MULTINATIONAL ENTERPRISES AND TAX HAVENS

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First, it is my pleasure today to officially welcome you on behalf of the Government and the people of Canada and to bring greetings from the Prime Minister and my colleagues in government.

We are honoured that the Inter-American Centre of Tax Administrators (CIAT) is holding its General Assembly for the first time in our capital city and we wish you every success in your important deliberations. Established in 1967 to promote mutual assistance between the various tax jurisdictions in the Western Hemisphere, CIAT now has 26 member-countries of North, Central and South America, as well as the nations of the Caribbean area. With its close associations with other international bodies, including agencies of the United Nations, it has played and can continue to play an important role in international affairs, especially in the broad field of taxation.

I also want to say that I appreciate the opportunity you have given me to speak to you today on a subject that I, as the Minister responsible for the Taxation function of our Federal Government, consider to be of great importance and of no little concern to all our tax administrations; that is, our tax problems related to multinational enterprises.

Basically, my concern as National Revenue Minister for Canada is that we collect from multinationals the correct amount of tax based on income earned within Canada so that other business enterprises and individuals are not required to pay more than their share. That is putting it in its simplest terms.

As a Minister of the Crown, I have, of course, other concerns about the operations of multinationals which my government has expressed on a number of occasions.

In the last few decades, business has become increasingly international, and while sovereign states co-operate in many fields and ventures, the multinational corporation has been functioning almost in a vacuum of international law or regulation. While all countries have their own domestic legislation, without international rules, together with better communication between countries, it is all too easy for multinationals to play one system off against the others.

A strong case can be made for many multinational enterprises in terms of sheer economic efficiency. Their capacity to mobilize information, expertise and money, as well as their ability to spread risk over many markets and sources contributes a high degree of efficiency to the world economy. However, even if you presume that multinationals abide by the national laws of the jurisdictions in which they reside, they can, through

their virtually uncontrolled international dealings, have a capability of avoiding legitimate taxation.

It is largely about the elusiveness of multinationals in the tax context that I want to address a few words to you today.

Referring to this elusiveness, Raymond Vernon, director of Harvard University's Centre for International Affairs, observed: "It is as if a country could command the hind legs of a giant beast without having access to the brain. Even the lot of the country that commands the brain is not altogether a happy one: so much of the beast lies beyond its reach. As far as that country is concerned, it is not clear whose interests are being served by the fact that the enterprise has outposts in other countries." That is the quotation.

These words capture the international concern over the economic and political power and the elusiveness of the multinational that has become more troubling in recent years. Proper taxation of these companies is one important area where this elusiveness causes problems.

Before dealing specifically with the tax issue, let me outline for you some of the general initiatives taken by our government in containing the giant beast I've been talking about.

Canada has been taking a leading part in the international consideration of multinationals in the O.E.C.D., the U.N., and the Commonwealth.

As you know, we fully participated in discussions of the Report of the Group of Eminent Persons, a Study of the Role of Multinational Corporations on Development and on International Relations to which I have referred, and our country was appointed a member of the U.N. Commission on Trans-national Corporations established in January of this year. We took a very active part in the Commission's first meeting in March and we intend to play a constructive role in the future work of the Commission.

As well, Canada is actively participating in the work of the Committee on International Investment and Multinational Enterprises which was established by O.E.C.D. in January of this year.

I should also mention that we took part in a Seminar of Commonwealth Officials and Experts on Multinational Corporations in London last January, and my Prime Minister participated in the discussion of a report of that Seminar at the recent meeting of Heads of Government in the Commonwealth in Jamaica. On that occasion, the Prime Minister offered to share Canadian experience with other members, particularly the developing countries.

Through these conferences and discussions with other countries, Canada has developed a general policy position on multinationals, with a view toward maximizing the benefits of hosting them, while at the same time, minimizing their negative effects.

The main elements of our position are as follows:

(1) That multinational corporations should operate within the laws of the host country, and should identify with and contribute to the aims and priorities of the host country.

(2) We subscribe generally to the work of the international groups such as the U.N. Centre for Information and Research on Trans-National Corporations. The aim of this exercise is to provide the information and assistance in the development of skills necessary to enable host governments to identify and articulate their national priorities, and to negotiate the terms of entry of multinationals in a form commensurate with these goals. At home, Canada places a great weight on the fundamental right of recipient countries to fashion the terms of entry for multinationals in a way that best coincides with domestic policy.

(3) We generally support U.N. co-ordinated exchanges of information in several technical areas relating to the activities of multinationals. Examples of progress to date include a draft international treaty on double taxation, a draft international agreement on transfer pricing, and a draft set of accounting standards.

(4) We subscribe to the idea of international work which will assist in developing countries to establish sound rational mechanisms to help them in screening, monitoring, regulating and controlling the operations of multinationals.

You may be familiar with a relatively new provision of Canadian law for the screening of Canadian takeovers by foreign investors. I am referring to the Foreign Investment Review Act, the effect of which is to ensure that any acquisition of a Canadian business by foreign investors is of significant benefit to Canada. Our Foreign Investment Review Agency examines proposed acquisitions, and those not in accordance with our objectives are blocked by the Government.

(5) We support the principle of an international Code of Conduct in the form of general guidelines for multinational enterprises and are hopeful efforts in that direction will be widely supported by other countries.

(6) Lastly, we reject the idea that home countries should be asked to, or be able to, control the activities of subsidiaries of their multinational enterprises in other countries.

We strongly hold that view, if for no other reason than that we ourselves have experienced problems in Canada over what appeared to be an extra-territorial application of the U.S. "Trading With the Enemy Act". Our Government on these occasions has had to draw to the attention of Washington that U.S. subsidiaries within our country were unable, or believed they

were unable, to fulfill contracts with countries excluded from direct U.S. trade. I hope you will agree with me that no country's economic activity should be restricted in this way by the domestic law of another jurisdiction.

Let me turn now to the tax area, and review a number of problems we have encountered, and the extent of our progress to date. I want to refer specifically to:

- the tax haven problem,
- the difficulty of obtaining information on multinationals and the need for better international cooperation, and
- the importance of strong domestic administrations.

Finally, I would like to raise with you several areas where countries, acting together, might strengthen our tax administrations.

There has been much talk this week of tax havens.

Since 1968, our Tax Avoidance and Special Investigations groups have been searching out and challenging tax haven situations. A substantial number of reassessments, some involving prosecution, have been issued, and the related tax recoveries have amounted to many millions of dollars.

At present, there are more than twenty important cases, either under investigation or in the appeal process, concerning substantial diversions of income from Canada.

The basic tax haven techniques are:

(1) The importing of goods or raw materials through a tax haven company. At it crudest, this is simply an invoicing operation that results in inflating the cost to the Canadian company.

(2) The exporting of goods or raw materials through a tax haven company to achieve the reduction of the price of sales by the Canadian company.

(3) The use of a tax haven to avoid tax on income from services rendered outside Canada.

(4) The artificial creation of expenses to a tax haven company such as interest, royalties - essentially passive income.

* Recently our Federal Court of Canada handed down an important and encouraging decision upholding our finding that a Canadian corporation's wholly-owned subsidiary in a tax haven country was, in effect, a puppet of the parent company. As a result, the income diverted to the offshore subsidiary was added back to the parent corporation's account. A rather substantial amount of income was involved.

Let me paraphrase what the court said: I believe that the parent company in Canada has camouflaged, disguised the operations of its tax haven subsidiary to make them appear as independent, whereas, in fact, the evidence, documentary and oral, is pervaded with the control, management and presence of the parent company ... It is surely not the name given to transactions or operations that determines their nature. Their nature is found by looking at what in fact they are, not at what they appear to be or are made to appear to be. That is essentially what the Court said.

There is nothing in Canadian income tax law to prevent an individual or corporation from carrying on a business through a subsidiary in a foreign country. What concerns us, however, is where a Canadian taxpayer has set up an offshore operation which, in fact, does not do what it is purported to do. The case I mentioned is a reassuring signal that our own interpretation of the law in this area is being supported by the Canadian Courts.

Where, after intensive investigation, it can be shown that the alleged business activities of the offshore company were, in fact, business activities of the Canadian company, the profits said to be earned by the offshore company will be brought into the income of the Canadian company. We now intend to move, with more confidence and vigor, against other similar arrangements.

Without dwelling on the point at the moment, let me stress the importance of cooperation between our administrations as an important key to containing the tax haven problem.

There is another area where we need more cooperation - that is in the exchange of information. Let me give you an example:

Assume that a Canadian corporation imports certain raw materials from a sister subsidiary in a second country. My Department's responsibility is to verify the reasonableness of the prices charged in this non-arm's length situation.

FOOTNOTE: * Dominion Bridge Company, Limited; judgement in an appeal by the taxpayer before the Federal Court of Canada, Trial Division; Appeal dismissed on April 30, 1975

We learn from the Canadian taxpayer that the foreign supplier company also makes substantial arm's length sales of the same commodity to customers in various other countries. Group pricing is under the direct control of the parent corporation in a third country. Officials of the Canadian company inform us that they have no access to pricing information concerning sales of their foreign sister corporation. My Department is then faced with an impasse, for even if special legislation were introduced requiring the disclosure of this information, enforcement would be impossible because of the different jurisdiction involved. At the same time, such information is necessary for a determination of the proper tax owing the Government of Canada.

It can be conceded, of course, that there may well be valid economic and business reasons justifying differentials in pricing by the multinational corporation concerned. But until one knows what these differentials are, if indeed they exist, how can their reasonableness or validity be established?

In my earlier example, an international exchange of pricing information between the various tax authorities concerned would enable each to deal with the taxpayer in an informed and rational manner.

The authority for an information exchange by revenue authorities is provided in tax treaties between Canada and other countries. We now have sixteen such bilateral tax treaties.

However, the existing opportunities for exchange of information under the treaties are quite controlled. As you know, Canada is at present renegotiating its bilateral tax treaties, and I am hopeful that with such a network, the opportunities for playing one system off against another, for reporting one set of facts differently to two or more jurisdictions, will be vastly diminished.

While a new level of international cooperation is fundamental to controlling the tax problems we are concerned with, each of our administrations must continue to seek a high degree of compliance with its domestic laws. Let me give you an example of the sort of problem we are encountering in Canada with increasing frequency.

Several years ago, the foreign parent of a Canadian-based manufacturing company was acquired by a large multinational corporation. Up to that time, the Canadian company had been paying a well-supported and regular fee to its parent for certain overhead costs, such as research, data processing costs, and other overhead items.

However, after the acquisition, the amount charged the Canadian subsidiary for inter-company purchases, for management fees and for inter company loans began to increase at an accelerated rate, removing millions of dollars for profit from Canada.

In a four-year period approximately $6,500,000 over what could be considered a fair charge had been removed in this way. Although, in this case, the excessive charges were isolated and disallowed, we must continue to be concerned about other similar abuses.

Similarly, we are encountering a proliferation of even more imaginative schemes designed to withdraw funds from Canada in ways that will escape legitimate Canadian Tax.

All this comes back to the well-being of our self-assessment system of taxation. As society becomes more complex, as taxpayers - including the multinationals - become even more sophisticated, governments must invest more money in their tax systems to close the tax gap. Although it would be premature for me to provide details, I am working now on a series of proposals that I am hopeful will significantly strengthen Canada's compliance effort.

This morning, I have placed before you a number of international tax problems, placed within the Canadian philosophy vis á vis multinational corporations.

It is obvious to me that in gathering the necessary information to properly administer our tax systems, and certainly to contain the tax haven problem, taxing authorities should get together more often.

You are all aware that tax haven conferences, organized by commercial interests, are held periodically to discuss the general advantages of havens, and more particularly the protection and concealment of assets, the hiding of information, and the avoidance and evasion of taxes. There is also an exchange of information on tax haven schemes and arrangements through a number of commercial publications.

It would be wrong to assume that just by improving the exchange of information, all problems would be solved. The tax haven company will continue to exist within the multinational groups.

But there is one missing link in the chain: That is, the taxing countries. Why shouldn't we try to forge that missing link?

Better information is a vital necessity. As well, however, we need a continuing forum within which to generate and explore new ideas. For example:

(1) Just how elaborate should treaties be in providing a formal basis for cooperation between authorities in properly coping with the tax problems of the multinationals?

I have pointed to the greater role expanded treaties could play in providing such a basis, but in the meantime, I am confident that much more can be done by willing administrations under many existing treaties.

(2) How feasible would the international team audit approach be for the multinational problem? Could the administration of, perhaps, three countries coordinate and synchronize the audit of a multinational corporation operating within their boundaries? Not only could information and expertise be pooled but the timing problem of examining three different components of a multinational

group at three different times would be overcome.

(3) Multinationals operate on a global basis, using teams of international tax experts to plan their affairs. Why can't we, the taxing countries, find some similar way of pooling our knowledge - of temporarily exchanging or sharing some of our people with other countries, to strengthen our approach?

(4) Would the United Nations not be the appropriate focus for joint research on the taxation of multinationals, and the exchange of views and information? From Canada's experience on the U.N. Commission I mentioned earlier, I suggest we, as tax administrators, should look carefully at this opportunity.

These are just a few of the many ideas that we need to continue to explore together. Let me say in closing that this week's activities, like earlier General Assemblies of CIAT, have made an important and valuable contribution to our mutual interests.

I am grateful that you have permitted me to intervene in your deliberations to share some of my thoughts with you. I hope the discussions that remain will prove interesting and productive. And on your return, I would ask you to extend warmest greetings from me personally to the revenue ministers of your home countries