Money moves: Tax planning in multinational companies - the case of Microsoft

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Multinational companies, in particular technological companies, utilise several tax strategies to minimise or even avoid taxes. Deferral is used to avoid U.S. withholding tax. Transfer pricing and check-the-box go hand in hand for transferring IPs from the United States to tax havens. Thin capitalisation is utilised to capture tax savings due to tax rate differences. By using advanced company structures and tax havens, the tax minimisation practices can be shielded from the tax authorities and from the public due to the secrecy legislation in tax havens.

Microsoft's effective tax rate was 21 percent in 2014 and 19 percent in 2013. This is significantly lower than the U.S. federal statutory rate of 35 percent. The reason is that earnings are channelled through regional operations in Ireland, Singapore and Puerto Rico. In addition, Microsoft exploits loopholes in U.S and international tax regulations to avoid U.S. withholding tax and tax on passive income. Microsoft's international operations and geographic locations are structured and managed for tax minimisation purpose. In particular, they use deferral, transfer pricing and check-the-box as vehicles.

Deferral allows Microsoft to avoid U.S. withholding tax on foreign income until the foreign earnings is repatriated to the United States. In practice, Microsoft keeps around 90 percent of the foreign cash indefinitely in operation centres in tax havens. In 2014, the money held offshore was $79.7 billion. That was 93 percent of their total cash holding of $85.7 billion. However, in reality this cash is brought back to the United States in form of investment done by the foreign subsidiaries.

By using cost sharing agreement and "buy-in" payment, Microsoft also manages to transfer intellectual property (IP) rights from the United States to foreign IP-Holding entities such as Flat Island Company, Microsoft Ireland Research (MIR), Microsoft Island Asia Ltd. (MAIL) located in Bermuda and Microsoft Operation Puerto Rico (MOPR). This transfer is done with a low price as it happens in an early stage of the development of the intangible assets. The IP-holding entities then relicense the rights to the operating entities. In this way, Microsoft keeps the profits received from licensing the IP rights in the IP-Holding entities and pay low taxes (14.4 percent in Ireland, 0.3 percent in Bermuda and 2 percent in Puerto Rico).

Using controlled foreign co-operations (CFCs) and check-the-box, combined with complex company structures, Microsoft is able to avoid tax payments on re-license transactions between the CFCs. This allows Microsoft to move the IP to low-tax jurisdictions without paying tax for the transactions. The company reduces its tax liabilities further by using a so-called double Irish Dutch sandwich involving the three subsidiaries Microsoft Financing International B.V. in the Netherlands, Round Island One in Ireland and RI Holdings in Bermuda.

Microsoft as a whole operates as a complex network of interconnected entities including subsidiaries registered in tax havens. The company is reluctant to disclose the company structure. This makes it difficult to identify and to understand how the subsidiaries relate to each other. Microsoft reduced the number of reported subsidiaries in tax havens from 10 in 2007 to only five in 2013 – three in Ireland, one in Luxembourg and one in Singapore. The Wall Street Journal has called this phenomenon “incredible vanishing subsidiary”. In addition, out of 942 subsidiaries, only 112 disclose key financial reports and 431 provide information about Microsoft ownership. In 2014, Transparency International reported that Microsoft scored 3.4 in corporate reporting transparency (0 is the least transparent and 10 is the most transparent).

Microsoft has 16 subsidiaries in Norway, but only 12 that are active, and only four publish financial information – Microsoft Norge AS, Microsoft Development Center Norge AS (MDCN), Microsoft Holdings Norge AS and Microsoft Domains AS. Microsoft Norge AS states that its function is to support partners in Norway. Even though some of these partners are developing software using the Microsoft platform, the firm claims that there are no value-added activities in Norway. As all goods are sold directly from Ireland (MIOL), there is no sales revenue booked in Norway. The operational earnings of Microsoft Norge AS is a six percent commission on total sales in the Norwegian market, received from MIOL. In the years 2009-2014, the booked revenue from the commission was NOK 3.471 billion. It implies NOK 57.865 billion in total sales in the Norwegian market. For the same period, Microsoft Norge AS paid NOK 310.5 million tax to the Norwegian tax authorities. This is only 0.56 percent of total sales.

If Norway enters an agreement with the EU and applies the CCCTB using “sales by destination” as factor, it will be possible to book the sales in the Norwegian market in Norway and to use this as a tax base. The tax payment for 2011-2014 would then have been NOK 15.4 billion instead of NOK 310.5 million. However, the sales revenue in the Norwegian market is booked in Ireland via Luxembourg (Microsoft Luxembourg S.A.R.L) to avoid both Norwegian and Irish income tax.

The costs of Microsoft Norge AS is on average 79 percent of the total revenue in the years 2009-2014. Microsoft Norge AS is financed by debt and the debt-to-asset ratio in 2014 was 19.80. This reduces the tax burden in Norway further.

Analysis of the other Microsoft subsidiaries in Norway shows that Microsoft seems to use MDCN AS, to shift revenue from North America to Norway in order to avoid the high corporate tax in the US. The acquisition of MDCN AS itself was a way to use the foreign cash held by MACS Holdings Limited in Bermuda. Despite the revenue and interest income received, MDCN AS run a deficit in 2010-2013. Microsoft Holdings Norge AS and Microsoft Domains Norge AS, book only costs and do not have any revenue. This results in zero tax.