GOLDEN DODGES

How McDonald's Avoids Paying Its Fair Share of Tax

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EXECUTIVE SUMMARY

McDonald's is one of the world's most recognized brands, and with restaurants in 119 countries, its iconic golden arches have spread to every corner of the globe. As it has expanded its footprint, the company also appears to have become a global tax dodger, increasingly structuring its business to avoid paying taxes, both in the U.S. and around the world.

Governments are increasing their scrutiny of McDonald's tax avoidance strategies and taking action to hold McDonald's accountable. For example, in 2013, French tax authorities launched an investigation into McDonald's practice of paying royalties to Luxembourg and Switzerland subsidiaries, which reportedly allowed the company to avoid paying tax on €2.2 billion in revenue.[1] In March 2015, it was reported that the European Commission had begun investigating McDonald's tax arrangements in Luxembourg.[2] This escalating scrutiny of McDonald's tax practices has begun to translate into real economic consequences for the company. In its third quarter 2014 corporate filings, McDonald's reported additional tax expenses of $260 million as a result of unfavorable tax rulings and a tax audit progression in international markets.[3]

This report details key tax avoidance strategies adopted by McDonald's and highlights potentially unlawful practices in many of its most important markets. The major findings include:

Over the past decade, McDonald's appears to have taken advantage of corporate tax loopholes to avoid paying U.S. tax on nearly **US$16 billion in foreign earnings**, saving as much as **US$1.7 billion in tax**.

McDonald's makes extensive use of tax havens, with at least **42 subsidiaries and branches** in tax havens around the world, including **31** that the company does not disclose in its annual report.

McDonald's uses royalty payments from franchisees and foreign subsidiaries in major markets to route profits to tax havens. These strategies may have allowed it to **avoid up to US$1.8 billion in tax** in those markets in the years between 2009 and 2013, including **€1 billion** across Europe and **AU$497 million** in Australia.[4]

McDonald's holds most of its cash in tax havens – its subsidiaries in Luxembourg alone held **US$1.9 billion in cash** at the end of 2013, accounting for more than **two-thirds of the company's total cash assets.**

As a result of the scale and seriousness of McDonald's tax avoidance, governments around the world should investigate the lawfulness of McDonald's tax arrangements and recover taxes where possible. Moreover, McDonald's should cease routing billions of dollars in earnings to tax havens, and instead reinvest in the franchisees and front-line workers that are the heart of its business.

INTRODUCTION

Transnational corporations like McDonald's are using aggressive strategies to avoid billions of dollars in taxes every year. Some estimates put the cost of tax avoidance by U.S. transnational corporations alone at more than US$100 billion per year.[5] Tax avoidance by profitable corporations simultaneously deprives national governments of resources for education, health care and infrastructure and shifts the responsibility for funding public services to small businesses and working families.

As a result, governments around the world are increasingly taking action to combat tax avoidance. In 2013, the Organization for Economic Cooperation and Development (OECD) and the Group of 20 (G20) major economies launched a joint initiative to ensure that corporate profits are taxed where they are earned, instead of being routed to tax havens like Luxembourg and Switzerland.[6] Similarly, the European Commission is conducting investigations into secret deals between corporations and tax haven countries within Europe that allow the corporations to save billions of euros in tax.

McDonald's is one of the world's most recognized brands, having grown to become the world's largest fast food company since opening its first store in Des Plaines, Illinois in 1955.[7] The company had US$87.8 billion in systemwide sales in 2014, nearly twice the sales of its largest competitor.[8] Its 36,000 stores serve approximately 69 million daily customers–nearly one percent of the world's population visits a McDonald's each and every day.[9] In addition, the McDonald's system employs 1.9 million people, making it the second-largest private sector employer in the world.[10] McDonald's is also one of the world's largest purchasers of agricultural staples and its largest distributor of toys.[11] In short, McDonald's practices set the standard in the fast food industry and throughout the service sector, reaching all corners of the global economy.

As the economy has globalized, transnational corporations like McDonald's have become increasingly reliant on income from intellectual property such as trademarks, patents and business methods. This type of income is highly mobile, allowing transnational corporations to shift profits to low-tax jurisdictions and avoid paying tax in many of the countries in which they operate. More and more U.S. companies are strategically assigning earnings to subsidiaries outside the U.S., allowing for the indefinite deferral of U.S. tax on those earnings. The amount of earnings booked offshore for tax purposes by U.S.-based companies nearly doubled between 2008 and 2013, reaching more than US$2 trillion in total.[12]

> McDonald's had US$87.8 billion in systemwide sales in 2014, nearly twice the sales of its largest competitor.

McDonald's is well-positioned to take advantage of the international loopholes and mismatched tax regimes that allow companies to pay very low tax rates on royalty income. Through its franchising model McDonald's generates much of its revenue from royalty payments from franchisees rather than through direct operation of stores. McDonald's franchisees pay royalties to the company – generally through a country-level subsidiary – in exchange for the right to use McDonald's intellectual property, including both the brand itself and the business methods used to establish the brand and sell its products. Globally, more than 80 percent of McDonald's stores are operated by franchisees and the company's profit margin on franchise revenues is 81.7 percent, more than five times as high as its 15.9 percent margin for corporate store operations.[13]

This report examines the most significant ways in which McDonald's may have structured its business to avoid taxes in many of the countries in which it operates. In addition to tax regulators in countries around the world, these potentially abusive tax practices should concern many stakeholders in the McDonald's system, including investors, franchisees and workers. Investor groups have pointed to tax avoidance as a major reputational and bottom-line risk to companies, threatening the future profitability and growth of the company.[14] From the perspective of franchisees, tax strategies which siphon profits from McDonald's operating markets to tax havens may limit the ability of the company to reinvest in its stores and support franchisee success. McDonald's workers, who are paid such low wages that they must rely on public benefits to make ends meet, might reasonably ask whether the money that the company holds in tax havens might be better used to invest in its employees.

MCDONALD'S MINIMIZES ITS TAX BILL IN THE U.S.

The U.S. tax system aims to tax both the domestic and foreign earnings of U.S. companies. However, many transnational corporations, including McDonald's, are able to take advantage of significant loopholes to avoid paying U.S. tax on foreign earnings. While the U.S. requires domestic companies to pay tax on income earned abroad, companies are able to defer paying U.S. tax on foreign earnings until those earnings are repatriated to the U.S. parent company. In practice, this can mean that tax liabilities on the profits assigned to foreign subsidiaries can be deferred indefinitely.[15]

Safeguards intended to prevent companies from using royalties and other passive income to shift profits from operating markets to tax havens without paying U.S. tax have also been progressively weakened over the past few decades. The combination of "check-the-box" rules allowing companies to disregard foreign subsidiaries for tax purposes and "look-through" rules allowing companies to defer tax on passive income such as royalties enables companies like McDonald's to significantly reduce their tax obligations.[16]

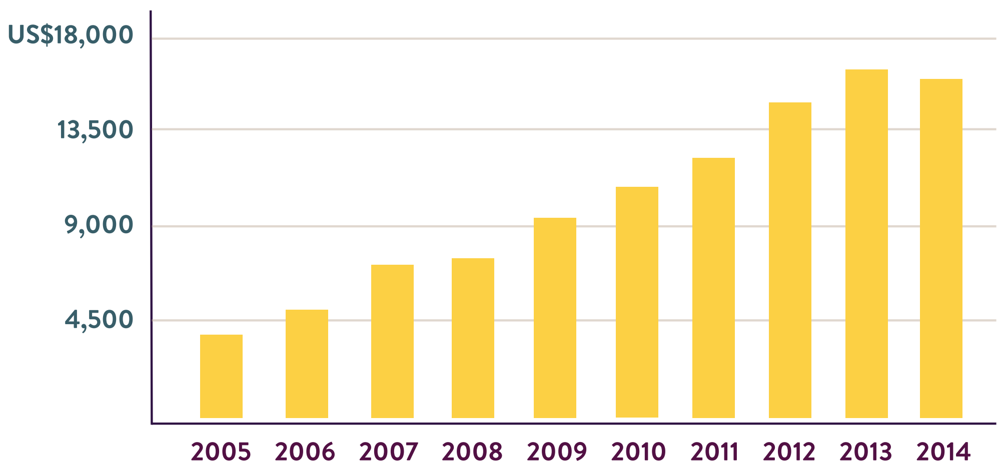
Transnational corporations can also use accounting gimmicks to avoid disclosing these deferred tax liabilities to investors and the public. Companies can assert that profits earned from foreign operations have been permanently reinvested outside the U.S. This allows them to avoid recording deferred tax liabilities on these foreign earnings in the accounts submitted to the Securities and Exchange Commission (SEC).[17]

The amount of funds booked offshore for tax purposes has grown dramatically over the past few years, nearly doubling from 2008 to 2013, as companies increasingly take advantage of these loopholes.[18] McDonald's is a prime example of this trend. It disclosed that it had approximately US$3.9 billion invested in subsidiaries and affiliates outside the U.S. in 2005.[19] By the end of 2014 this amount had ballooned to approximately US$15.4 billion, almost four times the amount of earnings the company had shielded from U.S. tax just nine years before.[20]

If McDonald's earnings were to be repatriated in the future, they would be subject to U.S. corporate income tax equal to the federal statutory rate of 35 percent less any foreign income taxes previously paid on those earnings.[21] McDonald's does not disclose what the potential tax liability on these earnings would be if repatriated. However, between 2005 and 2014 McDonald's effective tax rate on foreign earnings was 24 percent. The total tax liability can be estimated by multiplying the company's total funds invested abroad, US$15.4 billion, by the 11 percent difference between this rate and the U.S. federal statutory tax rate, resulting in US$1.7 billion in unpaid tax.[22]

It is also important to note that, despite the name, permanently reinvested funds are not actually stranded overseas. In fact, they are often accessible for use in the U.S. Cash held by foreign subsidiaries of U.S. companies can be invested in U.S. bonds or securities or put into accounts with U.S. banks. Permanently reinvested funds can also improve a company's balance sheet, lowering the cost of debt which can then be used to finance dividends and share buybacks.[23] Over the past decade as its permanently reinvested funds ballooned, McDonald's almost doubled its long-term debt while paying out a massive US$28.5 billion in the form of share buybacks.[24]

McDonald's investments in foreign subsidiaries for which U.S. income tax is not recorded, 2005-2014, millions of U.S. dollars



Note: Figures for 2014 likely were affected by the significant fall in the euro against the dollar, which results in a lower U.S. dollar valuation of assets held in Europe and denominated in euros.[25]

McDonald's tax practices have been investigated around the world

As a result of structuring its business to reduce its tax liabilities in the U.S. and around the world, McDonald's has faced increasing regulatory scrutiny over its tax practices in the past decade.

2005

Brazil's Federal Prosecutor General sued McDonald's Brazilian subsidiary over allegations that it had colluded with tax officials to improperly reduce the company's tax assessment. McDonald's had been allowed to fully deduct a royalty of five percent of sales for tax purposes, when it was only legally permitted to deduct one percent. McDonald's potentially avoided paying **BRL$78.6 million** in tax in 2000 and 2001 through this arrangement.[26]

The **Venezuelan** government ordered that certain McDonald's restaurants in the country be closed temporarily as a penalty for **failure to follow tax rules**.[27]

2007

In **Russia**, the company was ordered to repay more than **US$6 million** in back taxes after the Russian Tax Service accused McDonald's of using unlicensed suppliers, and as a result selling milkshakes, ice cream and Chicken McNuggets at an illegally discounted tax rate.[28]

2008

The **Venezuelan** tax authorities again closed **118** of McDonald's **132** restaurants in that country for irregularities in the chain's accounts, including 'inconsistencies' in the sales and purchases book, as well as in taxes collected.[29]

2010

The **United States** Internal Revenue Service concluded a field examination of McDonald's federal income tax returns for 2007 and 2008 and issued notices of proposed adjustments related to foreign tax credits of approximately **US$400 million** claimed by the company, which it subsequently protested with the IRS Appeals Office.[30]

2011

Tax authorities in **Russia** argued that McDonald's **should be paying the 18 percent** tax rate on profits that apply to restaurants when the company claimed that it was not a restaurant operator but rather a food retailer like a supermarket in order to claim the lower tax rate afforded to those businesses of **10 percent**. The company won on appeal.[31]

2013

The **Australian** Tax Office investigated McDonald's and its franchisees regarding the tax treatment of the sale of franchises.[32]

French authorities launched investigations against McDonald's for allegedly avoiding corporate taxes on **€2.2 billion** in revenue since 2009 by routing billions in royalties from its French operations to the Luxembourg-Swiss structure detailed in this report.[33]

2014

In its third quarter corporate filings, McDonald's reported additional tax expenses of **US$260 million** as a result of unfavorable tax rulings and tax audit progression in international markets.[34]

In its Annual Report, McDonald's disclosed that the **United States** Internal Revenue Service had disputed McDonald's tax treatment related to transfer pricing of certain internal transactions and had proposed a series of adjustments following an examination of McDonald's 2009 and 2010 U.S. federal income tax returns.[35]

2015

It was reported that the **European Commission** had begun investigating McDonald's tax arrangements in Luxembourg, requesting clarification from Luxembourg about the company's affairs in that country.[36] This followed the release of a report by American and European unions, which detailed the ways in which McDonald's was using royalty payments to reduce its tax bill in countries across Europe.[37]

ROYALTY PAYMENTS TO TAX HAVENS MINIMIZE MCDONALD'S TAX BILL ABROAD

As noted above, companies that rely on income from intellectual property are increasingly using international tax loopholes and mismatched tax regimes to significantly lower their taxes around the world. Royalty payments are one common device used by transnational corporations to limit tax obligations. Typically, subsidiaries operating in high-tax jurisdictions make royalty payments to intellectual property holding companies in low-tax jurisdictions. The royalties are treated as tax deductible expenses in the operating country, reducing the company's taxable income there. The same royalties may then receive preferential tax treatment in the destination country, such as being taxed at very low rates or not at all.[38]

services for franchisees.[42] Therefore, the pass-through of the full royalty amount to offshore subsidiaries likely includes a disguised distribution of profit from the franchising system. Any distribution of profit should be subject to corporate income tax in the country from which it originates.

When the entire royalty is sent to a tax haven, none of it is likely subject to corporate income tax in the coutnry in which it is generated. If it is paid to a foreign subsidiary in a low-tax jurisdiction, it is ultimately may be taxed at a very low rate, or may not be taxed anywhere at all.[43]

"McDonald's reported total cash holdings of US$2.8 billion in 2013. More than two-thirds of that amount, US$1.9 billion, was held by McDonald's Luxembourg entities."

Royalty payments from franchising and foreign subsidiaries are an important component of McDonald's aggressive tax avoidance strategy, and the company has used royalties to significantly lower its tax bills around the world.

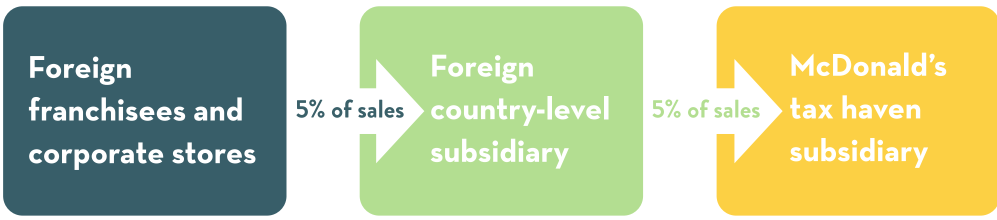
McDonald's royalties from franchising abroad

McDonald's is not only the world's largest fast food company, it is also the world's largest franchisor, earning billions in royalties from franchisees each year.[39] In 2013, McDonald's earned US$9.3 billion in payments from franchisees, 54 percent of which came from franchisees outside the U.S.[40]

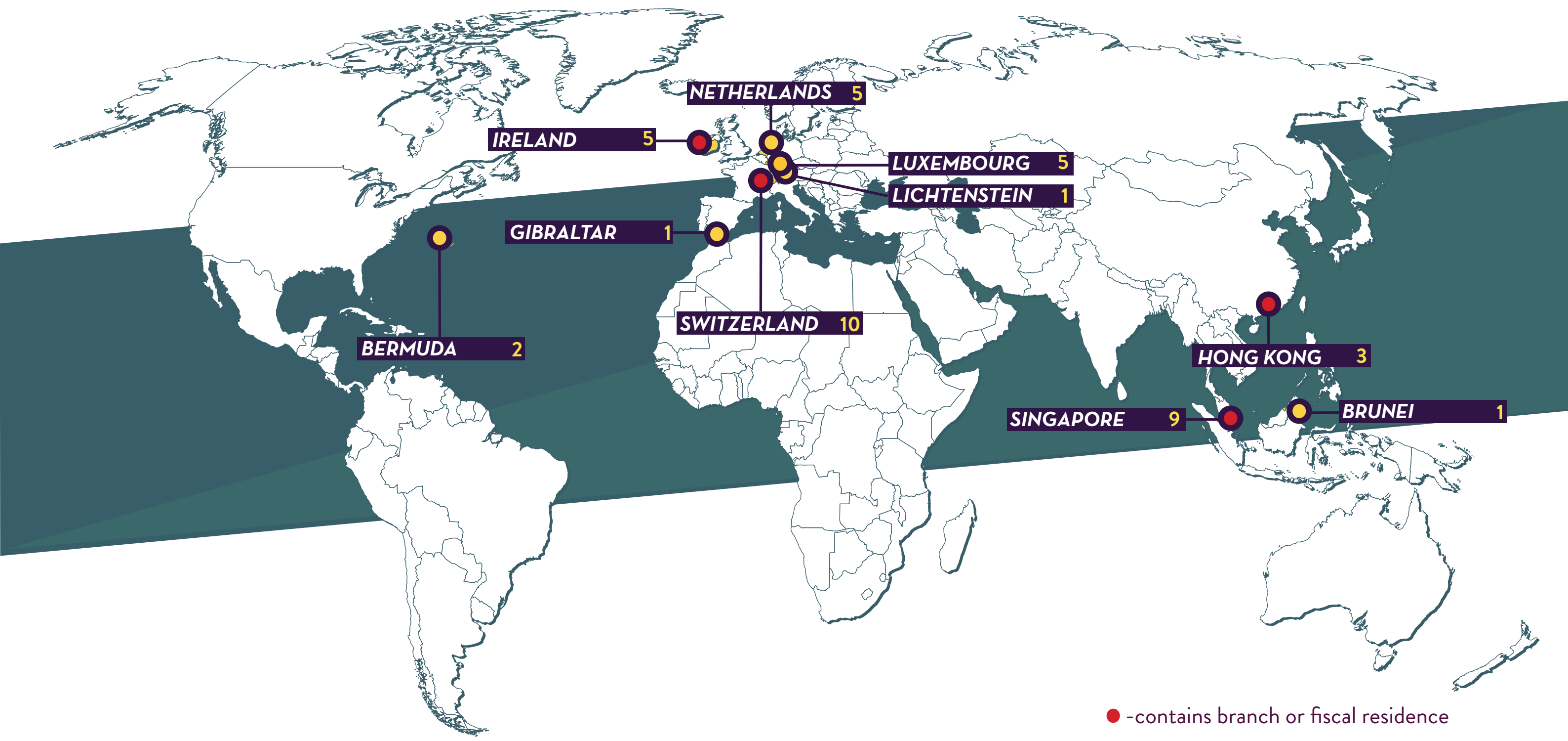
In most non-U.S. markets, McDonald's charges franchisees a royalty fee of five percent of sales. It also extracts the same royalty payment from its corporate stores in some countries, effectively charging its corporate stores for the right to operate McDonald's restaurants.[41] Franchise royalties are intended as payment for both trademarks and ongoing support. Yet, in many countries the country-level subsidiaries seemingly pass through the full five percent royalty on behalf of their franchisees and corporate stores to foreign McDonald's subsidiaries, often in low-tax jurisdictions. Those country-level subsidiaries do not appear to retain any of the royalties in-country to fund support

McDonald's does not fully disclose its subsidiaries in tax haven jurisdictions

McDonald's operates an extensive network of subsidiaries in tax havens, the majority of which it does not disclose, and is not required to disclose under SEC rules, in its annual report. In 2014, the company disclosed 11 subsidiaries in countries that are known tax havens.[44] In fact, a thorough investigation of country-by-country corporate registries shows that McDonald's has at least 42 subsidiaries and branches in tax haven countries, almost four times the number disclosed in its SEC filings.[45] While some of these subsidiaries likely have legitimate operating purposes, the presence of so many affiliated entities in jurisdictions known for facilitating tax avoidance is troubling. As discussed in a previous section, McDonald's holds a staggering US$15.4 billion in assets that are permanently invested in operations outside the U.S. While McDonald's does not disclose where it holds these funds, an analysis of the financial statements for McDonald's Corporation and its foreign subsidiaries reveals that most of the company's cash is held by its subsidiaries located in tax havens. Specifically, McDonald's reported total cash holdings of US$2.8 billion in 2013. More than two-thirds of that amount, US$1.9 billion, was held by McDonald's Luxembourg entities.[46]



McDonald's subsidiaries and branches in tax havens



Case Study: Europe and the Luxembourg Structure

McDonald's European division is an important source of profits, accounting for nearly 40 percent of the company's operating income in 2013.[47] McDonald's has grown to become the largest fast food company in Europe, with 7,850 stores and €20.5 billion in systemwide sales in the region in 2014.[48]

In 2009, McDonald's made two significant changes to its European corporate structure which may have been part of a strategy to cut its tax liabilities in Europe.

Firstly, in early 2009, McDonald's transferred its European intellectual property and franchising rights to McD Europe Franchising Sàrl, a Luxembourg-resident McDonald's subsidiary with branches in both Switzerland and the U.S.[49] This created a likely artificial structure with limited real economic activity. For example, despite receiving €833.8 million in royalties in 2013, the company had only 13 employees. Further, the company does not provide any indication in its Annual Accounts of ongoing investment in research and development.[50]

Secondly, in July 2009, following a number of changes to the tax treatment of royalties and intellectual property in Luxembourg and the U.K., McDonald's moved its European headquarters from London to Geneva.[51] It was widely speculated in the press that this move was tax related, with a McDonald's spokesperson stating that the move "will enable us to conduct the strategic management of key international property rights, which includes the licensing of those rights to McDonald's franchisees in Europe, from Switzerland."[52]

Since the restructuring of McDonald's operations in 2009, McD Europe Franchising Sàrl has become one of McDonald's largest subsidiaries in Europe. In the five-year period from 2009 to 2013, over €3.7 billion in royalties have been paid to this entity. As a result, McDonald's Luxembourg subsidiaries had accumulated nearly €2 billion in cash by the end of 2013.[53]

If McDonald's is fully exploiting this structure to avoid paying taxes on the entire amount of royalties earned in Luxembourg, the lost tax revenue to European governments could exceed €1.0 billion for the period 2009 to 2013.[54]

It is important to note that both the royalties received and profits reported by McD Europe Franchising Sàrl increased significantly between 2009 and 2013, but its reported tax has remained both low and stable from year to year, resulting in its effective tax rate falling over that period.[55] Despite receiving billions in royalties since its establishment, McD Europe Franchising Sàrl and its branches in the U.S. and Switzerland reported only €3.3 million in total taxes in 2013. In fact, McD Europe Franchising Sàrl reported less than a thousandth of that amount as payable on its Luxembourg operation – the entity's country of incorporation – was an astonishingly low €3,235.[56]

McD Europe Franchising Sàrl **2009-2013**

- Royalties: €3,708 million
- Estimated taxes saved across Europe: €1,060 million
- Taxes paid: €16 million
- Employees: 13

Case Study: France

There are 1,343 McDonald's stores in France, employing more than 63,000 workers.[57] These stores brought in systemwide sales of around €4.4 billion in 2013, making France McDonald's largest market in Europe and second-largest in the world.[58] Almost 83 percent of McDonald's stores in the country are operated by franchisees; the remaining stores are owned and operated by McDonald's itself.

France is reported to be among McDonald's most profitable markets in the world. However, a detailed review of financial statements shows the profitability of McDonald's main French subsidiary decreasing over a five year period, even as its sales increased. Inflated intercompany payments may shift profits out of France and reduce McDonald's tax bill.

McDonald's France SA is the largest McDonald's subsidiary in France by sales. In many McDonald's markets, there is one central national subsidiary responsible for directly operating corporate stores. In France, however, corporate stores appear to be operated by a series of smaller subsidiaries. McDonald's France SA likely receives royalties from both franchisees and corporate-owned stores.

McDonald's France has 28 wholly-owned subsidiaries, 13 of which appeared to directly operate corporate stores in 2013, representing nearly half of all corporate stores in France.[59] McDonald's France reported that these 13 subsidiaries were collectively unprofitable in 2013, losing €0.9 million on €439.2 million in turnover.[60] These losses are surprising considering that France is reportedly one of McDonald's most profitable markets.

One explanation for this lack of profitability may be the presence of an outsized amount of "other charges" in corporate stores' accounts compared to franchisee accounts. Under French accounting standards, the "other charges" category is used to consolidate certain costs, including royalties, attendance fees for board members, losses on bad debts, losses arising from the company's share of joint ventures, and any other charges that do not appear in other categories of operating expenses.[61] Of these, royalties are the only significant type of expense that McDonald's subsidiaries are likely to have.

In French franchisee financial statements, the category "other charges" was used exclusively to report royalties paid to McDonald's. These royalties were consistently five percent of sales, as expected.[62] However, upon examination of the five largest subsidiaries of McDonald's France SA that operate corporate stores, the category "other charges" averaged 20 percent of sales, quadruple the franchisee rate.[63] The table below lists the range and average of the major categories of expense associated with McDonald's store operations. By far the largest discrepancy between franchisees and corporate stores in terms of costs is the inflated "other charges" at corporate stores.

McDonald's France expenses as percentage of turnover at selected franchisees and operating subsidiaries, 2012-2013

	Franchisee range	Franchisee average	Corporate stores range	Corporate stores average
Goods for resale	0%	0%	1-2%	1%
Raw materials, supplies	23-24%	23%	26-27%	26%
Other purchases and external charges	25-32%	29%	16-20%	17%
Taxes and similar levies	2%	2%	2-3%	2%
Salaries	17-23%	19%	22-24%	23%
Social charges	5-6%	6%	7-10%	9%
Depreciation on fixed assets	2-3%	2%	2-3%	3%
"Other charges"	5%	5%	19-21%	20%
Profit/(Loss)	6-10%	8%	(7)-2%	(2%)

Corporate stores are both unprofitable and pay four times the amount in "other charges" that franchisees pay

These royalties are most likely paid to McDonald's France SA which, in turn, likely pays them to McDonald's Luxembourg subsidiaries. Since 2009, McDonald's France SA's Annual Accounts disclose significant increases in expenses, dramatically reducing the company's income. Despite an increase in its sales by 37 percent between 2008, the last year before the restructure, and 2013, its profit declined 14 percent during the period. McDonald's France SA has no employees, so such a substantial change in its profitability is difficult to explain.[64]

The largest increase in expenses is in "other charges", which have risen from approximately one quarter of McDonald's France SA's sales to one half since the establishment of the Luxembourg-Swiss structure. The "other charges" have also doubled as a proportion of systemwide sales over that period. Thus, these "other charges" are likely driving the declining profitability of McDonald's France SA.

These "other charges" are neither explained nor further disclosed in the McDonald's France SA Annual Accounts. As indicated above, this category of expense likely refers to royalty costs. This would suggest that McDonald's France is paying a much higher royalty as a percentage of sales to the Luxembourg entity than any other McDonald's subsidiary in Europe, or than that charged to McDonald's franchisees in France. Under international transfer pricing rules, intercompany payments like these must follow "arm's length" principles, where the payment must conform to the amount that would be owed if the parties were independent of one another.[65] These inflated additional payments may not meet the "arm's length" requirements of international transfer pricing rules.

Even if McDonald's France were not extracting royalties at a much higher rate than other markets, the extraction of the standard royalty rate of five percent could lower McDonald's tax bill by hundreds of millions of euros. If McDonald's France were only paying the standard five percent royalty rate on sales, the cumulative royalties paid between 2009 and 2013 would be €1,077.6 million. If the Luxembourg structure was disallowed under France's anti-abuse rules, the amount of unpaid tax could reach €386.2 million.[66]

In addition to assessing unpaid taxes, French anti-avoidance laws allow for a maximum penalty of 80 percent of unpaid tax in cases where companies engage in sham accounting or transactions with the primary motivation of avoiding taxes. Hence, the tax authorities could levy penalties as high as €308.9 million.[67]

The cumulative total of "other charges" paid by McDonald's France SA between 2009 and 2013 was €1,987.0 million.[68] If the entire amount of "other charges" reported by McDonald's France SA were royalty payments that were considered to be a tax motivated arrangement, this could result in tax authorities assessing unpaid taxes of €713.6 million. Penalties on this amount could be as high as €570.9 million. In total the company could receive a maximum bill of €1,284.5 million for the past five years.

McDonald's France SA "other charges" in relation to turnover and systemwide sales, 2007-2013, millions of euros

	2007	2008	2009	2010	2011	2012	2013
Systemwide sales	3,551	3,849	4,177	4,222	4,340	4,398	4,416
Net turnover	569	637	694	751	812	850	875
"Other charges"	146	163	337	378	410	426	437
"Other charges" over net turnover	26%	26%	49%	50%	50%	50%	50%
"Other charges" over systemwide sales	4%	4%	8%	9%	9%	10%	10%

Case Study: Australia

Australia is McDonald's fifth largest market by systemwide sales, with 943 stores employing 90,000 workers.[69] About 80 percent of McDonald's stores in Australia are operated by franchisees; the remaining stores are owned and operated by McDonald's itself.[70]

As appears to be the case in France, McDonald's Australian operations show an unusually high level of intercompany payments over the five years from 2009 to 2013. These payments may shift profits out of Australia to a subsidiary in Singapore, thereby reducing McDonald's Australian tax bill significantly.

McDonald's Australia Ltd. is McDonald's primary operating subsidiary in the country. It receives royalties – set at five percent of sales – from franchisees and also operates corporate-owned stores.[71] In 2013, McDonald's Australia Ltd. reported that it earned AU$154.5 million in service fees from franchisees.[72] If McDonald's also charges its Australian subsidiary a royalty of five percent of sales from its own corporate stores, then the expected amount of corporate store royalties would be AU$47.6 million.[73] As such, the expected amount of royalties paid on McDonald's operations in Australia would be a maximum of AU$202.1 million.

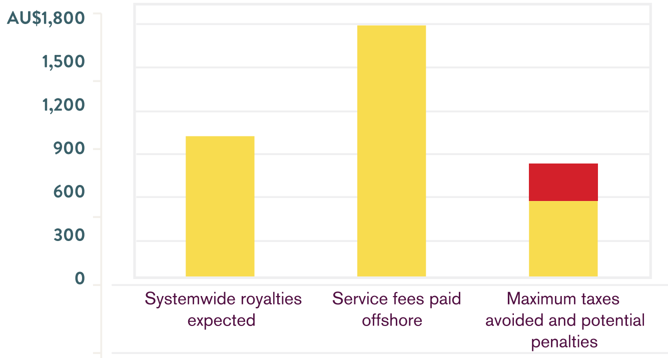
However, McDonald's Australia Ltd. reported paying service fees of AU$367.6 million to McDonald's Asia Pacific in 2013, equivalent to more than nine percent of systemwide sales. This is a significantly larger figure than one would expect if a five percent royalty rate were levied on all franchised and corporate stores.[74] In fact, in each of the past five years, McDonald's Australia Ltd. has reported nearly twice as much in outgoing service fee payments as would be explained by the royalties the company receives from franchisees plus any royalty paid on behalf of corporate stores. Since rent expense is a separate line item in the McDonald's Australia Ltd. reports, there is no known explanation for these payments other than an inflated service fee that serves as a distribution of profit out of Australia, similar to the additional "other charges" in France.

As noted above, service fees to a related party such as these are required to meet "arm's length" principles.[75] Given that the service fees paid are significantly higher than would be expected based on the standard McDonald's royalty payment of five percent, it is appropriate to question whether these fees may not be based on appropriate "arm's length" conditions. The payment of these services fees significantly reduces McDonald's Australia Ltd.'s taxable income. In 2013 alone, this strategy may have reduced McDonald's Australia Ltd.'s tax bill by more than half.[76]

This raises the question of whether the offshore payment of these service fees could have the dominant purpose of reducing the company's tax obligations in Australia and thus breach Australian anti-avoidance rules.[77] These rules allow the Australian Tax Office to subject such transactions to Australia's standard corporate income tax of 30 percent.

As such, the tax owed by McDonald's Australia Ltd. on all service fees paid offshore in the years between 2009 and 2013 could be as high as AU$497.1 million.[78] In addition to collecting the unpaid tax, Australia can levy penalties of up to 50 percent of the tax shortfall.[79] In McDonald's case, this could result in up to AU$248.5 million in additional penalties.

McDonald's Australia Ltd. systemwide royalties expected, actual service fees paid offshore, estimated tax avoided, and maximum potential penalties, 2009-2013, millions of Australian dollars



McDonald's royalty payments from Australia are paid to the Singapore branch of McD Asia Pacific, LLC, a McDonald's subsidiary registered in Delaware.[80] Singapore is widely considered a tax haven[81] and is fifth on the Tax Justice Network's most recent Financial Secrecy Index.[82] In 2009, the Singapore branch of McD Asia Pacific, LLC acquired intangible assets from Australia. Despite substantial revenues and profits, this Singapore branch pays almost no tax, noting in its annual accounts that it benefits from a concessionary rate offered by the Singapore Economic Development Board under a Group Development and Expansion Incentive. Its tax expense has been approximately US$5.3 million for each of the last four years despite significant changes in recorded profit over that period.[83]

CONCLUSION

McDonald's appears to have structured its global its global business to avoid paying taxes both in the U.S. and in many of its major markets around the world. It has done so by engaging in aggressive and potentially abusive strategies. By using royalties to shift profits from foreign markets into tax havens, and avoiding paying tax on billions in foreign earnings in the U.S., McDonald's may have avoided paying US$1.8 billion or more in taxes since 2009 alone.

Recommendations to governments and regulators

McDonald's extraction of royalties from the countries in which it operates stores is not without serious consequences. As governments around the world introduce budget cuts to deal with crippling shortfalls and mounting debt, the tax avoidance practices of transnational corporations suggest an austere future, in which public expenditures are funded from taxes on a decreasing proportion of the economic activity taking place.

At the same time, the U.S. tax system has enabled McDonald's and other major transnational corporations based in the U.S. to flout worldwide tax rules and stash a significant portion of their assets abroad in tax havens and financial secrecy jurisdictions. This trend creates an unsustainable drag on the economy, in which many flagship companies do not pay their fair share. Since 2005, corporate tax revenue has declined as a percentage of GDP in nearly three quarters of OECD countries. At the same time, corporate tax as a proportion of GDP declined by 17 percent in both the OECD and the U.S., a precipitous drop that contributes to the substantial budget crises facing governments around the world.[84]

The following steps are recommended to address the serious and growing problem of corporate tax avoidance in general, and at McDonald's specifically.

1. **Governments around the world should investigate McDonald's** and assess the lawfulness of the company's tax arrangements, in particular the payment of significant royalties and service fees from operating markets to subsidiaries in low-tax jurisdictions. Should McDonald's be found to have breached anti-avoidance rules or other national tax laws, countries should pursue McDonald's for the full amount of taxes owed, and levy the maximum penalties allowable, due to the scope and seriousness of the practices outlined in this report.

2. Regulators in countries where McDonald's operates or franchises stores **should collaborate and proactively share information regarding ongoing investigations** into the company's tax practices.

3. Broadly, governments should **increase their investment in human capital in tax agencies** in order to give regulators the resources necessary to pursue corporate tax avoidance and recover unpaid tax.

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