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Multinational enterprises and corporate tax planning: a review of literature and suggestions for a future research agenda

Article

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Starbucks

This short case study aims to demonstrate the ways in which an MNE can bring different profit shifting mechanisms together in a tax planning strategy. Starbucks was selected as a case study as it has been labelled as a 'tax avoiding' company in the UK but works in a traditional 'bricks and mortar' industry rather than being a 'digital' company.

Starbucks is known for its huge chain of coffee shops but it also reaches back down its supply chain to buy green coffee beans and roast them (Starbucks 2014). Starbucks' clearest Firm Specific Advantages (FSA) however, are its name and brand which confer opportunities to profit shift.

International Operations

Starbucks operates across three international regions: Americas (US, Canada and Latin America), Europe, Middle East and Africa (EMEA) and China and Asia Pacific (CAP). It remains a Home Region company, however, with 70 per cent of sales coming from the American region (Starbucks 2017). Starbucks operates stores themselves but also licenses to other operators. At the end of their fiscal year 2018 they had 29,324 stores globally. Half of the total number of stores are licensed and half are company operated. Licensed stores contributed 11% of total revenue for 2018 (Starbucks 2018). Licensed stores pay Starbucks a proportion of their revenue with most of the costs borne by the licensee. They must also pay for Starbucks royalties and buy their products (coffee beans etc) directly from Starbucks. Licensees are used only when Starbucks feel that they can provide access to good retail space or other local expertise. Various forms of licensing, including franchising are used.

The overall headquarters for the Starbucks Corporation are based in Seattle. Each of the three international regions has their own headquarters. The 33 countries making up Europe, Middle

East and Africa region were based in Amsterdam until 2014 when they were moved to the UK. Separate companies based in the market countries remit profits (if any) back to EMEA headquarters. A global coffee bean purchasing business is operated from Lausanne, Switzerland. No accounts are publically available for this part of the business.

Starbucks in the UK

Following concern about Starbucks low tax payments in the UK in 2012 (it had paid £8.6m tax in the preceding 14 years), Starbucks, with Google and Amazon were called to give evidence in front of the House of Commons Public Accounts Committee (House of Commons, Public Accounts Committee 2012) where they confirmed that they had made losses in all but one year of UK operations but claimed that their optimism was based on their future forecasts for the business. Starbucks argued that the property costs in the UK were making it difficult for it to become profitable.

Perhaps in response to this criticism, in 2014 Starbucks announced that they were moving their regional headquarters from Amsterdam to the UK. Starbucks explained that this move was because the UK is the largest market in the region. The UK stand-alone company was dissolved and replaced with a new company, Starbucks EMEA Ltd. It has also been suggested that the move made sense from a tax perspective due to the UK's recent change to a territorial tax system – where companies are charged tax only for the income earned within the UK. Companies are no longer charged tax on income earned outside the UK. This means that no taxes are charged on the royalties received in the UK from the rest of the region. This makes the UK a more efficient location for tax purposes than the Netherlands.

Starbucks has been accused of using its intellectual property (IP) to transfer profits. The UK company (previously a Dutch company) now owns the IP relating to the Starbucks logo and drinks recipes etc. This company then receives royalty payments from other operating companies which reduce their profits, transferring them to the central company. This company *"owns the licenses in respect of Starbucks intellectual property, which it has in turn sub licensed to other Group companies…"* (Starbucks EMEA Ltd., Full accounts, 2017 p 24 filed with the UK Companies House)

Starbucks EMEA Ltd paid an effective tax rate (ETR) of just 2.8% in the year ending October 2017 ($5.9m tax on profits of $213m). The profit figure however, contained a dividend of $150m from another group entity on which tax had already been paid. Without this payment the EMEA business had an ETR of 9.4%, compared to a statutory rate of 19.5% in the UK.

Starbucks EMEA Revenue Breakdown

$'million	**Period ended 1 Oct 2017**	
Royalty income	225	220
License fee income	7	7
Other	(3)	
Interest receivable and similar	24	27
Disposal of assets	51	
Dividend income from group undertakings	148	150
Total turnover	452	404

Source: Starbucks EMEA Ltd (2017)

An example of how this royalty fee affects profits can be seen by examining the UK business. The UK operating business is Starbucks Coffee Company (UK) Ltd which paid a royalty fee of £27million for the year ending 1 October 2017 (Starbucks Coffee Company (UK) Ltd 2017). Without this fee its profitability would have increased from £4.5million to £31.5million.

Supply Chain

Starbucks adds value by breaking down its supply chain to buy and roast coffee beans. Controlling their own supply gives them a secure, good quality supply. According to their annual reports, Starbucks roasts beans in the Netherlands and the US (Starbucks 2017). A Starbucks subsidiary in Switzerland (Starbucks Coffee Trading Sarl) buys coffee beans for the global company. In 2012 this business was revealed to employ only 30 people and to charge a mark-up of 20 per cent on the coffee sold on to Starbucks operating companies including the UK company (House of Commons, Public Accounts Committee 2012). In 2012 Starbucks were reported to be paying a corporation tax rate there of approximately 12% (House of Commons, Public Accounts Committee 2012). More up to date information is not available and without more detailed information, presumably available to the tax authorities, it is impossible to calculate whether this is an 'Arm's Length' transfer price.

Tax avoidance strategy

Following the bad publicity, particularly around the Public Accounts Committee enquiry Starbucks offered to pay an extra £20million in corporation tax over the next two financial years. Margaret Hodge reveals (Hodge 2016) that rather than approaching HMRC to discuss their tax affairs the Starbucks UK managing director spoke directly to her to offer to make this payment. Hodge argues that this offer demonstrates the problems with the corporation tax system when MNEs choose to make tax payments rather than paying the tax assessed by the tax authorities.

Starbucks parent firm's permanent retained earnings (PRE)

$'million	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
PRE	3,700	3,300	2,800	2,200	1,900	1,500	987	646	520	409

Source: Starbucks Inc. Annual Reports 2008-2017

Starbucks have continued to hold significant earnings offshore rather than return them to the US and face tax on repatriation. The latest annual report (Starbucks 2018) states that Starbucks still have no intention of returning these earnings to the US despite the recent changes to the tax regime introduced in the American Tax Cuts and Job Act 2017 by the Trump Administration. The table below shows the rate of accumulation of these earnings.

Starbucks: Conclusions

Examining the case of Starbucks provides clear insight into the way that this company, operating in a very traditional 'bricks and mortar' manner, is still able to reduce its tax liabilities. It demonstrates the way in which Starbucks are able to reduce their UK profitability by using a range of different mechanisms. Whilst not a digital company or one operating in an IP intensive industry Starbucks have used royalties and license fees to shift profits between jurisdictions. Whilst obtaining details about the internal operations of a company is difficult this case study illustrates the importance of tax to companies; tax affects where companies locate their headquarters as well as how they structure their business more broadly.