A BITTER PILL

Pharmaceutical Companies' Tax Avoidance in New Zealand

New Oxfam research shows that four pharmaceutical corporations—Abbott, Johnson & Johnson, Merck & Co. (also known as MSD), and Pfizer—systematically stash their profits in overseas tax havens. They appear to deprive developing countries of more than NZ$150 million every year—money that is urgently needed to meet the health needs of people in these countries—while vastly overcharging for their products. It is estimated that New Zealand loses NZ$21 million every year. This report outlines how these big pharmaceutical corporations deprive governments across the world from much needed funds to invest in their people. This behaviour widens the yawning gap between rich and poor, between men and women, and between advanced economies and developing ones. This research provides yet another example of why we need to act to stop unfair tax avoidance in New Zealand and around the world.

This briefing focuses on four pharma companies' practices in New Zealand. The four companies are Johnson & Johnson, Pfizer, Abbott and Merck & Co. This briefing focuses on the USA-based pharmaceutical company Merck and Company Inc., sometimes known as Merck Sharp & Dohme (MSD) outside of the USA, not the German-based pharmaceutical company Merck KGaA. While Abbott, like Johnson & Johnson, provides a variety of health care services and products, this report refers to Abbott as a pharmaceutical or drug company. All figures are in New Zealand dollars, using an exchange rate of 1USD=1.49NZD (as of August 2018). To see data and analysis for other countries, see the global report (released at 00.01GMT 18 September):
M. Fried. (2018). *Prescription for Poverty: drug companies as tax dodgers, price gougers and influence peddlers* [Available at https://www.oxfam.org.nz/]. This country briefing uses the term 'avoiding tax' or 'tax avoidance' to mean lawful practices which unfairly reduce tax. Oxfam objects to these practices but does not claim that they are unlawful or liable to penalties.

WHAT'S THIS REPORT ABOUT?

The world's biggest drug companies are putting poor people's health at risk by depriving governments of billions of dollars in taxes that could be used to pay for clinics and schools, nurses, doctors and medicines.

New Oxfam research shows that four major pharmaceutical firms – Abbott, Johnson & Johnson, Merck & Co., and Pfizer – systematically stash their profits in overseas tax havens.[1] As a result, these four corporate giants appear to deprive the United States of $3.4 billion[2] annually and deny other advanced economies of $2.1 billion. And they appear to deprive the cash-strapped governments of developing countries of an estimated $167 million every year – money that could be spent on vaccines, midwives, or rural clinics.

Such unfair tax avoidance corrodes the ability of governments everywhere to provide the public services that are essential to reducing poverty and that are particularly important for women. When health systems crumble, women and girls step into the breach to provide unpaid care for their loved ones, compromising their own health and their prospects for education and employment. When governments are deprived of tax revenues, they often seek to balance the budget by raising consumption taxes that take a large bite out of the little cash poor women have.

This new research shows that New Zealand appears to lose an estimated $21 million from the four companies each year. Last year, Oxfam's research uncovered that Reckitt Benckiser (RB) may have avoided paying as much as $15.2 million in tax in New Zealand and $395 million globally in the three years to 2016.[3] Combining the estimated tax losses from this new research with the RB research indicates that New Zealand is potentially losing up to approximately $78 million every three years, from just five companies. This is money our government could be using for more nurses in our hospitals, more teachers in our schools, and more social housing for families.

It is our hope that this report will encourage the four companies and others to reform their policies and practices, and that it will spur governments to enact rules that promote responsibility and benefit all society. We believe such a change is in the companies' long-term interest. Just as extreme inequality is toxic for society, undermining public institutions is no recipe for a stable, profitable industry.

A FIGHTING CHANCE?

Tobeka Daki, a single mother of two boys who was also a health activist from Mdantsane township in East London, South Africa, was diagnosed with breast cancer in 2013. In addition to a mastectomy and chemotherapy, she needed a medicine called trastuzumab to improve her chances of survival. In South Africa a 12-month course of trastuzumab costs approximately US$38,000, around five times the average household income.[4] Tobeka's chance of survival was denied because neither she nor the public system could afford the medicine. Tobeka's cancer spread to her spine and within three years of diagnosis she was dead.

One of the most pernicious aspects of extreme inequality today plays out in the field of health. Simply for being born poor and a girl, a young woman will have to struggle harder to get an education and a decent job, and she is less likely to get the various forms of health care she needs. She will be one of the millions of people around the world for whom decent health care and medication are unaffordable luxuries only available to the rich.

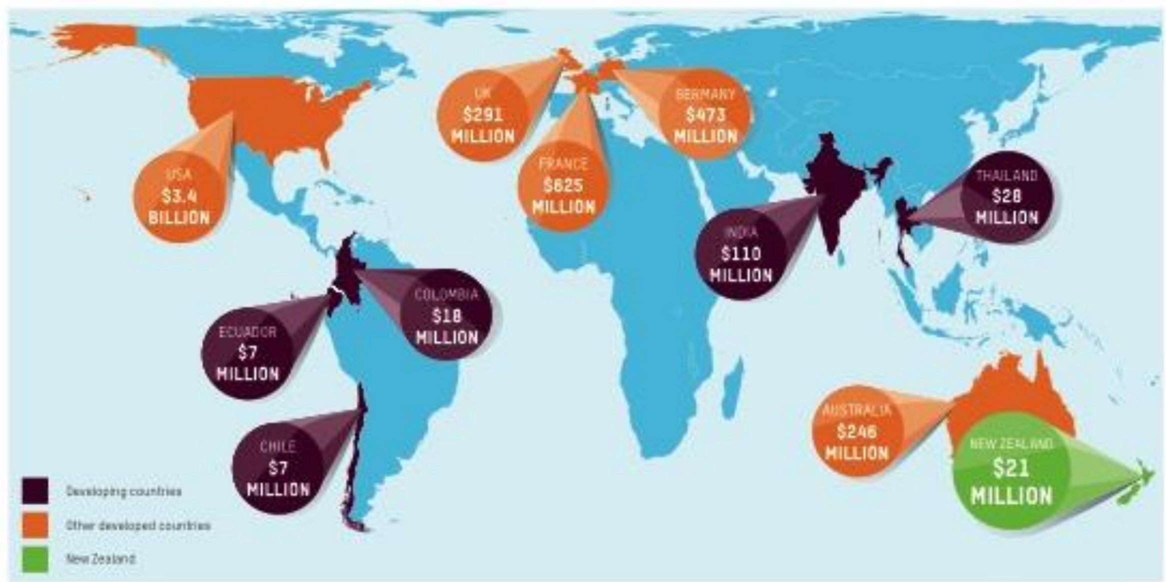
Women and girls pay the price for unfair corporate tax avoidance. When governments lose revenue from corporate tax avoidance, they have fewer funds available to invest in public services that give people the means to better their lot. This particularly hurts women and girls, who are more likely to live in poverty and to rely on publicly funded health care, and less likely to be able to pay for health care. When public services are inadequate or unavailable, women and girls often provide the care that public services don't. This means they miss out on opportunities for education and employment. One study highlighted that women contribute $4 trillion to health care (paid and unpaid), and estimated that women's unpaid health work comprised half of this, at 2.35 percent of global GDP.[5] So while poor women are contributing to the economy through their unpaid care, powerful multinational corporations appear to be avoiding paying their fair share.

UNFAIR TAX AVOIDANCE GLOBALLY AND IN NEW ZEALAND

Because the companies reveal little financial information about their subsidiaries, Oxfam's investigation barely scratches the surface. Yet even a small sampling suggests a striking degree of unfair tax avoidance. In just seven developing countries – Chile, Colombia, Ecuador, India, Pakistan, Peru, and Thailand – Oxfam estimates that these US drug corporations appear to underpay by $167 million in taxes every year. And in nine wealthy countries, Abbott, Johnson & Johnson, Merck & Co., and Pfizer may underpay by an estimated $5.5 billion – $3.4 billion of it in the United States.[6]

Unfair tax avoidance by the four companies led to an estimated loss of over NZ$150m in seven developing countries.

FIGURE ONE: ESTIMATED UNFAIR TAX AVOIDANCE IN SELECTED DEVELOPING AND ADVANCED COUNTRIES.



What is telling is that the companies' profit margins tend to be in inverse proportion to the applicable tax rate in each country: where tax rates are standard, profits are low; where tax rates are abnormally low, profits are abnormally high. The analysis done by Oxfam does not prove that the companies are engaged in profit-shifting that crosses the line of what is allowed under existing rules. Only tax authorities with access to companies' full tax returns can determine whether some transactions are unlawful. But while the information available publicly is far from complete, the pattern is consistent: subsidiaries located in tax havens are on average significantly more profitable than those located elsewhere. That is not what one would expect if the geographic distribution of profits reflected the geographic distribution of the real value of economic activities.

Unfair tax avoidance helps explain the extreme profitability of these companies (along with high prices, and influence peddling – see the full report), and the extreme benefits they offer their wealthy shareholders and senior executives. The 25 largest US drug companies had global annual average profit margins of between 15 and 20 percent in the period 2006–2015; the figure for comparable nondrug companies was four to nine percent.[7] These high profits, in turn, increase the incentive that these corporations have to shift profits and avoid tax.

Tax loss in New Zealand

Oxfam analysed the financial accounts where the four companies conduct business covering the United States, seven developing countries, eight developed countries and four tax havens.

Oxfam estimates that the four companies reduced their tax bills by around NZ$21 million every year in New Zealand

Oxfam estimated the tax losses to a country based on the difference between the actual tax paid and the hypothetical tax due on profits in line with the global average profit margin. To calculate the tax shortfall in each country, each company's revenues in that country were multiplied by the global profit margin to obtain the counterfactual profit that companies would make in that country if profit margins were uniform all over the world. The country's statutory tax rate was then applied to that counterfactual profit to obtain the counterfactual tax owed in that country. Finally, the actual tax paid in that country was subtracted from the counterfactual tax owed to obtain the tax shortfall.

In developed and developing countries alike, the profit margin tended to be lower than the global average, whilst in tax havens the profit margin was higher than the global average. Whilst our estimates are based on an imperfect method holding the profit margin consistent across all countries, this approach is the most reasonable given the lack of publicly available data from all four companies.

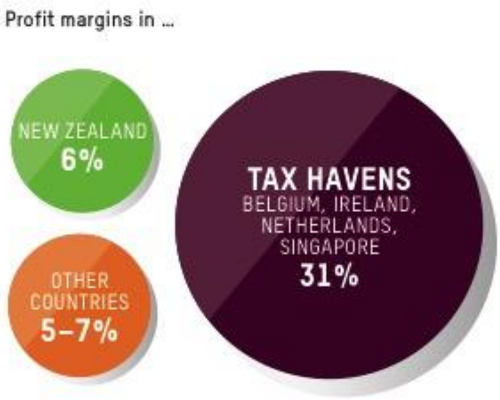
Data availability was particularly poor in tax havens and developing countries, but in New Zealand, we were able to obtain data for all of the four pharmaceutical corporations' subsidiaries operating in the country.

In New Zealand, the four companies collectively brought in revenues of an average $519 million a year between 2013 and 2015, and posted profits of about $30 million a year. In total, each year the four companies paid an estimated average $8 million in taxes. Meanwhile, our method estimates an annual tax underpayment of approximately $21 million for the four companies.

As Figure Two below shows, the four companies' average total profit margin in New Zealand was six per cent, compared to an average seven percent across eight developed countries, and an average five percent in the seven developing countries. Yet somehow, in the four tax havens – Belgium, Ireland, Netherlands and Singapore – where profits are often not taxed, the companies managed to earn an average 31 percent profit margin.

We are not suggesting these pharmaceutical companies are doing anything illegal. Yet, Oxfam's report suggests that these companies are structuring their operations to enable shifting profits to tax havens. These companies could choose to pay their taxes in an open and fair way, particularly given their very profitability depends on the functioning public health systems that taxes often go towards.

FIGURE TWO: COMBINED PROFIT MARGINS IN NEW ZEALAND AND OTHER COUNTRIES COMPARED TO TAX HAVENS



PROGRESS, BUT MORE TO DO

The New Zealand government has made reforms over the past few years that go some way to stopping the revenue loss from multinational corporations' unfair tax avoidance. These reforms were in response to the OECD/G20's Base Erosion and Profit Shifting project, which was launched in 2015 to curtail multinational tax avoidance. New Zealand adopted country-by-country reporting requirements in late 2016 for corporate groups headquartered in New Zealand with annual consolidated group revenue of over approximately $1.3 billion. The New Zealand IRD's initial population analysis suggests that around 20 New Zealand-headquartered corporate groups are affected.[8] The first reporting of country-by-country data was due to take place during the 2017 calendar year.[9] However, this information is only accessible to tax authorities, not the public, and does not include all multinational corporations operating in New Zealand.

New Zealand took further positive steps just this year, passing the Tax (Neutralizing Base Erosion and Profit Shifting) Act. This Act puts in place measures that would prevent multinational corporations from using some of their favoured techniques for shifting profits out of New Zealand, such as artificially high interest rates on loans and exploitation of different countries' tax rules to pay as little tax as possible.

These changes are moving New Zealand in the right direction. Yet, it will be hard for the public to assess what impact they will have, because none of the changes require multinational corporations to publish financial information for every country where they do business. Although the country-by-country reporting requirement will assist, there is no mechanism in place to assess whether or not multinational corporations simply find other ways to use loopholes in tax laws to avoid paying tax. Only public country-by-country reporting will enable the informed debate necessary to restore legitimacy in the tax system.

People in New Zealand and everywhere need systematic tax transparency so everyone can see what taxes companies are paying in which countries, and where unfair tax avoidance might be happening. This will help to deter unfair tax avoidance in the first place, and also help governments identify loopholes that should be closed. Making information public can also allow civil society and academics to assist governments in analysing multinational corporations' unfair tax avoidance practices, increasing efficiency and effectiveness, as well as the knowledge pool about these highly complex taxation issues. As this research highlights, it is hard to assess the scale of the problem because it is so hard to get information. We need this information to be publicly reported.

BIG PHARMA, BIG TAX AVOIDER

As with most drivers of inequality, the unfair tax avoidance practices of these companies are not accidental. They result from deliberate choices made by companies. It is our hope that this report will encourage the four companies and others to reform their policies and practices, and that it will spur governments to enact rules that promote responsibility and benefit all society. We believe such a change is in the companies' long-term interest. Just as extreme inequality is toxic for society, undermining public institutions, like a fair tax system, is no recipe for a stable, profitable industry.

Besides draining money from social services, unfair tax avoidance worsens the suffering for women caused by the implicit and explicit gender biases in tax systems, because unfair tax avoidance requires governments to raise a greater proportion of their revenue from other sources. Most developing countries raise two-thirds or more of their tax revenue through consumption taxes, which eat up a larger proportion of income the poorer you are. And women are more likely to be poor than men.

Corporations and governments share the blame for our broken and dysfunctional tax system that privileges multinational corporations and the wealthy over everyone else. Pharmaceutical corporations should not be able to cloak their financial and tax affairs in secrecy, and avoid tax with impunity. Governments must stop the dangerous race to the bottom on taxes, and they must commit to investing in the public services their citizens – particularly women and girls – need.
We can all play a role in holding the pharmaceutical corporations to account.

RECOMMENDATIONS

The four companies need to reform their tax practices. There is also an important role for governments to act to ensure they do not lose revenue from multinational corporations' tax avoidance strategies. The New Zealand government has taken important steps to stem its losses from multinational tax avoidance, but there is more it can do. Oxfam is especially concerned that developing countries have not benefited enough from existing international tax reforms and need to benefit from the data contained in country-by-country reporting. For their benefit and wider public good, we are calling for all companies to implement real tax transparency through publishing their country-by-country reports.

Governments need to ensure all companies pay the right amount of tax in the right place.

We call on companies to:

Be more transparent by publishing all information necessary for citizens to understand and assess the company's tax practices.

- Publish full country-by-country reporting of key financial information.
- Publish a full list of all company subsidiaries in every country where they operate.

We call on governments to:

Require companies to adhere to full transparency and pay their fair share of taxes.

- Mandate and implement public country-by-country financial reporting for all large multinational corporations.
- Require large multinational corporations to pay a fair, effective tax rate on their profits, strengthen rules to discourage profit-shifting, and take action against tax havens.

We call on citizens to:

Join Oxfam New Zealand to ask our government to require **public** country-by-country financial reporting for all multinational corporations, so we can see what they are doing and make them pay their fair share.

[1] In 2013, Abbott spun off its proprietary R&D-based pharmaceutical business into a separate corporation named Abbvie, while Abbott focused on medical devices, diagnostics, nutrition, and branded generic pharmaceuticals. See “Abbott Completes Separation of Research-Based Pharmaceuticals Business,” PR Newswire, January 2, 2013, https://www.prnewswire.com/news-releases/abbott-completes-separation-of-research-based-pharmaceuticals-business-185406542.html.Abbott does not sell pharmaceuticals in the US, although Abbott does continue to sell pharmaceutical products as a major part of its global business. While Abbott, like Johnson & Johnson, provides a variety of health care services and products, this report refers to Abbott as a pharmaceutical or drug company.

[2] Except where noted, all dollar amounts in this report are in New Zealand dollars. The exchange rate used was the average exchange rate across August 2018: 1USD=1.49NZD, Available at: https://www.rbnz.govt.nz/statistics/b1

[3] Oxfam New Zealand and Oxfam International, (2017) *Making Tax Vanish*, Available at: https://www.oxfam.org.nz/reports/making-tax-vanish-how-practices-consumer-goods-mnc-rb-show-international-tax-system-broken

[4] Drew DeSilver, “Chart of the Week: How South Africa Changed, and Didn’t, Over Mandela’s Lifetime,” Pew Research Center, December 13, 2016, http://www.pewresearch.org/fact-tank/2013/12/06/chart-of-the-week-how-south-africa-changed-and-didnt-over-mandelas-lifetime/.

[5] Ana Langer, et al., ‘Women and Health” The Key for Sustainable Development’, The Lancet 386, no. 9999 (19 September 2015): 1165-1210, https://www.thalancet.com/action/showPdf?pii=S0140-6736%2815%2960497-4; and ‘Women Are the Backbone of Healthcare with Few Rewards for $3tn Contribution’, The Guardian, 5 June 2015, https://www.thaguardian.com/global-development/2015/jun/05/women-backbone-healthcare-3tn-contrubtion

[6] The developing countries examined were Chile, Colombia, Ecuador, India, Pakistan, Peru, and Thailand; the wealthy countries were Australia, Denmark, France, Germany, Italy, New Zealand, Spain, and the UK. The presence of the four companies in sub-Saharan Africa is very limited. Either the companies’ products are not sold to consumers in many African countries, or they are imported and distributed by unrelated companies. Alternatively, the companies may be violating permanent establishment rules to avoid tax.

[7] US Government Accountability Office (GAO), “Drug Industry: Profits, Research and Development Spending, and Merger and Acquisition Deals,” GAO-18-40 (2017), 16.

[8] Inland Revenue Department, New Zealand Government, *New Country-by-Country Reporting Requirements,* Available at: https://www.ird.govt.nz/international/business/international-obligations/country-by-country-reporting/new-country-by-country-reporting-requirements.html

[9] Inland Revenue Department, New Zealand Government, *New Country-by-Country Reporting Requirements,* Available at: https://www.ird.govt.nz/international/business/international-obligations/country-by-country-reporting/new-country-by-country-reporting-requirements.html

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This paper was written by Oxfam New Zealand and Oxfam International. It is part of a series of papers written to inform public debate on development and humanitarian policy issues.

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The information in this publication is correct at the time of going to press.

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