News Analysis: The European Greens and IKEA: The €1 Billion Question

By

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The OECD's final base erosion and profit-shifting project reports and the European Commission's proposed anti-tax-avoidance directive have done nothing to quiet the controversy in Europe over the tax rates paid by multinational enterprises and the avoidance techniques they use to reduce them. The outcry is particularly poignant in the European Parliament, which has responded by summoning representatives from a long list of major multinationals before its TAXE II committee to defend their tax arrangements. The latest contribution to the controversy is a February report published by the European Parliament Greens/European Free Alliance (Greens) titled "IKEA: Flat Pack Tax Avoidance", which alleges that the multinational furniture retailer uses a complex array of artificial arrangements to engage in large-scale tax avoidance.

Although it addresses a number of arrangements, the report estimates that one such structure in particular -- the franchise relationship between the IKEA brand owner and the entities that operate IKEA stores -- cost EU countries €1 billion in lost revenue over the 2009-2014 period. According to the report, neither the OECD's BEPS project recommendations nor the commission's proposed anti-tax-avoidance directive are adequate to prevent multinationals from engaging in similar practices. (Prior coverage of the IKEA report. Prior coverage of the final BEPS project recommendations. Prior coverage of the commission's proposed anti-tax-avoidance directive.)

The report featured prominently in the TAXE II committee's intense questioning of Inter IKEA Holding S.A. CEO Sören Hansen at a March 15 hearing. (Prior coverage.) The report's conclusions were accepted and cited as authoritative by committee members from across the political spectrum, with committee Chair Alain Lamassoure of the center-right group of the European People's Party commending it as "a very detailed, precise report, [and a] very well turned-out one."

However, the report has faced criticism as well, including by Hansen in his statements before the TAXE II committee. "The so-called report," as he described it, is based on "wrong assumptions leading to wrong conclusions," especially regarding the franchise relationship between the IKEA and Inter IKEA groups. *Forbes* contributor Tim Worstall titled his opinion piece on the report "The Green Party Doesn't Grasp EU Tax Laws Concerning IKEA," and concluded that "as is usually wise, we can just ignore the Greens on this subject as on so many others." Nevertheless, Worstall found the report sufficiently noteworthy to address it in his column (http://goo.gl/HaNsqZ).

Given its political impact, the methods and assumptions used to calculate the €1 billion EU revenue loss estimate warrant careful examination.

Are IKEA and Inter IKEA Really 1 Entity?

Critical to the report's headline €1 billion revenue loss estimate is the premise that "IKEA is paying royalties to itself." However, Hansen argued before the TAXE II committee that this claim is based on "misunderstandings regarding the IKEA franchise systems and [mix-ups] between the different so-called IKEA companies."
The IKEA business is based on a franchising system under which Inter IKEA Holding S.A., through a group subsidiariary, licenses the IKEA trademark and "concept, franchises systems, methods, and solutions" to the franchisees that operate IKEA stores. By far the largest of those franchisees is the IKEA group, which as of the end of each group's 2014 fiscal year operated 315 of the 365 IKEA stores (86 percent). If, as Hansen insisted, IKEA and Inter IKEA are two independent groups with an arm's-length franchise relationship, this would undermine the Greens' argument that the payments are part of a single overall tax avoidance strategy.

The parent company of the IKEA group is INGKA Holding B.V., which is wholly owned by the Stichting INGKA Foundation. Both entities are resident in the Netherlands. The parent company of the Inter IKEA group, Inter IKEA Holding S.A., is located in Luxembourg and wholly owned by Interogo Foundation in Liechtenstein. Inter IKEA Holding's franchising division is operated by Inter IKEA Systems B.V. in the Netherlands.

The Greens' report dismisses the claim that the IKEA and Inter IKEA groups operate independently, largely on the basis of the relationships it identifies between directors on both foundations' boards with the Kamprad family: Stichting INGKA Foundation and Interogo Foundation were both created by INGKA B.V. founder Ingvar Kamprad, and members of the Kamprad family are guaranteed minority representation on each board. Two of the founder's sons sit on Stichting INGKA Foundation's five-person board and another sits on Interogo Foundation's seven-person supervisory council. Most of the remaining seats on both foundations' boards are held by close business associates of the Kamprad family, and multiple individuals are former IKEA or Inter IKEA executives who have gone back and forth between the two during their careers.

For the IKEA group's parent company, Kamprad is senior adviser to the board, and one of his sons is among the board's seven directors. Another of Kamprad's sons is the chair of the five-person board of Inter IKEA Holding.

Based on those relationships, the Greens' report concludes that "the private foundations that own both corporate groups are controlled by members of the Kamprad family and a small circle of trusted associates," and attributes the division between the two groups to a single tax avoidance strategy.

A similar conclusion was reached by Peter Sundgren, a former director with the Swedish Institute for Foreign and Commercial Law and author of the WebJournal on International Tax in Sweden, who in 2012 wrote (http://goo.gl/luIzFA) that the boards of IKEA and Inter IKEA shared multiple directors, and that "Mr. Kamprad and his family have total control of the financial affairs of the Interogo group."

Under article 9 of the OECD's model tax convention, association exists when one entity (or a shared third entity) "participates directly or indirectly in the management, control or capital" of another. The Kamprad family has only minority representation on the boards of IKEA and Inter IKEA, with the remaining directors generally being close business associates, which could potentially present an obstacle to approaching the two groups as associated enterprises for tax purposes. Nevertheless, the substantial influence of Kamprad family members in both groups may lend some support to the Greens' approach.

The Franchise Fee: Mispriced or Artificial?

As noted above, the report's most prominent claim is that the 3 percent franchise fees paid by IKEA franchisees, including by the IKEA group, have resulted in an estimated €1 billion in lost tax revenues by EU tax authorities over the 2009-2014 period.
Because the reported effective tax rate of the Inter IKEA group is lower than that of the IKEA group (13 percent versus 18 percent for the 2009-2014 period), payments from the latter may result in an aggregate tax benefit. However, even assuming that IKEA and Inter IKEA are associated, that royalties are paid by one to the other does not by itself establish inappropriate tax avoidance under the standards set by the OECD and incorporated into bilateral tax treaties. Entities selling under the IKEA trademark would have to pay royalties to the trademark's owner, whether related or not, regardless of the group's intangible holding structure. For the royalties to represent inappropriate avoidance according to current rules, they would have to be mispriced or subject to nonrecognition.

Although Inter IKEA's largest franchisee by far is IKEA, it does have what appear to be independent franchisees as well. That Inter IKEA charges all of its franchisees the same 3 percent royalty may provide support using the comparable uncontrolled price method. However, more detailed information than is publicly available would be needed to fully assess the comparability of those licenses and to determine the best transfer pricing method. It is possible that the prices Inter IKEA charges on its wholesale sales (accounting for €7.6 billion of its total €15.3 billion in revenue from 2009-2014) to what may be its independent franchisees in the Middle East and Asia alter the parties' returns and render the CUP method inapplicable.

However, even if the royalty rate itself is arm's length, the transaction may still be mispriced if Inter IKEA's role is limited to legal ownership of the IKEA brand intangibles and it does not control any of the important risks or functions that contribute to their value. Under the guidance provided by the OECD in its report on actions 8-10 of the BEPS project, legal ownership does not by itself entitle the owner to retain any share of the returns from the intangibles. Those returns are ultimately due to the party or parties that control the risk of intangible development and the functions related to the development, enhancement, maintenance, protection, and exploitation of the intangibles. (Prior coverage.)

Hansen told the TAXE II committee that Inter IKEA has more than 1,000 employees and "conducts a substantial and important business in and from the Netherlands with qualified staff, training facilities, etc." Responding to suggestions that Inter IKEA is a conduit entity, he said, "I know it will make my colleagues at Inter IKEA Systems B.V. -- a thousand of them -- sad to hear that someone thinks they do not contribute to the development of the IKEA brand and rollout globally of the IKEA stores." Inter IKEA's website sends a consistent message, stating that Inter IKEA has "specialist competence in areas such as marketing & sales, retail logistics, store design and establishment, communication & interior design, customer relations, market research, competitor monitoring, market surveillance of new and existing markets, [and] logistics and media production."

Assuming the accuracy of those claims, it may be difficult to argue that Inter IKEA is nothing more than a legal owner due little, if any, of the returns from the brand intangibles it licenses. According to Michael McDonald, financial economist (business and international taxation) with the U.S. Treasury Department's Office of Tax Analysis and delegate to the OECD's Working Party 6, control of risk is a threshold question and tax authorities shouldn't engage in a "worldwide search for control."

Regarding the possibility that tax authorities may disregard the transaction altogether, the OECD's transfer pricing report approves of nonrecognition only when the transaction as structured is "commercially irrational," and OECD officials have emphasized that this power should be exercised only under the most exceptional circumstances in which the transaction makes no economic sense. Given this restrictiveness, it may be difficult to establish that the arrangement between IKEA and Inter IKEA meets this standard. Assuming that the parties are treated as related but that the transaction is recognized, any adjustment would be limited to a reduction of the 3 percent franchise fee.

Lost Revenue Calculations

However, the Greens have been clear that they are unsatisfied with the standards set by the OECD's BEPS project and the commission's proposed anti-tax-avoidance directive, and one of the purposes of their report was to highlight the shortcomings of the rules currently in place. If the rules on selection of transfer pricing methods, entitlement to returns from intangibles, or nonrecognition were different, or if the system were changed entirely to something like formulary apportionment, a different outcome may result.

Assuming that the franchise fees are mispriced, subject to nonrecognition, or part of an inappropriate avoidance strategy permitted under current rules, questions remain regarding the way the Greens calculate revenue loss. The €1 billion figure is based on an estimate of gross franchise fees received for sales in the EU, and then multiplying that amount by the average of EU countries' statutory corporate tax rates weighted by IKEA's number of stores in each country. For this purpose, EU sales were estimated by calculating the percentage of IKEA stores in EU countries (stated to be 61.9 percent), and multiplying that percentage by Inter IKEA's reported revenue from franchise fees and sales through the IKEA catalog (€6.1 billion). This results in an estimate of about €3.8 billion.

Calculating lost revenue in this way makes some assumptions, the most important of which are that Inter IKEA's franchise fees from all sources are suspect, there are no costs associated with Inter IKEA's franchising activities that should be deducted against franchise fee revenue, and all franchise fees are deductible at the full statutory rate for IKEA group entities but face no tax at all when received by Inter IKEA.

As explained in the report, total franchise fees were calculated by multiplying the 3 percent royalty rate by the sum of Inter IKEA's franchise fees and catalog sales. This approach assumes that all of Inter IKEA's franchise fee revenue is associated with a tax avoidance strategy, not just the fees paid by the IKEA group. Some of the franchisees do appear to be truly independent, particularly those in Australia, southeastern Europe, the Middle East, and Asia (with the exception of the IKANO group, which is owned by the Kamprad family).

It's not clear why Inter IKEA's global franchise fee revenue from both related and independent franchisees should be grouped together and then allocated back to EU countries based on the number of stores. Given the report's focus on the fees paid specifically by "IKEA to itself" the IKEA group and the resulting revenue loss specifically for EU countries, multiplying 3 percent by the IKEA group's EU sales may have been the more direct and reliable approach.

For the 2009-2014 period, the IKEA group reported total revenue from the sale of goods of about €156 billion, 3 percent of which is €4.6 billion. Using the group's reported share of European sales for each year (77.8 percent on a weighted-average basis) results in an estimate of about €3.6 billion, and using store count (as the report does for many of its allocations) to allocate European sales to EU countries results in an estimate of about €3.1 billion. This represents a reduction of €653 million from the report's estimate.

The next step in estimating EU revenue loss is to determine the amount, if any, of costs associated with the franchise fee revenue that should be deducted in estimating taxable income. Those may reflect the activities Inter IKEA describes in its annual reports and website, including marketing and sales, store design, training of IKEA store employees, catalog design, communications, and logistics.

The report assumes that no part of Inter IKEA's total operating costs, which totaled €12.5 billion over the 2009-2014 period, is associated with producing its estimated €3 billion to €4 billion in EU franchise fee revenue. If none of Inter IKEA's cost of sales, operating expenses, and depreciation and amortization are associated with its EU franchising revenue, they must all be attributable to its other activities. This would imply that Inter IKEA incurred massive losses on its other activities.

Estimating the amount of costs that should be set against franchise fee revenue is complex, but Inter IKEA's annual reports do provide some basis for an estimate. Operating costs potentially related to EU franchising activities (such as payroll and depreciation and amortization) can be allocated by revenue. For purposes of this estimate, allocated costs probably should not include materials costs (likely primarily associated with wholesaling to other franchisees).

Because of the questions they raise, at least some portion of what the company reports as "other operating expenses" should also be excluded. As the Greens' report discusses in detail, the amounts reported as other operating charges before 2012 likely include large trademark royalties paid to Interogo Foundation. This inference is based on statements made by Inter IKEA executives indicating that trademark royalties were paid to Interogo Foundation, as well as the dramatic decline in the amounts reported as other operating charges following Inter IKEA's purchase of the trademark from the foundation in January 2012. The charges totaled €2.6 billion over the 2009-2011 period, or 39 percent of Inter IKEA's revenue from all sources for that time. In contrast, they amounted to €581 million during 2012-2014, or 7 percent of total revenue during that period.

Supporting this conclusion, an Inter IKEA representative confirmed to Sundgren in a 2012 email exchange posted on Sundgren's blog that Inter IKEA B.V. made licensing payments to Interogo Foundation before the sale of the trademark.

Royalty payments to an associated enterprise located in a tax haven that in all likelihood controls few, if any, of the core risks or functions relating to the licensed intangible clearly raises the income-shifting concerns that the OECD's report on actions 8-10 was meant to address. However, the post-2011 other operating charges do not include a royalty element, and at least some portion of the 2009-2011 charges is likely unrelated to those payments.

Using other operating charges as a percentage of sales for 2012 through 2014 to estimate the non-royalty portion of other operating charges for 2009 through 2011, 79 percent of those charges (€2.1 billion) consist of royalties paid to Interogo Foundation in those years. This implies a trademark royalty rate of 70.4 percent of franchise fee and catalog revenue (the royalty revenue base assumed by the Greens' report), consistent with the 70 percent royalty cited by Sundgren in his 2012 article:

> By means of what appears to be a back-to-back royalty agreement between Inter Ikea Holding and Interogo -- but there could be additional agreements and companies interposed in this stratagem -- 70 percent of the royalties are subsequently passed on to Interogo.

Assuming a 70 percent royalty and allocating the other costs to EU franchise activities based on revenue results in a cost allocation of €584 million for the 2009-2014 period, reducing the estimate of shifted income from about €3.1 billion to about €2.5 billion.

Regarding the rates at which the EU franchise fees paid by IKEA are deductible and taxable, the report's store-weighted average tax rate estimate was between 26.7 and 27.7 percent in each year over the period compared to the IKEA group's aggregate effective tax rate of 18.2 percent. However, much of this discrepancy is attributable to the IKEA group's significant amounts of tax-exempt income. After removing the impacts of adjustments for tax-exempt income, nondeductible expenses, and recovered and unrecovered net operating losses, the IKEA group's effective tax rate was 23.7 percent for the 2009-2014 period. If the goal is to estimate revenue loss resulting from the rate differentials rather than to determine what rate should have been applied as a policy matter, using this rate may be more appropriate approach.

As noted above, the report assumes a tax rate of 0 percent on Inter IKEA's franchise fee income, which differs significantly from the Inter IKEA group's reported weighted-average effective tax rate of 13 percent for 2009-2014. It is likely that Inter IKEA's reported rate is inflated by non-arm's-length pricing of transactions with associated entities that are not included in its consolidations, and the report justifies the zero rate assumption by adding back total other operating charges and interest paid to Interogo Finance S.A., and dividing income tax paid by that amount. The resulting effective tax rate of 3 percent, which the report computes on the basis of 1991-2014 instead of 2009-2014, was considered trivial enough to disregard.

This approach assumes that the entire amount of other operating charges is artificial, even after Inter IKEA presumably ceased paying the suspect royalties to Interogo Foundation in 2012. As noted above, the primary reason for questioning other operating charges is that they may include those royalties, and the same reasons for concluding that a large portion of the 2009-2011 other operating charges consisted of those payments leads to the conclusion that the amounts reported for 2012-2014 are free from the taint of those payments. Accordingly, it may be more appropriate to add back only the estimated portion that consists of trademark royalties.

Regarding the interest expense addback, income shifting through interest payments to Interogo Finance arguably shouldn't factor into an estimate of tax revenue loss from the franchise fees paid by the IKEA group, and the cost allocation described above doesn't include those charges. Because this is a separate transaction that raises different issues and is subject to different rules, it may be more appropriate to assess the resulting revenue loss separately. Base erosion through interest payments such as these was addressed in the OECD's report on action 4 (rather than its report on actions 8-10) and they may be subject to the action 4 report's interest expense limitations. (Prior coverage.)

If Inter IKEA's effective tax rate on its franchise fee income really is nearly zero, it's not clear what purpose was served by shifting income to Interogo Finance through interest payments in the first place.

Marc Auerbach, the author of the Greens' report, defended the report's approach in light of what he described as "strong circumstantial evidence that a good portion of these fees have escaped taxation historically, and because there is evidence of ongoing avoidance."

"The €1 billion figure is to estimate the effect on tax revenues of the source countries, but we don't really know how the royalties will be taxed." Auerbach said. "Until we actually know what's happening, I think it's reasonable to emphasize the loss of revenue in source countries. We can only see what we can see."

Nevertheless, removing the addbacks of the untainted other operating charges and the interest payments results in a weighted-average effective tax rate of 6.6 percent over the 2009-2014 period, rising from 2.1 percent during 2009-2011 (when trademark royalties were still being paid) to 13.7 percent in 2012-2014 (when they were not). Using these approaches to determine the tax differential for each year results in an EU-country revenue loss estimate of €389 million. If the full Dutch statutory rate is used (as the report does for other purposes), this would entirely eliminate the benefit and even result in a slight tax increase.

While this suggests the Greens' estimate may be overstated by a factor of more than 250 percent, the amount (an average of €65 million each year) is still significant enough to make it difficult to "just ignore the Greens on this subject," as Worstall advised.

Royalties to Interogo Foundation

Although the Greens' report arguably overstates revenue loss strictly from the franchise fee payments from IKEA to Inter IKEA, other transactions undertaken during the same period in connection with the same overall arrangement may have resulted in additional revenue loss. Broadening the scope to include two related transactions in particular -- Inter IKEA's pre-2012 trademark royalties payments to Interogo Foundation and its post-2011 interest payments to Interogo Finance -- may narrow the gap between the report's estimate of lost tax revenue and the estimate reached above.

One implication of assuming that Inter IKEA has a tax rate greater than zero is that there is a tax arbitrage opportunity in shifting income from Inter IKEA to Interogo Foundation in Liechtenstein. Using the same 70 percent royalty rate and revenue base (franchise plus catalog revenue) assumptions used to analyze franchise fees paid by IKEA results in an estimate of

€1.1 billion in shifted income.

Because the estimate of Inter IKEA's effective tax rate on franchise fee income discussed above is a function of those payments and the relevant period is 2009-2011, the company's reported effective tax rates for each year during that period (ranging from 7.7 to 22.1 percent), may better reflect the rate at which it would be taxed if the payments were not made. Those estimates imply lost revenue to EU countries of €136 million over the 2009-2011 period, bringing the estimate of total avoided tax up to €525 million. If the Dutch statutory tax rate is used instead of Inter IKEA's effective tax rate, the estimate rises to €258 million, raising the total tax avoidance estimate to €647 million.

Alternatively, as Sundgren has argued, it's possible that the franchise fees should have trigged withholding tax. Based on the inference that there was in effect a back-to-back royalty arrangement, Sundgren has argued that Interogo Foundation was the beneficial owner of the franchise fee royalties before 2012. Because the royalties would then be treated as having been paid to an entity in Liechtenstein rather than to Inter IKEA Systems B.V. in the Netherlands, they would have been subject to source-country withholding in many countries.

Under this scenario, franchise fees paid to Inter IKEA Systems B.V. by IKEA group entities in most EU countries in which it has a major presence (including Germany, France, Sweden, and the United Kingdom) and low rates in the others (5 percent in Italy and 6 percent in Spain). In contrast, if the royalties were paid directly from IKEA group entities to Interogo Foundation, they would have triggered source-country withholding tax (generally in the range of 10 percent to 30 percent) in many EU member states. Liechtenstein had no double tax treaties providing for 0 percent withholding in force with EU countries that had IKEA stores during the 2009-2011 period.

According to Sundgren, Inter IKEA Systems B.V. was merely a conduit for royalties ultimately paid to Interogo Foundation, and the royalties should be treated as paid from IKEA group entities directly to Interogo Foundation.

Using a store-weighting approach (as the Greens' report does for other allocations) to allocate estimated total EU royalties to individual member states, and applying each country's withholding tax rate (if any) on royalties to those amounts, results in weighted-average withholding rates of about 1.7 percent for royalties paid to the Netherlands and 17.2 percent for royalties paid to Liechtenstein. This rate differential implies that over the 2009-2011 period, the IKEA group would have owed an additional €226 million in withholding tax if Interogo Foundation had been treated as the beneficial owner of the franchise fee income. Adding this to the total revenue lost from franchise fees paid to Inter IKEA brings the total to €615 million.

Interest Paid to Interogo Finance S.A.

When Inter IKEA purchased the trademark from Interogo Foundation for €9 billion in 2012, it financed the transaction in part with a €5.4 billion loan from Interogo Finance S.A., an entity associated with Interogo Foundation but excluded in Inter IKEA's consolidations. The loan bears an interest rate of 6 percent, resulting in an interest deduction for Inter IKEA of €324 million each year. With average after-tax profit of about €323.9 million each year during the 2012-2014 period, Interogo Finance S.A.'s other sources of income, costs, and taxes represent a trivial

percentage of its income. Depending on whether the interest payments were deductible at Inter IKEA's reported effective tax rates in each year or at the full Dutch statutory rate of 25 percent, this arrangement resulted in total tax savings of between €132 million and €242 million.
The Greens' report regards this transaction -- in which Interogo Foundation appears to have indirectly financed its own sale of the IKEA trademark to Inter IKEA -- as entirely artificial. By financing the purchase of the same trademark, the transaction conveyed similar intangible exploitation rights to Inter IKEA. But instead of paying royalties that will never be taxed to one "Interogo" entity under a license, Inter IKEA pays interest that will never be taxed to another "Interogo" entity under a loan agreement. Nevertheless, the transaction is unlikely to satisfy the strict standards for nonrecognition adopted in the OECD's BEPS report on transfer pricing.

Although the actions 8-10 report provides for the reallocation of the risk and returns of intangible development based on the concept of control, there are no corresponding provisions for the risks and returns on capital, despite the overlap in concepts and the ability of companies like Inter IKEA to convert one type of transaction into the other. OECD officials and delegates to Working Party 6 have stressed that "respect for capital" is at the heart of the separate-entity approach, which was ultimately retained in the final BEPS reports. As a result, any transfer pricing-based adjustment would be limited to lowering the interest rate on the loan.

Instead, the OECD chose to address base erosion through interest payments using deductible expense limitations based on the ratio of net interest to earnings before interest, taxes, depreciation, and amortization. The OECD's action 4 report recommends that countries adopt net interest-to-EBITDA caps of 10 to 30 percent, or if they so choose, the corresponding ratio for the multinational group as a whole (if higher). The commission's proposed antiavoidance directive adopts the top of this range.

On a consolidated basis, Inter IKEA Holding's net interest-to-EBITDA ratio was -3.2 percent (indicating net interest income) in 2009, 9.9 percent in 2010, and 20 percent in 2011, none of which would run afoul of the directive's proposed cap. However, the ratio increased dramatically following the loan from Interogo Finance and the corresponding €324 million in annual interest payments, resulting in ratios of 38.2 percent in 2012, 38.6 percent in 2013, and 34.4 percent in 2014. Interest paid to Interogo Finance alone exceeded 30 percent in 2012 and 2013, falling to 29.1 percent in 2014. Assuming that Inter IKEA Holding's property, finance, and retail divisions (which operate through different subsidiaries) had positive EBITDA each year on an aggregate basis, these ratios would increase if the analysis were applied solely to Inter IKEA Systems B.V.

If a 30 percent cap were in effect for 2012 through 2014 and applied to the Inter IKEA group as a whole, €78.8 million in interest expense would have been disallowed in 2012 and 2013, and €46.4 million would have been disallowed in 2014. If the disallowed deductions were taxed at Inter IKEA Holding's reported effective tax rate in each year, it would have owed additional tax of €9.1 million in 2012, €10.8 million in 2013, and €7.2 million in 2014 for a total of €27.2 million. Depending on whether the disallowed interest expense would have been taxable at Inter IKEA's effective tax rates or the Dutch statutory rate, the 30 percent cap would have eliminated €27 million to €51 million (or about 21 percent in either case) of the tax benefit resulting from the loan, increasing its 2012-2014 effective tax rate from 13.7 percent to between 15.4 percent and 16.9 percent. Its 2009-2011 rate would not have been affected.

These increases are likely too modest to satisfy the Greens. But as the commission's proposed anti-tax-avoidance directive says, its purpose is to set minimum standards and member states are free to adopt stricter limitations in their domestic laws. If the lower bound of 10 percent applied during the period, Inter IKEA's 2012-2014 effective tax rate would have risen to between 20.4 percent and 26 percent, depending on the rate assumptions. Between €111.4 million and €201.8 million of the benefit, which in each case would have accounted for between 83 percent and 85 percent, would have been eliminated.

Conclusion

For the reasons discussed above, the Greens' €1 billion estimate may be inflated, especially to the extent that it relates only to the franchise fees paid by IKEA group entities to Inter IKEA. However, even a critical assessment of their approach results in an estimate of between €657 million and €890 million if the Inter IKEA and IKEA groups are treated as related parties and the royalties paid to Interogo Foundation and interest paid to Interogo Finance are taken as part of the same overall arrangement. Nothing in the OECD's BEPS report on transfer pricing makes it clear whether IKEA and Inter IKEA should be treated as associated enterprises, and the 3 percent franchise fee may be supportable even if they should. Assuming, as is likely, that the arrangement doesn't satisfy the strict criteria for nonrecognition, any adjustment would have to be made on the basis of pricing. If Inter IKEA's franchise relationships with unrelated parties are comparable to its franchise relationship with the IKEA group, the uniform 3 percent royalty may be difficult to challenge under current standards. If the royalty rate can in fact be supported as arm's length, the estimated €389 million aggregate tax benefit would remain.
Regarding the royalties paid by Inter IKEA to Interogo Foundation before 2012, the standards adopted in the OECD's transfer pricing report may warrant disallowing deductions for these payments. As owner of Inter IKEA Holding, there is no question whether the foundation is an associated enterprise. To the extent that Interogo Foundation's role was limited to legal ownership of the trademark and Inter IKEA group entities controlled all of the important risks and functions related to the trademark, they would be entitled to the entire return associated with it. Alternatively, the royalties could have been subject to source-country withholding under either the standards in place at the time, those in the OECD's action 6 report, or the proposed EU antiavoidance directive. Depending on which approach is appropriate, the estimated total tax benefit would be reduced by between €136 million and €258 million.

Given its mechanical application, the OECD's BEPS report on action 4 would restrict Inter IKEA's 2012-2014 interest expense regardless of its relationship with other entities. Depending on the fixed ratio adopted and tax rate assumptions, the tax benefit of €132 million to €242 million could be reduced by between €27 million and €202 million if applied to Inter IKEA on a consolidated basis. Under any tax rate assumptions, the 30 percent interest expense limitation in the commission's proposed antiavoidance directive would eliminate only about 21 percent of the tax benefit resulting from these payments. In contrast, adopting a fixed ratio of 10 percent (the lower end of the OECD's recommended range) would eliminate between 83 to 85 percent of the benefit.

These estimates imply that of the €657 million to €890 million in tax benefits, only €163 million to €460 million would have been eliminated had the post-BEPS standards applied during the period. This corroborates the Greens' argument that under the BEPS project recommendations and the commission's proposed antiavoidance directive, multinational groups can still enjoy significant tax benefits using transactions between associated enterprises. Whether their calls for greater transparency and a common consolidated corporate tax base in the EU would be effective in significantly reducing these benefits is unclear, but the Greens may be right that the new standards will allow substantial tax avoidance to continue.