

No tax and chill:

Netflix's offshore

network



NETFLIX

Key facts and figures:

- **\$1.2bn – Global profit of Netflix in 2018**
- **Up to \$430m – profit from international operations moved into tax havens in 2018**
- **€48m – amount of revenue reported by Netflix's main UK company, Netflix UK Services in 2018.**
- **£860m – estimated revenues from UK subscribers in 2018**
- **18 production companies in the UK potentially eligible for UK Tax Credits**
- **Total tax relief claimed by UK companies in 2017 and 2018 £924,000**

Summary

Facebook, Amazon and Google, have all received a significant amount of scrutiny in recent years about their tax affairs, but the last of the FANG group of companies, Netflix, has not.

One reason for this could be that that Netflix has historically not been as profitable as other digital companies, as it has spent large amounts of money building an international presence and buying film rights. However, recent years have seen the company's profits rocket, from \$123m in 2015, to \$1.2bn in 2018.

In this report, we provide an analysis of Netflix's corporate structure which shows that the company has implemented a similar tax avoidance structure to many other multi-national companies operating in the digital space. Revenues are not collected in the country where they are made. Instead, customers are charged from an offshore company. Profits appear to then be moved from the hub company to a tax haven through the use of intra-company transactions.

Netflix's historically lower profit margins mean that the scale of any tax avoidance will be much lower than other well known companies that employ similar tactics.

However, the structure that the company operates presents a significant risk factor for the tax base of many countries as the company expands its presence, increases market share and sees an increase in profits.

In total, we estimate that the company moved between \$327.8m to \$430m in profits to low tax jurisdictions from its international operations.

Netflix also presents another issue particular to the film and television world, which is the way in which it is able to attract tax credits. The company is now ramping up production of original content in the UK, and it is likely that this will attract substantial subsidies from the UK taxpayer. Indeed, recently the company said that it is spending over £400m making original content in the UK this year, which means that it is likely to be eligible for tens of millions of pounds in tax relief when it next reports its UK accounts.

This demonstrates a significant loophole when it comes to the administration of tax credits for multinational companies, which can take advantage of credits by locating costs in the jurisdictions where they are on offer, whilst at the same time putting their revenues somewhere else entirely.

Netflix

Netflix is a global provider of video on demand. Originally starting in the mail order DVD market in the US, the company has been a pioneer of video rental over the internet. More recently the company has started producing its own content to add to its offer.

Netflix started international operations in 2010, entering its first market outside the US, Canada. The company quickly expanded into other markets and in 2016 announced that its content would be available worldwide in every country other than the People's Republic of China.



Netflix structure

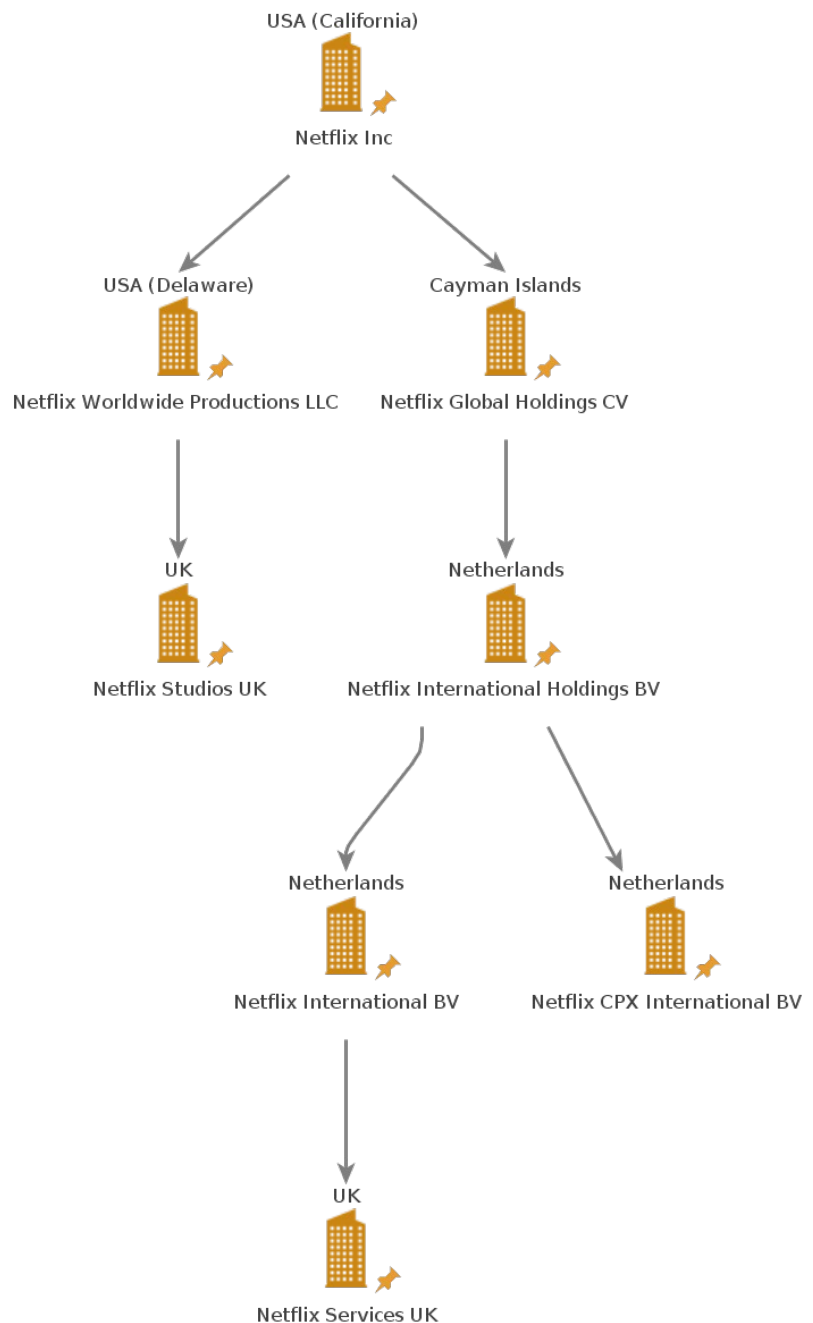
If we look at the corporate structure of Netflix, we can see it operates a similar structure to several well known companies engaged in tax avoidance.

Netflix does not book the revenues it gains from its subscriptions via a local subsidiary. When the company started selling subscriptions in the UK in 2012 it did so through a Luxembourg company, Netflix Luxembourg. When Netflix Luxembourg was set up in late 2011, the company did not have any customers in Luxembourg and the company published its accounts in British Pounds.

In 2015, just after the company started selling subscriptions in Luxembourg, Netflix moved its European operations to Amsterdam and a Dutch company, Netflix International BV.

Netflix International BV now accounts for the majority of revenues the company makes outside of the US. In 2018 that company earned revenues of €5.5bn (\$6.27bn). Reported revenue from Netflix's "international streaming" segment stood at \$7.8bn in 2018.

Netflix International BV, together with its parent Netflix International Holdings BV made profits of €151m in 2018, a profit margin of just 2.7%. One of the factors in the relatively low profit margin at the Netflix International companies was the €4bn paid to "other group companies". The company had a tax bill of €91.61m in 2018, however, €84.9m of this was a bill for Brazilian withholding taxes and another €2.6m was for Uruguayan non-resident income tax. For 2018 the company paid just €4m in tax in the Netherlands. In 2017, there



was no tax paid at all in the Netherlands with all taxes incurred by the company arising in Brazil.

Netflix International BV is owned by Netflix International Holdings, another Dutch company, which is in turn owned by Netflix Global Holdings CV. A CV usually denotes a Dutch company, however, the Netflix global accounts state that this company is based in the USA, however a search of corporate registries in the US yielded no records for the company. To confuse matters further, the founding documents of Netflix International Holdings state that Netflix Global Holdings CV has an address in the Cayman Islands. Netflix now say that they have retired their Cayman entity. Where the company is actually domiciled remains a mystery.

Profits at Netflix International

How much profit Netflix makes, or doesn't make outside of the US is a bit of a mystery. In fact, Netflix themselves appear to have difficulty with that calculation.

According to the consolidated annual accounts of Netflix, the company made losses in its "International Streaming" segment in every year between 2011 and 2018, when it turned a profit for the first time.

Despite this, the Netflix accounts in 2017 disclosed that the company had accumulated a total of \$484.9m in foreign earnings. The disclosure was made as part of their calculations of their liability for the transition tax imposed on US companies as part of the Trump administration's reforms to corporate taxation.

Until 2017 US corporations were in theory subject to US federal taxation on their worldwide profits, but corporations could permanently defer paying taxes if they re-invested those profits overseas. This led to many US corporations moving their non-US profits into tax havens, where they were 'permanently re-invested' in government bonds and marketable securities. Corporations built up huge cash piles offshore that were untaxed anywhere.

The transition tax was designed to deal with this historic issue, and the tax was imposed on the profits that US corporations had accumulated in tax havens from their non-US operations. As part of their disclosure, Netflix stated that their figures on non-US profit that would be subject to the tax were provisional pending more detailed work required to calculate the exact liability.

In the 2018 accounts for Netflix, that detailed work had been completed, and Netflix reversed their entire tax liability arising from the transition tax. There is no detailed

explanation provided on how the calculations on accumulated foreign income could have been incorrect by almost half a billion dollars.

Netflix – GILTI of tax avoidance?

In December 2018 The Times [reported](#) that Netflix's accounts were under examination by HMRC, although there was no detail provided on specific issues HMRC were probing. Newspapers reporting on the news noted how Netflix reported tiny revenues in the UK, which did not match information about the number of subscriptions the company is known to have in the UK.

Some commentators were quick to point out that selling subscriptions from overseas was not tax avoidance, people in the UK are free to buy products from overseas.

However, there is little doubt that Netflix has structured itself to avoid paying tax, and evidence from the company's US filings suggest that the company is moving money from its international markets into tax havens.

In 2017, in addition to the one time transition tax, the US federal government introduced a number of anti-avoidance rules to ensure that profits made overseas were subject to some minimum level of taxation. One of these rules is the GILTI – which targets returns to intellectual property in low tax jurisdictions. The operation of the GILTI rule is complex, but the effect is to put a minimum tax of 10% on profits on intangible assets located overseas. Because of the way in which the tax includes credits for taxes paid to foreign governments, the tax only targets profits declared in jurisdictions with a tax rate of less than 13.125%.

As part of their tax disclosure in their 2018 annual report Netflix notes that the company was subject to a tax charge of \$43m due to the US Minimum Tax on Foreign Entities. We believe that this is likely to be the Global Intangible Low Tax Income (GILTI) provision of the 2017 Trump Tax Reform.

The disclosure from Netflix that some of its income is subject to a minimum tax level, appears to confirm that the company is moving profits into tax havens. The disclosure that \$43m is subject to the a minimum tax rate, suggests that between \$327.8m and \$430 of non-US profit was shifted into tax havens by Netflix in 2018.

Netflix in the UK

Our research found 19 companies controlled by Netflix operating in the UK. Only one of these companies, Netflix Services UK, has filed accounts, with the rest being established only recently.

Netflix Services UK does not have any customers in the UK, it provides services to Netflix International in the Netherlands, which sells directly to UK customers. In common with similar tax avoidance structures, Netflix Services UK is paid little more than is required to cover its costs and makes little profit. In 2018 the company reported revenues of €48m, with pre-tax profits a little over €2m.

The real value of the UK market to the company is far higher. The revenue of Netflix in the UK is relatively easy to calculate. There are surveys of TV usage which tell us how many subscribers it has in the UK, and Netflix publishes data on average revenue per subscriber.

Data from the Broadcasters' Audience Research Board show that Netflix hit 10 million subscribers in Q4 2018. Although a more mature market than some other places where Netflix operates, the company's growth in the UK has still been impressive. The company had 5.2 million subscribers in the UK in 2016.

At the beginning of 2018 the company had 9.11 million subscribers and 10.31 million by the end of the year. Netflix's average revenue per user in its international streaming segment was \$113 a year according to their corporate accounts, which, if we take the average number of subscribers throughout the year (9.71 million) translates to revenues from UK subscribers of \$1.09bn (£860m) in 2018. This is equivalent to 14% of the company's international (non-US) streaming revenues. In reality the UK will have even larger revenues because the average global revenue per user will include Brazilian subscriptions which are charged at a lower rate.

Netflix Services UK claims to have 29 staff. These staff are apparently very highly paid. With a wage bill of €6.2m, that is the equivalent to an average salary of €214,000.

LinkedIn suggests that there are substantial numbers of employees in the UK (200+). Netflix themselves say they have 20,000 people working on Netflix productions in the UK. Many of these will be freelancers working on specific productions, or working for independent production companies contracted to Netflix. It is not known how many employees are working for the production companies which the company has recently set up in the UK.

In December 2017 Property Week reported that Netflix had secured a new 12,000 Sq ft London HQ.

All of this confirms that the company has a substantial presence in the UK and it is not clear why the accounts of its main UK subsidiary only disclose a few members of staff.

Reliefs and Rebates

In 2017, Netflix Services UK received some £307k in reliefs, leaving the company with a £179k income tax credit. The 2018 accounts disclose reliefs of over half a million, leaving Netflix UK seeing a further £51k tax credit.

High-End Television Tax (HETV) Tax Relief in the UK allows TV projects with a minimum expenditure of £1m per broadcast hour to “claim a payable cash rebate of up to 25% on UK qualifying expenditure”.¹ There is no limit on the budget, or on the amount of relief payable – but the relief is capped at 80% of the core expenditure.

Reports have claimed that the first season of *The Crown* cost £97.4m² – more than the £82m Sovereign Grant paid to the Queen by the British Treasury. If this is the case for future series of *The Crown*, and if 80% of the expenditure is in the UK, then the studio producing the show stands to bank £19.5m in tax relief per season.

In March 2018 Netflix Studios UK was established to produce content for Netflix. In the 9 months to the year end, the studio received £125k in tax reliefs. With operating expenses of £4.2m in a 9 month period, which is likely to increase over the coming years, there is potential for the studio to claim millions a year in HETV relief.

Double dipping

The UK operates a generous system of tax credits for the creative industries. Tax credits reduce a company’s tax bill by increasing the amount that a company is allowed to deduct from their profit for tax purposes, based on the amount of money it is able to spend on certain items. If the amount of credit exceeds the total profit made, then a company can receive cash back from HMRC.

In the UK companies can receive tax credits for a variety of activities in the creative sector, including film production and the production of high-end television programmes. In 2018 a number of productions distributed by Netflix were eligible

1 <http://britishfilmcommission.org.uk/plan-your-production/high-end-television-tax-relief/>

2 <https://www.bbc.co.uk/news/world-42439285>

for tax credits, War Machine, The End of the F****ng World, Altered Carbon, Safe, Black Mirror Series 4, The Crown Series 2 and The Angel.

Of all of these, only War Machine has Netflix listed as a producer, the others were made by third party production companies and then distributed on the Netflix platform.

However, Netflix in recent years been taking a much more active role in the production of its own content. The company has established 18 production companies in the UK, and recently announced that it was taking out a [long term lease on Shepperton Studios](#) to create a dedicated UK production hub.

None of the Netflix UK production companies have yet filed annual accounts, however, we expect that these companies will be eligible for UK high end television tax credits, which could lead to substantial amount of government cash flowing towards Netflix.

The result of this would be that Netflix manages to get a double tax benefit. On the one hand claiming tax credits on the costs it locates in the UK, whilst apparently moving revenues offshore.

Conclusions

From an analysis of Netflix's accounts, it seems clear that the company is structured to minimise taxes in its operations outside of the US, and maximise the amount that the company receives from the taxpayer in the form of tax credits.

It is clear from the facts that we have been able to establish that Netflix has a tax structure which is typical of many digital companies we have studied. Sales are made from outside the UK, even though there is a substantial UK presence. This offshore sales hub is located in a jurisdiction with a strong treaty network (the Netherlands). The sales hub makes a very low profit margin as large costs are paid to related companies. The UK office sells its services to the wider Netflix group at a low margin and as a result there is little profit left in the UK. It is likely that the company operates in a similar way in other jurisdictions.

In 2018, Netflix Services UK made revenues of just €48m and a profit of €2.3m. Had Netflix's revenues from its UK subscribers been included in the accounts, it would have had revenues of £860m.

It is difficult to say how this would translate into profit in the UK without access to more detailed accounts of Netflix's operations.

Netflix's own figures show that the company has historically made a loss on its international streaming segment, however this does appear to conflict with data published by the company elsewhere, particularly regarding its potential liability for taxes on its foreign profits in the US.

The numbers published on the U.S. GILTI charge, suggest that the company moved between \$327.8m and \$430 of non-US profit into low tax jurisdictions in 2018.

This structure is particularly concerning given the steep rise in the profits at Netflix in recent years, which suggest that the problem can only get worse.

There is also another concern in the UK, given the fact that the company is substantially increasing its production activities and could be eligible for UK tax credits for high-end television.

We believe that the Netflix case raises some real concerns about the operation of the high-end TV tax relief scheme, which could see it being used by companies to claim credits on production costs, whilst locating the income from those productions offshore.

Our research was put to Netflix ahead of publication. The company declined to comment.