are inflated or deflated if they do not reflect the course of real value.

– John C. Commons, Legal Foundations of Capitalism, 1957 (1924): 9

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Corporate tax avoidance is an emerging academic topic (e.g., Dallyn, in press; Jenkins & Newell, 2013: 381; Sikka & Willmott, 2010; Sikka, in press). Tax has long been marginalized in political science, law, and social policy, and it has not received the ‘intellectual attention it deserves from accounting scholars’ (Boden, Killian, Mulligan, & Oats, 2010: 541–544). This obscurity has gradually changed. Tax avoidance has gathered increasing attention in academia, among inter- and non-governmental organizations and the media (for example Oxfam, 2016). Tax policies are no longer an isolated enclave within enterprises; rather, they are discussed ‘in the boardroom’ (KPMG, 2005). These tensions have resulted in calls for research of ‘transfer pricing in broader social, political and organizational contexts’ in order to understand how accounting techniques re-allocate wealth (Sikka & Willmott, 2010: 353).

This, however, is easier said than done. Graham and Tucker (2006: 2, 22) note that ‘information about tax shelters is notoriously hard to find’, suggesting that scholars should ‘creatively obviate this lack of information’ in order to understand tax shelters better (Lisowsky, 2010). Hanlon and Heitzman (2010: 157) also suggest the use of ‘some other’ data sources. We answer to these calls by providing a multiple case study (Yin, 2003) of mining industry tax planning. Cognizant that enterprises in most major mining countries are not obliged to disclose financial accounts of their subsidiaries, we turned our attention to thin capitalization related tax avoidance in an extractive-rich country where local financial accounts were available – Finland. The Finnish mining industry has developed significantly in the past decade, while still being of a reasonable size for an industry-wide analysis (see Section 3.2). In addition, Finland is a member of the EU and the OECD, and its corporate income taxation system is similar to most countries (see Section 3.2). Therefore, the findings can be used to assess the deficiencies of the global tax system in general. Moreover, our analysis on three different thin capitalization structures can be useful, not only in understanding the specific rules are needed to tackle them, but also in illustrating the underlying problems in the current international corporate taxation regime.

The literature on corporate tax avoidance has typically relied on two categories: intra-firm transfer pricing and thin capitalization (e.g., Becker, Fuest, & Riedel, 2012). These categories are occasionally supplemented by a third category of intellectual property rights (IPR) related tax avoidance (e.g., Corrick, 2016; Dischinger & Riedel, 2011). Of these, thin capitalization is typically understood as a practice whereby subsidiaries based in low-tax countries grant loans to subsidiaries in high-tax countries where the interest costs are tax-deductible (Becker et al., 2012; Buettner & Wamser, 2007; Bartelsman & Beetsma, 2003; Clausing, 2003; Desai, Foley, & Hines, 2005). For reasons discussed later, for the most part multinational corporations can select their capital structure in each country independent of the external funding needs of individual investments (Ting, 2014). Furthermore, IPR-related tax avoidance is usually discussed in the context of patents, copyrights and other products of the knowledge economy (e.g., Dischinger & Riedel, 2011). We contrast these generalizations by analyzing seven different types of tax avoidance arrangements we discovered in our case studies. In addition to thin capitalization we also discuss other arrangements such as the use of immaterial mining concessions in tax planning. This is the first contribution of this article.

Second, and related to the previous point, we argue that a better understanding of the cash flows and profit shifting arrangements can be helpful in developing the research methodologies that assess the effects of corporate tax avoidance. Since the mid-1990s, a lacunae of statistical research has emerged focusing on the factors and drivers of corporate tax planning. Based on the findings from our case studies, we maintain that many of the approaches and variables typically employed by econometric studies on corporate tax avoidance are too straightforward. As for an example, the statutory corporate income tax rates – a very common variable in the statistical research on corporate tax avoidance – play very little role in our case studies. We found that the low tax rates derived largely from specific tax incentives and questionable advance tax rulings while statutory tax rates had only a minimal role. The LuxLeak tax deals (Marian, 2016a) and multiple famous cases discussed in the media related to American technology corporations such as Apple have previously highlighted this phenomenon (European Commission, 2016a; Vleggeert, 2016). Many academics and the OECD (2015a) have also noted that the data used in quantitative tax avoidance studies is poor, which seriously impacts its use in the analysis of tax avoidance. We are able to tackle this problem by using multiple data sources and show that the databases used in econometric studies do not include the tax avoidance structures we discover. We discuss the deficiencies of quantitative tax avoidance research more in Section 2.1.

Third, drawing from the tradition of evolutionary economics as well as from contemporary research on the global political economy, we maintain that much world trade has little to do with market mechanisms as the prices are planned in corporate headquarters (Ylönen & Teivainen, 2015). The dominant quantitative approach in tax research offers few tools for analyzing this phenomenon because it operates on an aggregate statistical level, thus framing the phenomenon in a way that provides little information on the specifics of tax avoidance policies. We criticize some of the taken-for-granted assumptions behind the existing studies (Golden-Bibble & Locke, 2007: 6) and provide suggestions on how to improve their research methodologies. Contributing to the nascent literature on wealth chains, we argue that the artificial corporate price planning mechanisms thrive on two pillars of the international tax system, namely the separate entity doctrine and the arm’s length principle. According to these principles, individual companies belonging to the same group are separately liable for their taxes and use of the arm’s length prices in their mutual transactions. The separate entity doctrine not only facilitates tax

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1 When using concepts such as ‘tax avoidance’ or ‘tax planning’, we do not judge the legality of the arrangements, since aggressive tax planning structures are often legal (OECD, 2013). The national tax authorities and ultimately courts assess the legality of certain arrangements based on local legislation, obtaining also confidential corporate information not available for research purposes (for further discussion, see for example Otusanya, 2011).
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