TaxWatch
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26/04/19
Margrethe Vestager
Commissioner for Competition
European Commission
Rue de la Loi / Wetstraat 200
1049 Brussels

Dear Commissioner Vestager,

I am writing to request that the European Commission opens an investigation into the tax avoidance scheme implemented by Google. Specifically, we would like to request that the Commission investigates whether the tax authorities of Ireland and the Netherlands have entered into any special arrangements with Google over the treatment of royalty payments for the use of intellectual property, and whether this has given a competitive advantage to the company.

Google's tax avoidance scheme

Google has implemented a tax avoidance scheme which uses payments between companies located in two European states in order to avoid paying billions of euros in taxes to European Union countries every year.

A company based in Ireland, Google Ireland Limited, accepts the vast majority of Google's revenue from its external clients in Europe. This company then pays a significant amount of its earnings to a company in the Netherlands. This arrangement has been in place since at least 2004 according to the accounts of the Dutch company, Google Netherlands Holdings.

The Dutch company then pays out practically all of its revenue to a second Irish company, which is tax resident in Bermuda.

Google's royalty payments

The mechanism used to move money between Ireland, the Netherlands and Bermuda is a payment of royalties for the use of Google's intellectual property. This royalty payment makes up a huge proportion of Google Ireland's costs. In most years royalties comprise over 50% of the company's operating costs, and 99.9% of Google Netherlands Holdings' costs.

Google Ireland Holdings, a company registered in Ireland but tax resident in Bermuda, is the end beneficiary of these royalties. Google Ireland Holdings performs no research and development itself, instead making payments to other Google companies to finance Google's R&D costs. However, in the accounts of Google Ireland Holdings we have seen, approximately 50% of its revenues remain in Bermuda as profit.

The net effect of this structure is that the vast majority of Google's European profit is allocated to the ownership (but not the production) of intellectual property in Bermuda.

This is not a situation which is mirrored by the US arm of Google's operation, as no payments from Google's US companies appear to be being made to Google Ireland Holdings from Google's US subsidiaries.

We believe that the large allocation of European profits to Google Ireland Holdings, and the intra-company payments that underpin them would be difficult to justify under an arm's length analysis. At the very least, they merit further investigation.

To put these payments into some context, the New Zealand revenue authority categorises royalties that exceed 25% of gross profit as high risk, triggering an automatic review. Google Ireland pays over 60% of its gross profit out as a royalty, and historically the figure has been as high as 75%.

In 2011 the High Technology Sector of the Licensing Executives Society (US branch) conducted their first survey of royalties paid by firms on a commercial basis in the high technology sector. It found that the average royalty rate was between 5-6% of revenue (not gross profit). Google Ireland paid 46% of its revenue out as a royalty in 2017.

Under the arms-length transfer pricing principle, tax authorities should adjust the royalties paid by companies to connected parties to reflect a reasonable royalty rate. The structure implemented by Google raises a question as to whether the company has reached any special arrangements with the Dutch or Irish tax authorities in order to assist them to move profits out of Europe and into Bermuda.

The European Commission has previously ruled on similar cases involving the payments of excessive royalties. In 2017 the Commission found that Luxembourg had given Amazon a selective benefit by allowing royalty payments which were not in line with economic reality.

Given the extremely large payments being made by Google, there is an important public interest in the Commission now opening an investigation into Google's tax structure and specifically whether the Irish and Dutch tax authorities have provided state aid to Google, either through any special tax arrangements, or by failing to properly investigate Google's structure.

We look forward to your reply.

Yours faithfully,

George Turner

Director

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