SHAREHOLDERS *for* CHANGE

BAD CONNECTION

What (the lack of) tax transparency tells us about European telecommunication companies

BAD CONNECTION

What (the lack of) tax transparency tells us
about European telecommunication companies

SHAREHOLDERS for CHANGE

TABLE OF CONTENTS

CREDITS

A study commissioned by SfC - Shareholders for Change

Authors: Tommaso Faccio (University of Nottingham - ICRICT),
Claudia Apel and Mauro Meggiolaro (Merian Research)

Graphics and design: Publistampa arti grafiche
www.publistampa.com

INTRODUCTION

The avoidance of corporation tax by multinational enterprises (MNEs) – essentially on behalf of their shareholders – is facilitated by current international tax rules, which allow profit shifting between MNEs' affiliates through the pricing of intra-group transactions. MNEs are able to exploit this system to minimise their tax liability, by shifting profits to countries with low or zero tax rates, undermining the tax base of those where real activities take place and reducing government revenues worldwide, in both developed and developing countries.

The scale of this profit shifting to low-tax jurisdictions - known to the International Monetary Fund (IMF) as "conduits"[1] - is very large, involving as much as two-fifths of MNE profits. It has also exacerbated tax competition between countries: the global average statutory corporate tax rate has fallen by more than half over the past three decades.[2]

As a consequence, G20 world leaders in 2013 gave their support to the Organisation for Economic Cooperation and Development (OECD) project on base erosion and profit

[1] The category of "conduit" countries refers to "countries that are widely perceived as attractive intermediate destinations in the routing of investments—whether for tax or other reasons". The IMF identifies Bermuda, Ireland, Luxemburg, the Netherlands, Singapore and Switzerland as "conduit" countries. See: IMF (2014). Spillovers in International Corporate Taxation. IMF Policy Paper, [online] available at: https://www.imf.org/external/np/pp/eng/2014/050914.pdf.

[2] Zucman, G., Tørsløv, T., and Ludvig, W. (2018), The Missing Profits of Nations, NBER Working Paper No. 24701.

shifting (BEPS), calling for reform of the rules to ensure that MNEs would be taxed "where economic activities occur and value is created".[3] However, the approach taken under the BEPS project still relies on transfer pricing rules and the so called "arm's length principle". Unfortunately, this principle is extraordinarily difficult to apply objectively in practice.[4]

Today profits can be shifted between the affiliates of multinationals in many ways: a) through the provision of services or sale of goods (multinational groups can manipulate intra-group exports and import prices so that subsidiaries in high-tax countries export goods and services at low prices to related firms in low-tax countries and import from them at high prices; such transfer price manipulations reduce profits in high-tax countries and increase them in low-tax countries); b) through intra-group lending (affiliates in high-tax countries borrow money from affiliates in low-tax countries, which again reduces profits in high-tax countries and increases them in low-tax countries) and c) the licensing of intangible assets (e.g. proprietary trademarks, logos and patents owned by affiliates in low-tax countries are licensed to other affiliates within the group; these affiliates then receive royalties which reduce profits in high-tax countries). These intra-group transactions are very difficult to be evaluated under the "arm's length principle", which requires significant resources from skilled tax authorities and maintains the incentive for multinationals to create ever more complex group structures to minimise taxes.

Tax avoidance by multinationals is helped by the lack of transparency on the tax matters of multinationals in each jurisdiction in which they operate. Civil society organisations have long called for public insight into basic information about where corporations do business and what they pay in taxes in the countries where they operate ("country by country reporting" or CBCR) – which would help dissuade multinational corporations from shifting their profits to tax havens or low tax jurisdictions (conduits).

There is also growing recognition of the value that public country by country reporting would bring to, for example, investors. Multinationals' approaches to taxation can have reputational impacts and represent financial risks, but under current disclosure rules shareholders frequently have little to no information available on the tax strategy of a corporation. Public country by country reporting would allow investors to identify corporations that enhance shareholder value through sound investments, rather than into corporations that rely on aggressive tax planning strategies.

As part of the work on "base erosion and profit shifting" (BEPS), the OECD and G20 have agreed to introduce confidential country by country reporting, which only allows certain tax administrations to access the information. The first exchanges of country by country reporting data between tax administrations have occurred in 2018. Full public country by country reporting was also already introduced for banks in the EU already in 2013.

Vodafone Group Plc ("Vodafone") is the first large multinational enterprise to have voluntarily published, in 2018, country-by-country (CbC) data regarding its international operations, showing revenues, profit, taxes, number of employees and capital investments in each jurisdiction in which it does business. This data was analysed in a paper by Tommaso Faccio and Valpy Fitzgerald[5], published by the Transnational Corporation Journal in July 2018[6].

Vodafone's country by country data provides a unique opportunity to analyse "profit shifting" (i.e. shifting of taxable profits from one jurisdiction to another) allowed by gaps

[3] http://www.g20.utoronto.ca/2013/2013-0905-tax.html, paragraph 7.

[4] The "arm's-length principle" of transfer pricing states that the amount charged by one related party to another for a given product must be the same as if the parties were not related. An arm's-length price for a transaction is therefore what the price of that transaction would be on the open market. Assessing this price may be simple for commodities or goods that are exchanged in open markets. On the contrary, when dealing with proprietary goods and services or intangibles, arriving at an arm's length price can be a much more complicated matter (See: http://www.ustransferpricing.com/arms_length_principle.html).

[5] Tommaso Faccio is the Head of the Secretariat of the Independent Commission for the Reform of International Corporate Taxation, or ICRICT (www.icrict.com), and Lecturer in Accounting at Nottingham University Business School. Valpy Fitzgerald is one of ICRICT's Commissioners and Emeritus Professor of International Development Finance at Oxford University.

[6] Tommaso Faccio and Valpy Fitzgerald, Sharing the corporate tax base: equitable taxing of multinationals and the choice of formulary apportionment, Trasnational Corporations, Unctad, Volume 25, Number 2, 2018

and loopholes in domestic and international tax law, in order to reduce corporate tax liability. This data allows us to determine Vodafone's presence in conduits and to compare misalignment between reported profits and indicator of economic activities (e.g revenue, employees).

It is known that telecommunication companies, and primarily Vodafone, score historically well in terms of ESG (environment, social, governance) criteria and are thus present in many SRI (socially responsible investing) funds' portfolios. This is the result of their general good governance and low exposure to environmental and human rights issues, in part due to the very nature of their business.

As Vodafone's major European competitors Deutsche Telekom, Telecom Italia and Orange do not publish country by country data, we considered it was useful to analyse other public data available to: a) identify whether Vodafone's peer companies Deutsche Telekom, Telecom Italia and Orange also make use of affiliates located in conduits; b) shed more light on the sector's tax practices that, despite being acceptable from a legal point of view are, in certain cases, ethically disputable; c) identify potential aggressive fiscal planning that may represent a risk for the companies' bottom line, as a result of fines or proceedings by tax authorities; d) consider the implications for socially responsible investing.

This research is based on publicly available reports that we downloaded from the companies' websites, acquired from company registers in a number of jurisdictions or extracted from company databases.

Taxation issues, as underlined in this research, have a number of implications for SRI and mainstream investors.

As underlined by Norges Bank Investment Management, asset manager of the Norwegian Government Pension Fund Global (the largest global sovereign wealth fund with c€869bn AUM), "multinational enterprises should be ready publicly to explain the business case for locating subsidiaries in "closed" jurisdictions, significantly low-tax environments, or countries where no local employees carry out substantive business functions or the number of such employees is disproportionately low compared to the economic value generation attributed to that part of the business"[7]. Moreover, they "should publish country-by-country breakdowns of how and where their business model generates economic value, where that value is taxed and the amount of tax paid as a result".

As this research demonstrates, the analysed companies (especially Vodafone's peers) are still far from an acceptable level of disclosure and responsibility as far as tax practices are concerned.

[7] https://www.nbim.no/contentassets/48b3ea4218e44caab5f2a1f56992f67e/expectations-document—-tax-and-transparency—-norges-bank-investment-management.pdf

CHAPTER 1

EXECUTIVE SUMMARY

- Tax avoidance by multinational corporations is facilitated by the lack of tax transparency in corporate reporting. Tax transparency is a crucial step in the fight against corporate tax avoidance: it drives better decision making, enhances security for investors and leads to a more stable and fair environment for corporations;
- Vodafone is the first large multinational to have voluntarily published country by country reporting data. This data clearly shows the misalignment between the current taxable profit allocation and indicators of the group's real economic activities (sales, employees and assets) in the countries where Vodafone operates and thus the potential for BEPS (base erosion and profit shifting) activities by the group, through the use of low-tax "conduit" countries;
- The largest share of Vodafone's profits (38%) are generated in two conduit jurisdictions, Luxembourg and Malta, where the group has just 325 employees (out of a total of 108,271 employees worldwide[8]);
- Whilst Vodafone should be applauded for being a leader in tax transparency, the data shows how this multinational has chosen to structure itself so to minimise taxation in countries in which it operates. This has likely resulted in significant revenue losses for UK (and other countries') tax authorities. This is particularly detrimental for developing countries, as they rely on corporation tax receipts more heavily than developed countries;

[8] Source: Vodafone Group plc, Annual Report 2017, pag. 27

- Telecom Italia, Deutsche Telekom and Orange (Vodafone's peers) do not publish country by country reporting data. As such, one wonders whether the reason for not publishing this data is that these companies have a more aggressive tax profile than Vodafone's;
- In order to understand whether this may be the case we have reviewed publicly available information on the group structure of Vodafone's peers and identified their affiliates located in conduits, namely Ireland, Luxembourg, Netherlands, Cyprus and Malta;
- For all of Vodafone's peers, intra-group transactions have been identified, that could result in profit shifting and tax avoidance. For each company, including Vodafone, a number of questions have been drafted to help investors engaging the companies on tax related issues.

CHAPTER 2

VODAFONE COUNTRY BY COUNTRY REPORTING DATA

Vodafone is the first large multinational to have voluntarily published country-by- country data, in a report titled *Vodafone Group Plc – Taxation and our total economic contribution to public finances 2016-2017*.[9] The data provided by the group for 2016-17 allows the identification of the sixty countries where the group operates, the scale of operations in each country, and the allocation of group taxable profits across the different countries. Although the data Vodafone supplies fall short of the country-by-country data that MNEs will eventually have to file with tax authorities across the world as part of the OECD CbCR guidelines,[10] as well as of the EU proposal for a directive on corporate tax transparency country-by-country reporting[11] and of the data advocated by tax justice campaigners,[12] these data do finally provide country-by-country information on the revenue and taxable profits, corporate tax payments, employees and assets of the multinational.

A review of the Vodafone report shows that overall taxable profits (profits before tax) for the Group for 2016-17 amounted to €1.9 billion on a revenue of €57.1 billion, a relatively narrow profit margin of 3%. The country by country

[9] https://www.vodafone.com/content/dam/sustainability/pdfs/vodafone_2017_tax.pdf.

[10] http://www.oecd.org/tax/beps/guidance-on-country-by-country-reporting-beps-action-13.htm.

[11] https://ec.europa.eu/info/publications/proposal-directive-corporate-tax-transparency-countrycountry-reporting_en.

[12] https://www.taxjustice.net/topics/corporate-tax/country-by-country/.

reporting data disclosed by Vodafone clearly shows the misalignment between the current taxable profit allocation and indicators of the group's real economic activities (sales, employees and assets) in the countries where Vodafone operates and thus the potential for BEPS activities by the group through the use of low-tax "conduit" countries.[13] **TABLE 1** shows the group revenue, profit before tax, employment, assets and tax paid for the 10 largest countries of operation, which accounted for some 70% of group activity by sales. We have also calculated the effective tax rate paid (tax paid divided by profit before tax). Data for a single year are not always representative: nonetheless it is notable that 6 of these 10 countries reported losses; and one country (Italy) achieved an effective tax rate well below the statutory "headline" rate (for 2016 27.5%). In contrast, sales revenue does seem broadly correlated with employment and assets, taking into account the relative capital intensity of developed and developing countries.

TABLE 1 Vodafone Group countries of operations, top 10 countries ranked by revenues, 2016-2017 [€ millions]

Country	Revenue	Profit before tax	Employees	Assets	Corporation tax
1 Germany	10619	-636	15714	1925	89
2 United Kingdom	7536	-504	17951	1491	-89
3 India	6847	-338	23836	1313	340
4 Italy	6249	686	7339	881	87
5 Spain	4983	-74	5188	748	0
6 South Africa	4187	1077	5213	544	359
7 Turkey	3053	-59	3410	336	61
8 Netherlands	1867	-7	3601	303	-15
9 Egypt	1334	268	8381	208	110
10 New Zealand	1311	47	2965	144	19

Source: *Vodafone Group Plc – Taxation and our total economic contribution to public finances 2016-2017**

TABLE 2, in contrast, shows the top ten Vodafone countries of operations ranked by size of reported profits. The most notable feature is the size of profits reported in Luxembourg, far larger than sales (although these are commensurate with employment), and in Malta, leading inevitably to the hypothesis that these two are the main "conduit countries" for the group, with reported profits roughly equal to net profits for the group as a whole and very low effective tax rates.

In sum, it is clear that considerable profits are allocated in two tax jurisdictions with negligible sales and employment – whether for reasons of "tax planning" or "commercial reasons" is unclear. However, the data also allow us to see how Vodafone tax base is distributed across tax jurisdictions.

TABLE 2 Vodafone Group countries of operations, top 10 countries ranked by profits, 2016-2017 [€ millions]

Country	Revenue	Profit before tax	Employees	Assets	Corporation tax	Effective tax rate (%)
1 Luxembourg	187	1450	325	17	5	0.3
2 South Africa	4187	1077	5213	544	359	33.3
3 Italy	6249	686	7339	881	87	12.7
4 Kenya	810	293	1729	126	118	40.3
5 Egypt	1334	268	8381	208	110	41.0
6 Malta	86	124	347	14	9	7.3
7 New Zealand	1311	47	2965	144	19	40.4
8 Romania	774	39	4197	146	6	15.4
9 Czech Republic	507	32	1694	92	4	12.5
10 Tanzania	386	29	556	62	23	79.3

Source: *Vodafone Group Plc – Taxation and our total economic contribution to public finances 2016-2017**

FIGURE 1 shows how these profits (that is, the corporation tax base) are distributed between regions, based on the World Bank's classification[14] of low-income, lower-middle-income, upper-middle-income and high-income countries. This aggregation also helps to smooth out some of the noise inherent in the individual country figures. Vodafone's profits are reported to be 1% to low-income countries, 14% to lower-middle-income countries, 27% to upper-middle-income countries, 19% to high-income countries and 38% – the largest share of all – to the "conduit group" of Malta and Luxembourg.

* https://www.vodafone.com/content/dam/sustainability/pdfs/vodafone_2017_tax.pdf

[13] It should be stressed that we are in no way suggesting that Vodafone has engaged in any illegal tax practices.

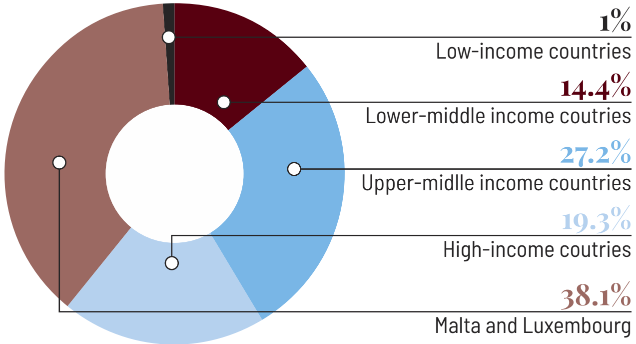
[14] https://datahelpdesk.worldbank.org/knowledgebase/articles/906519

* https://www.vodafone.com/content/dam/sustainability/pdfs/vodafone_2017_tax.pdf

FIGURE 1

Distribution of reported Vodafone profits by region, 2016-2017 (%)

Source: *Vodafone Group Plc – Taxation and our total economic contribution to public finances 2016-2017**



The low revenue reported by the Group in Luxembourg and Malta (significantly lower than profits) suggests that those reported profits (profit before tax) arise in relation to intra-group activities (e.g. interest payments, service charges, royalties, etc). If this is the case, then profits in Luxembourg and Malta would have been matched by reduced profits in other jurisdictions in which the group operates. As the profits in Luxembourg and Malta are subject to low taxation, this results in overall tax savings for Vodafone.

Our analysis does not suggest that transactions fail to follow current international tax rules or that the group has artificially transferred profits from one jurisdiction to another to minimise tax payments. In order to be able to do that, we would need to review the individual group entities' tax returns in Luxembourg and Malta.

However, the analysis demonstrates that the current international tax rules allow multinationals to structure themselves so that significant profits are allocated to their operations in low tax jurisdictions like Luxembourg and Malta, as is the case with Vodafone. Therefore, the current system of international tax rules results in a misalignment between the group's allocation of profits and the group's indicator of the real economic activities (e.g. sales, employees and assets).

This is particularly detrimental for developing countries, as they rely on corporation tax receipts more heavily than developed countries.

* https://www.vodafone.com/content/dam/sustainability/pdfs/vodafone_2017_tax.pdf

CHAPTER 3

VODAFONE'S ACTIVITIES IN LUXEMBOURG

Significant information is provided in the Vodafone's report to justify the legal allocation of profits to Luxembourg (see **APPENDIX A**). However, it is worth noting that:

- Vodafone benefits from significant historic losses in Luxembourg due to impairment of investments (as a consequence of the Mannesmann operation, see **APPENDIX A**), which offset profits allocated to Luxembourg's entities, so that limited corporate taxation is paid in Luxembourg. These losses are significant (€19,6bn[15]) and will ensure that for, the next few years, Vodafone will continue to pay very little tax in Luxembourg.
- The possibility to offset losses on impairment against profits for tax purposes is not allowed in many other EU countries (e.g. Spain, UK) but it is allowed by tax authorities in Luxembourg.
- Vodafone had significant historic losses in Luxembourg as a result of the loss in value of the acquisition of the Mannesmann conglomerate in 2000 (see **APPENDIX A**).
- Since 2001, Vodafone affiliates (in UK and elsewhere) started making large interest payments on money they borrowed from affiliates in Luxembourg[16]. These payments have reduced taxable profits in the countries in which Vodafone operates and increased taxable profits in

[15] https://www.vodafone.com/content/annualreport/annual_report17/downloads/Vodafone-full-annual-report-2017.pdf

[16] https://uk.reuters.com/article/uk-vodafone-tax-idUKBRE85P0G020120626

Luxembourg. As these profits were offset by available losses in Luxembourg, this is likely to have resulted in tax avoidance by Vodafone through the use of this funding structure.

- Vodafone structured its funding operations so that funding was provided to the group from affiliates located in Luxembourg. This was Vodafone choice, legal as it might have been, but still a choice to shift profits from the UK and other high tax jurisdictions into Luxembourg.
- Vodafone is a UK head quartered group and if the group did not have the intention to reduce its tax bill, they could have structured their tax affairs so that funding for the group was provided to overseas affiliates by UK entities, so that any profits associated with this function would have been subject to UK corporate taxation. UK Corporation tax rate was 30% until the 2008 financial crisis and it is now 19%, significantly above the 0% effective rate available to Vodafone in Luxembourg due to its historic losses.
- The UK tax authority HMRC challenged the use of some of these Luxembourg entities in a long dispute which resulted in a settlement which included a payment of over £1bn by Vodafone (see more details below). This indicate that Vodafone's tax avoidance structure was considered aggressive by UK tax authorities.
- Estimates of the UK Parliament Public Accounts Committee put the revenue losses associated with this structure for the UK government to £7bn for taxable years up to 2010. As this profits shifting structure was still in place in 2016/2017 and allowed profits of €1.4bn to be allocated to Luxembourg just in 2016/2017, the overall amount of losses to the UK since this alleged tax avoidance structure has been in place is likely to be very significant.
- As the UK entered a period of austerity following the 2008 financial crash, with significant cuts to public services, the impact of this loss of revenue is not hard to imagine.
- Whilst Vodafone should be applauded for being a leader in tax transparency, the reality is that the data shows how this multinational has chosen to structure itself so to minimise taxation in countries in which it operates. This has likely resulted in significant revenue losses for UK (and other countries') tax authorities.

3.1 QUESTIONS TO VODAFONE

- Please quantify the level of taxable profits reported by Luxembourg affiliates in the period 2001-2018.
- Please quantify the corporation tax savings which have resulted from Vodafone operating centralised funding and global services functions in Luxembourg, in the period 2001-2018, vis à vis the same functions being provided by UK affiliates subject to UK corporation tax.
- By choosing to structure centralised funding and global services functions out of Luxembourg, Vodafone has taken away significant corporate tax revenues from the UK (and other countries) tax authorities. Was the negative impact of your decisions on the tax revenues of other countries in which you operate taken into account in making the decision to structure the above activities in Luxembourg?
- Please quantify what would be the business impact of transferring the functions currently performed in Luxembourg to your UK affiliates, so that the profits associated with their activities are subject to a normal level of taxation.
- Please, quantify the tax fees paid to consulting, legal, accounting, tax firms to create and support your tax structures in Luxembourg and Malta in the period 2001-2018. Costs identified should be those associated with tax advice which was provided with the aim of saving corporation tax.

We now turn our analysis on the tax transparency (or lack of) of Vodafone's European competitors.

CHAPTER 4

TAX PRACTICES AT VODAFONE'S PEERS: TELECOM ITALIA, DEUTSCHE TELEKOM AND ORANGE

Vodafone has voluntarily decided to publish its country by country reporting data, even if the data shows that for 2016/2017 nearly 40% of its taxable profits are allocated to conduits.

Telecom Italia, Deutsche Telekom and Orange (Vodafone's peers) do not publish country by country reporting data. As such, one wonders whether the reason for not publishing this data is that these companies have a more aggressive tax profile than Vodafone's.

In order to understand whether this may be the case we have reviewed publicly available information on the group structure of Vodafone's peers and identified their affiliates located in conduits, namely Ireland, Luxembourg, Netherlands, Cyprus and Malta.

Where possible, we obtained a sample of these affiliates' accounts to determine whether these are involved in intragroup transactions, which could indicate that these could result in profit shifting and tax avoidance.

For each of the analysed groups, we have listed a number of questions that shareholders may want to ask the management of these groups.

The data used in the analysis are taken from the companies' financial accounts that were acquired from company registers or extracted from company databases.

4.1 TELECOM ITALIA

Telecom Italia's affiliates located in conduits are listed below:

- Telecom Italia Capital SA - Luxembourg;
- Telecom Italia Finance SA - Luxembourg;
- Telecom Italia Finance Ireland Limited - Netherlands;
- Telekom Italia Sparkle Netherlands BV - Netherlands;
- TI Sparkle Netherlands BV - Netherlands;
- Nenaneco Ltd - Ireland;
- TI Sparkle Panama SA - Panama.

We have reviewed the accounts of Telecom Italia Capital SA Luxembourg and Telecom Italia Finance SA Luxembourg.

Telecom Italia Capital SA Luxembourg – 2017 accounts

The purpose of this entity is to provide intra-group funding. As at December 2017, funding provided to affiliates amounted to €4.1bn. However, interest income received is offset by interest payable, both to affiliates and external lenders, so that taxable profits are limited (<€5m for both 2017 and 2016).

Although the size of this entity's activities is significant, only 3 FTE (full-time equivalent employees) were employed by it in 2017 (as underlined in Telecom Italia Capital SA's 2017 accounts, note 20).

Telecom Italia Finance SA Luxembourg – 2017 accounts

The purpose of this entity is also to provide intra-group funding. As at 31 December 2017, funding provided to affiliates amounted to €1.8bn. The entity's activities resulted in net profits of €59m in 2017 and €138m in 2016.

From the notes to the accounts reported below, we can see how the difference between interest income received from affiliates (**NOTES 24** and **25**) and interest payable (**NOTE 27**) to affiliates is significant for both 2017 and 2016. This would result in profit shifting from overseas affiliates to Telecom Italian Finance SA. As the accounts do not present a tax reconciliation, it is unclear whether any of this income is taxable. No corporation tax is payable on these profits.

NOTE 24 Income from other investments and loans forming part of the fixed assets

a) derived from affiliated undertakings

EUR	December 31, 2017	December 31, 2016
Interest on long term loans to Parent Company	94.405.789,26	129.498.855,24
Interest on long term loans to TIM Group companies	1.218.988,78	1.107.334,61
	95.624.778,04	**130.606.189,85**

NOTE 25 Other interest receivable and similar income

a) derived from affiliated undertakings

EUR	December 31, 2017	December 31, 2016
Interest and commissions on receivables from Parent Company	1.144.531,10	1.833.014,39
Interest and commissions on receivables from TIM Group companies	1.134.764,01	2.956.258,60
Income on derivatives with Parent Company	54.561.268,86	46.043.326.31
Income on derivatives with TIM Group companies	42.152.313,42	41.209.292,31
MEB Option premium amortization	0,00	27.692.292,31
	98.992.877,39	**119.734.810,93**

NOTE 27 Interest payable and similar expenses

a) concerning affiliated undertakings

EUR	December 31, 2017	December 31, 2016
Guarantee fee due to Parent Company	348.941,15	431.454,15
Charges on derivatives with Parent Company	32.498.867,68	33.921.794,95
Charges on derivatives with TIM Group companies	62.101.903,98	64.771.984,75
Interest due to TIM Group companies	182.071,57	68.900,13
	95.131.784,38	**99.194.133,98**

Source: excerpts from the 2017 accounts of Telecom Italian Finance SA - Luxembourg

The difference between interest income received from affiliates (a total of €194.61m in 2017 and €250.33m in 2016, see **NOTES 24** and **25**) and interest payable to affiliates (€95.13m in 2017 and €99.19m in 2016) is significant for both 2017 (€99.48m) and 2016 (€151.14m).

Although the size of this entity's activities is significant, only 10 FTE were employed by this entity in 2017 (as underlined in Telecom Italia Finance SA's 2017 accounts, note 35).

4.1.1. Questions to Telecom Italia

- Why does Telecom Italia not publish country by country reporting data in its financial statements? These should include turnover, taxable profits before tax, corporate tax paid, tangible assets and number of employees for each jurisdictions in which the group operates.
- Would you commit to publish this information in the next group financial statements?
- For each of the identified group companies in Luxembourg, Netherlands, Ireland and Panama, please provide details of their role in the organisation, including the number of employees.
- For each of the identified group companies in Luxembourg, Netherlands, Ireland and Panama, please provide details of intra-group transactions.
- Please, quantify the level of taxable profits reported by Luxembourg, Netherlands, Ireland and Panama affiliates in the period 2001-2018.
- Please, quantify the corporation tax savings which have resulted from Telecom Italia operating intra-group funding and other functions in Luxembourg, Netherlands, Ireland and Panama in the period 2001-2018, vis a vis the same functions being provided by Italian affiliates subject to Italian corporation tax.
- Please, quantify what would be the business impact of transferring the functions currently performed in Luxembourg, Netherlands, Ireland and Panama to your Italian affiliates, so that the profits associated with their activities are subject to a normal level of taxation.
- Please, quantify the tax fees paid to consulting, legal, accounting, tax firms to create and support your tax structures in Luxembourg, Netherlands, Ireland and Panama in the period 2001-2018. Costs identified should be those associated with tax advice which was provided with the aim of saving corporation tax.

4.2 DEUTSCHE TELEKOM

Deutsche Telekom's affiliates located in conduit jurisdictions are listed below:

- Deutsche Telekom Europe Holding BV – Netherlands;
- Deutsche Telekom Europe BV - Netherlands;
- Consortium 1 Sarl – Luxembourg;
- Consortium 2 Sarl – Luxembourg;
- GTS Central European Holdings Ltd – Cyprus;
- Carduelis BV – Netherlands;
- GTS Central European Holding BV – Netherlands;
- T-Mobile Netherlands Holding BV - Netherlands;
- T-Mobile Netherlands BV - Netherlands;
- T-Mobile Infra BV - Netherlands;
- T-Mobile Klantenservice BV - Netherlands;
- T-Mobile Netherlands Retail BV - Netherlands;
- Deutsche Telekom Holding BV - Netherlands;
- Deutsche Telekom International Finance BV - Netherlands;
- Deutsche Telekom Healthcare Solutions Netherlands BV – Netherlands;
- T-Systems Nederland BV _ Netherlands;
- T-Systems Luxembourg SA - Luxembourg;
- T-Mobile Netherlands Holding BV - Netherlands.

We have reviewed the accounts of Deutsche Telekom International Finance BV and T- Systems Nederland BV to understand whether these companies are involved in intra-group activities which may lead to tax avoidance.

Deutsche Telekom International Finance BV Netherlands – (2017 accounts)

The main activity is the provision of intra-group funding. The accounts show that interest income of £1.12bn is received by this entity from the parent company, and other group companies, in Germany. The company employs 1 person. The notes to the accounts also show that the company has agreed a minimum tax payment with the Dutch tax authorities:

Geographic information

Interest income mainly from group companies according to their country of operations:

THOUSANDS OF €	31.12.2017	31.12.2016
Germany	1,120,502	1,120,941
Austria	3,810	9,685
Hungary	13,100	16,712
	1,137,412	**1,147,338**

Income taxes

Income taxes in the statement of comprehensive income:

The following table provides a breakdown of income taxes in the statement of comprehensive income:

THOUSANDS OF €	2017	2016
Current income tax expenses	(2,491)	(1,635)
Deferred tax income	15,444	2,449
	12,953	**814**

Source: excerpts from the 2017 accounts of Deutsche Telekom International Finance BV - Netherlands

Details of this advanced pricing agreement (APA) with tax authorities are not publicly available. Germany has a higher corporation tax rate (between 30% and 33%)[17] than the Netherlands (25%), so any taxable profits shifted from Germany to the Netherlands would result in tax avoidance.

Whilst this entity in 2017 and 2016 has been loss-making, it has so far accumulated more than €300m of profits as at 31 December 2017 (€301,078,000), as shown in its balance sheet information. If these profits are as a result of interest income from affiliates located in jurisdictions with a higher corporate tax than the Netherlands (e.g. Germany), then this would have resulted in tax avoidance. As the above figure can be reduced by dividend payments to other affiliates - out of retained earnings, the actual amount of profits generated by this entity since its inception is unclear.

SHAREHOLDER'S EQUITY	**8**	**262,758**	**306,498**
Issued Capital		500	500
Retained earnings		301,078	308,426
Net loss		(38,820)	(2,428)
Total Liabilities and shareholder's equity		**32,204,204**	**28,328,102**

Source: excerpt from the 2017 accounts of Deutsche Telekom International Finance BV - Netherlands

[17] https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-corporate-tax-rates.pdf

T- Systems Nederland BV Netherlands – (2016 accounts)

The following information is provided on the core activity of this business.

General

T-Systems Nederland B.V. is part of Deutsche Telekom. Based on a global infrastructure of data centers and networks, T-Systems operates information and communication technology (ICT) systems for multinational corporations and public sector institutions. T-Systems provides integrated solutions for the networked future of business and society. The company's employees combine industry expertise and ICT innovations to add significant value to customers' core business all over the world. In 2016 T-Systems Nederland B. V. played again an active part of its parent company's strategy to enable growth in Western Europe.

Source: excerpt from the 2016 accounts of T- Systems Nederland BV - Netherlands

The results for 2016 and 2015 were as follows:

		2016		2017	
(x 1,000)	**Note**	**€**	**€**	**€**	**€**
Net turnover	16.	**201,427**		**239,113**	
Total operating income			201,427		239,113
Costs of goods and services purchased	17.	89,571		119,222	
Staff costs	18.	56,955		59,797	
Depreciation and amortization costs	19.	14,374		20,228	
Other operating expenses	20.	**29,669**		**32,695**	
Total operating expenses			**190,569**		**231,942**
Operating result			10,858		7,171
Financial result	21.		**864**		**3,397**
Result on ordinary activities before taxation			11,722		10,568
Tax on result	22.		**10,106**		**0**
Result after tax			**21,828**		**10,568**

Source: excerpt from the 2016 accounts of T- Systems Nederland BV - Netherlands

The effective corporation tax rate suffered by this entity is 0%, as this entity benefits from tax losses available to offset trading profits. At 31 December 2016, available tax losses to offset future profits amounted to €51m (source: T- Systems Nederland BV Netherlands – 2016 accounts).

As the company provides services to the following related parties, any profits shifted from these entities into T- Systems Nederland BV would have been subject to corporate taxation at 0% and therefore resulted in tax avoidance:

Related parties

During 2016 T-Systems Nederland B.V. supplies and services were delivered to and from the following related parties:

Parent-company:

Deutsche Telekom Ag

Group companies:

DeTe FleetServices GmbH
T-Deutschland Festnetz
T-Systems Multimedia Solutions
T-Systems Polska Sp. z o.o.
DT AG Digital Services
T-Systems Schweiz AG
Deutsche Telekom Training GmbH
T-Systems Nordic A/S
T-Systems Limited
DT Shared Services s.r.o.
T-Systems ITC Iberia S.A.
T-Systems South Africa
T-Systems Austria GesmbH
T-Systems Slovakia s.r.o.
T-Systems Individual Desktop
T-Systems Malaysia Sdn. Bhd.
T-Systems France SAS
T-Systems Argentina S.A.
T-Systems Mexico, S.A. de C.V.
T-Systems Czech Republic a.s.
T-Mobile Netherlands B.V.
T-Systems Luxembourg SA
T-Systems International GmbH
T-Systems Belgium N.V.
T-Systems do Brasil Ltda
T-SystemsDDM GmbH
T-Systems Spring Italia s.r.l.
Deutsche Telekom RSS GmbH
IT Services Hungary

Source: excerpt from the 2016 accounts of T- Systems Nederland BV - Netherlands

The above analysis shows that the Deutsche Telekom group has structured intra-group operations in the Netherlands. In absence of country by country data, it is difficult to determine the amount of tax avoided through the use of the group's affiliates in conduit jurisdictions, hence the need for more information as listed in section 5.2.1 below.

This analysis does not try to demonstrate or to quantify the possible tax avoidance by Deutsche Telekom. Its aim is to show that the company's lack of transparency prevents stakeholders from understanding the potential impact of complex tax structures.

4.2.1 Questions to Deutsche Telekom

- Why does Deutsche Telekom not publish country by country data in its financial statements? These should include turnover, taxable profits before tax, corporate tax paid, tangible assets and number of employees for each jurisdictions in which the group operates.
- Would you commit to publish this information in the next group financial statements?
- For each of the identified group companies in Luxembourg, Netherlands, Cyprus, please provide details of their role in the organisation, including the number of employees.
- Please, confirm whether you have any tax rulings (Advance Pricing Agreements or other) in any of the above countries.
- If so, please provide details of these tax rulings, showing their tax impact on taxable profits reported in the above countries.
- Please, provide details of intra-group transactions for each of the identified group companies in Luxembourg, Netherlands and Cyprus.
- Please, quantify the level of turnover and taxable profits reported by Luxembourg, Netherlands and Cyprus affiliates in the period 2001-2018.
- Please, quantify the corporation tax savings which have resulted from Deutsche Telekom operating intra-group funding and other functions in Luxembourg, Netherlands, Cyprus in the period 2001-2018, vis à vis the same functions being provided by German affiliates subject to German corporation tax.
- Please, quantify what would be the business impact of transferring the functions currently performed in Luxembourg, Netherlands and Cyprus to your German affiliates, so that the profits associated with their activities are subject to a normal level of taxation.
- Please, quantify the tax fees paid to consulting, legal, accounting, tax firms to create and support your Luxembourg, Netherlands and Cyprus tax structures in the period 2001-2018. Costs identified should be those associated with tax advice which was provided with the aim of saving corporation tax.

4.3 ORANGE

Orange's affiliates located in conduit jurisdictions are listed below:

- Orange Business Luxembourg SA - Luxembourg;
- Orange Communication Luxembourg SA - Luxembourg;
- Equant Network Systems Ltd – Ireland;
- Equant Network Services International Ltd – Ireland;
- Orange Business Netherlands BV – Netherlands;
- Equant European Networks SA – Netherlands;
- Atlas Services Netherlands BV – Netherlands;
- EGN BV – Netherlands;
- Equant Panama SA – Panama;
- Orange Business Services Singapore Ltd – Singapore.

We have analysed the accounts of Orange Business Luxembourg SA.

Orange Business Luxembourg SA (2017 accounts)

The following description is provided on the activity of the company:

The Company is the representative of the Orange Business Services ("OBS") group in Luxembourg. The structure of the OBS organisation, its product portfolio and the worldwide coverage of its network make the OBS group a leading provider of telecommunication services for multinational companies. These services are provided largely through its own infrastructure.[18]

The company has reported a profit of ca. €0.5m for 2017. No corporation tax is paid on this profit as losses are available to offset trading income. The company's income is both with related parties and third parties, as shown below. A significant proportion of this income is with Orange SA, which is tax resident in France. As France corporation tax rate for 2017 was 33%, any profits shifted from Orange SA to Orange Business Luxembourg SA would have not be subject to tax, due to the availability of losses and therefore may have resulted in tax avoidance.

[18] Luxembourg Business Registers, Orange Business Luxembourg SA (2017 accounts).

Note 10 - Net turnover

Net turnover of EUR 3,716,581 (2016: EUR 3,287,053) consists of EUR 1,091,916 (2016: 1,264,285) and EUR 2,624,665 (2016: EUR 2,022,768 for services rendered to third parties and related parties, respectively.

Details of the company's tax structure is provided below:

Note 5 - Amounts owed by affiliated undertakings (becoming due and payable within one year)

As at 31 December 2017, the Company had a current account receivable of EUR 1,545,088 (2016: EUR 1,282,875) with Orange S.A., the parent company.

The mechanism for Transfer Pricing (TP) under the Telecommunications Services Agreement (TSA) between most Orange Business Services entities consists of a profit-split method whereby the profits or losses of each entity in the TSA are adjusted based on its percentage share of the key cost drivers of the business. This agreement resulted in the Company recognising EUR 2,624,665 of revenues in 2017, and EUR 0 (nil) of costs (2016: EUR 2,022,768 revenues and EURO costs).

Source: excerpts from the 2017 accounts of Orange Business Luxembourg SA.

Orange has also significant operations in the UK. We have analysed the financial statements of Orange Brand Services Limited, UK.

Orange Brand Services Limited – UK (2017 accounts)

The principal activity of this entity is the management, development and exploitation of the Orange brand, as well as the provision of management services for its ultimate parent company, Orange SA. Therefore, the company provides intra-group services and receives fees from intra-group entities. These fees amounted to ca. €0.5bn in both 2017 and 2016, resulting in profits of €335m and €266m in 2017 and 2016 respectively.

As these profits are taxed at 19%, any profit shifting from Orange SA (or other entities taxed at higher rate) would result in tax avoidance. As the majority of its turnover its with the rest of the world, it is likely that many of the entities which Orange Brand Services Limited provide services to will be countries with a corporation tax rate above 19%. Some of these entities are listed below.

The activities of the company depend upon the requirements of the ultimate parent company, changes in which will have an impact on the revenues earned by the company.

Under the Orange S.A. strategy, the majority of the Orange Group's operating companies use a single commerciai brand which is the "Orange" brand. As a result, from 2006 onwards a number of existing Group companies have been rebranded to Orange and new licences have been branded to Orange from their inception. The company signed a number of new royalty bearing Brand Licence Agreements ("BLAs") with various Orange S.A Group companies, which resuhed in the company incurring non-recurring (re)branding costs in respect of the affiliates concerned.

Source: excerpt from the 2017 accounts of Orange Brand Services Limited, UK

Statement of comprehensive income for the year ended 31 december 2017

	Note	2017 €000	2016 €000
Turnover	4	**486,597**	476,945
Administrative expenses		**(150,505)**	(209,847)
Operating profit	5	**336,092**	267,098
Interest payable and similar expenses	9	**(581)**	(773)
Profit before tax		**335,511**	266,325
Tax on profit	10	**(65,494)**	(59,050)
Profit for the financial year		**270,017**	207,275

Turnover

	2017 €000	2016 €000
The management, development and exploitation of the "Orange" brand	**462,656**	445,649
The provision of management services for the company's ultimate parent company	**23,941**	31,296
	486,597	476,945
Analysis of turnover by country of destination:	**(581)**	(773)
	2017 €000	**2016 €000**
United Kingdom	**4,403**	9,104
Rest of the World	**482,194**	467,841
	486,597	476,945

Source: excerpt from the 2017 accounts of Orange Brand Services Limited, UK

Related party transactions

The following companies are subject to a common controlling influence, Orange S.A. The company has taken advantage of the exemption in FRS 101 from the requirement to disclose transactions with wholly owned entities of Orange S.A. group.

	Sales €000	Debtors €000
2017		
Orange Cote d'Ivoire (ex SIM)	11,915	8,072
Orange Madagascar (à partir 01/01/04)	980	452
Jordan Telecom (IG) (ex 0951)	1,259	1,132
Orange Romania (ex Mobilrom)	15,028	3,260
Orange Moldova (ex Voxtel)	1,964	474
Mobilecom (ex PetraCell) (IG) (ex 0952)	2,535	1,684
Orange Botswana (ex Vista Cellular)	1,176	781
Orange Cameroon (ex SCM)	4,092	6,956
Orange Cara"ibe (ex FCM))	3,632	872
Celi Plus	1,342	238
Orange Polska S.A. (ex TP SA)	28,092	14,281
Orange Tunisie (ex Divona Telecom)	3,399	17,528
EE Limited (ex Everything Everywhere Limited)	4,403	986
Jordan Data Communications Co (IG)(ex 1628)	1,010	899
Sonatel Multimedia	218	232
Getesa	196	9,081
Sonatel (ex 0606) (IG)	541	12
Sonatel Mobile (ex 0609) (IG)	6,645	4,702
Orange Mali (ex 0796 Ikatel) (IG)	6,690	2,961
Sonatel Business Solutions (ex CG e-Solutions)	37	45
Orange Cameroun Multimédia Services	-	80
Orange Bissau	445	80
Orange Guinée	3,275	1,674
Orange Niger	1,263	309
Telkom Kenya	-	-
	100,137	**76,791**

Source: excerpt from the 2017 accounts of Orange Brand Services Limited, UK

The above analysis shows that Orange has structured intra-group operations in Luxembourg and the UK. In absence of country by country data, it is difficult to determine the amount of tax avoided through the use of the group's affiliates in conduit jurisdictions, hence the need for more information as listed in section 4.3.1 below.

This analysis does not try to demonstrate or to quantify the tax avoidance of this multinational, but to show the lack of transparency and that the veil of secrecy currently in place prevents stakeholders to understand the potential impact of these complex tax structures.

4.3.1 Questions to Orange

- Why does Orange not publish country by country reporting data in its financial statements? These should include turnover, taxable profits before tax, corporate tax paid, tangible assets and number of employees for each jurisdictions in which the group operates.
- Would you commit to publish this information in the next group financial statements?
- For each of the identified group companies in Luxembourg, Netherlands, Ireland, Singapore, Panama and UK, please provide details of their role in the organisation, including number of employees.
- Please, confirm whether you have any tax rulings (Advance Pricing Agreements or other) in any of the above countries and the UK.
- If so, please provide details of these tax rulings, showing their tax impact on taxable profits reported in the above countries.
- Please provide details of intra-group transactions for each of the identified group companies in Luxembourg, Netherlands, Ireland, Singapore, UK and Panama.
- Please, quantify the level of turnover and taxable profits reported by Luxembourg, Netherlands, Ireland, Singapore, UK and Panama affiliates in the period 2001-2018.
- Please, quantify the corporation tax savings which have resulted from Orange operating intra-group licensing and management services and other functions in Luxembourg, Netherlands, Ireland, Singapore, UK and Panama in the period 2001-2018, vis à vis the same functions being provided by French affiliates subject to French corporation tax.
- Please, quantify what would be the business impact of transferring the intra-group functions currently performed in UK, Luxembourg, Netherlands, Ireland, Singapore and Panama to your French affiliates, so that the profits associated with their activities are subject to a normal level of taxation.
- Please, quantify the tax fees paid to consulting, legal, accounting and tax firms to create and support your Luxembourg, Netherlands, Ireland, Singapore, UK and Panama tax structures in the period 2001-2018. Costs identified should be those associated with tax advice which was provided with the aim of saving corporation tax.

APPENDIX A

The following is an extract from the Vodafone's tax report (from page 13 onwards)[19].

"One country that has been the focus of public and political scrutiny in recent years is Luxembourg. Vodafone has a significant presence in the country, and our subsidiaries there play a central role in managing some of the most important aspects of Vodafone's global operations, including centralised procurement, financing and roaming.

Our subsidiaries in Luxembourg are not 'brass plate' companies. They are substantive entities that carry out extensive activities that are critical to our businesses worldwide. We employ more than 300 people in Luxembourg.

Their responsibilities include:

- *management of the financing of many of our international operating companies and joint ventures, providing internal loans on a commercial 'arm's-length' basis to reflect the costs of borrowing from an external bank, in line with international best practice;*
- *negotiation and implementation of international roaming agreements with over 700 partners that enable Vodafone customers to communicate when travelling across more than 200 countries;*
- *leadership, management and day to day operations of our global purchasing function – the Vodafone Procurement Company (VPC) – negotiating and administering more than €14 billion of global supplier contracts; and*
- *our start-up incubator hub, Tomorrow Street, created in partnership with the Luxembourg government, to lead on innovation.*

[19] https://www.vodafone.com/content/dam/sustainability/pdfs/vodafone_2017_tax.pdf

In common with many other EU member states, Luxembourg's tax legislation is scrutinised and approved by the country's parliament. The tax principles its laws are based on are largely in line with those of many other member states, including a standard corporation tax rate that (at 26.0%) is higher than the corporate tax rate in a number of other EU member states".

TAX LOSSES AND LUXEMBOURG

As is the case in many member states, Luxembourg tax law also includes features that are particular to that country and were designed to shape the local tax regime to incentivise inward investment. One of those features is particularly significant from Vodafone's perspective. Under long-established Luxembourg tax rules, a reduction in the book value of a company's investments (an impairment or writedown of goodwill) that has been verified by independent auditors and the local tax authorities is recognised as a tax loss that can be offset against future profits. This would occur, for example, if a multinational group with a subsidiary in Luxembourg acquired another business but then saw the value of that acquisition reduced as a result of deteriorating market conditions or performance. The difference arising between the acquisition cost and the newly reduced value of the acquired business – and therefore the loss experienced by shareholders – is treated as a loss for tax purposes and can be offset against profits. While it may be a 'paper loss' up until the point where the company seeks to realise the asset, for the company's shareholders it is unquestionably a loss nevertheless. Similar rules were in place in Germany when Vodafone acquired the Mannesmann conglomerate in 2000. That acquisition was followed by the dotcom crash, wiping tens of billions of euros off the value of the former Mannesmann business, resulting in significant losses for the Luxembourg subsidiary involved, and ultimately for all of Vodafone's shareholders. Under the standard Luxembourg tax code, we are able to offset those historical losses against profits realised within our Luxembourg subsidiaries.

There are two additional points of note:

- *the Luxembourg government recently introduced changes to the tax regime that have placed a time limit on how long losses incurred after 1 January 2017 can be utilised, although this does not affect Vodafone's losses dating back to the Mannesmann acquisition; and*
- *under UK CFC rules, a proportion of profits from our Luxembourg subsidiary's global financing activities are also taxable in the UK.*

THE HMRC VODAFONE CONTROLLED FOREIGN COMPANY SETTLEMENT

In 2010, Vodafone and HMRC concluded a long-running legal dispute focused on a specific point of UK and European tax legislation with a full and final settlement of €1.25 billion. The background to this settlement is highly complex. It was focused on an area of law whose application was unclear and which successive UK governments agreed needed to be rewritten. It involved nine years of legal argument, three court cases and two independent appeals, followed by a detailed HMRC review and settlement in 2010. That settlement was then followed by a National Audit Office (NAO) inquiry in 2012, assisted by a former High Court judge, Sir Andrew Park. The NAO report concluded that the HMRC/ Vodafone settlement was a good outcome for the UK taxpayer and that if Vodafone had chosen to continue litigation instead of settling with HMRC, "there was a substantial risk that the Department [HMRC] would have received nothing".

The dispute focused on the UK tax authorities' interpretation of Controlled Foreign Companies (CFC) legislation and began when Vodafone bought the Mannesmann conglomerate in Germany in 2000. The acquisition was largely for shares and involved no borrowings or loans from Vodafone's UK business. Importantly, there was no reduction in Vodafone's UK tax contributions as a consequence, and the dispute was not related in any way to the tax liabilities arising from our UK operations. We therefore questioned the UK tax authorities' application of the rules on both factual and legal grounds, in common with a number of other companies who had also challenged the UK's approach to CFC legislation. Vodafone's subsidiary in Luxembourg is the main financing company for our many operations around the world (see our Luxembourg section).

The UK tax authorities argued that, had those financing activities been established and undertaken in the UK, they would have attracted tax in the UK, and that therefore tax should be payable under UK CFC provisions. Vodafone argued that, as a matter of European law, we were freely entitled to establish activities wherever we chose, and that as a matter of fact, these were neither artificial arrangements nor did they have any impact on Vodafone's UK tax liabilities. The underlying facts were scrutinised by the UK tax authorities and the points of law involved were examined in detail by the European Court of Justice, the UK High Court and the UK Court of Appeal, prior to the decision to reach a settlement. Subsequently, the UK Government sought to address a number of inconsistencies and flaws in UK CFC legislation, clarifying the UK's approach to this complex area of international taxation in new rules that took effect in January 2013.

Published on 5 December 2018 by SfC - Shareholders for Change
www.shareholdersforchange.eu

SHAREHOLDERS for CHANGE