



# UNHAPPY MEAL

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*€1 Billion in Tax Avoidance on the Menu at McDonald's*



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**CHANGE to WIN**

# Preface

**T**his report is the product of a coalition of European and American trade unions, representing more than 15 million workers in different sectors of the economy in 40 countries, and War on Want, the U.K.-based anti-poverty campaign group. The members of the coalition work towards an economy built on decent jobs and a fair, progressive tax system at the global, E.U., and national levels. It is the first time that we have joined forces to highlight an example of corporate tax avoidance, a critical issue affecting the future of democracy and the welfare state.

Almost everyone knows someone who works or has worked in one of McDonald's 7,850 European stores. While McDonald's portrays itself as a vital provider of jobs, particularly for youth, its workers often experience precarious, low-wage work with little prospect for steady employment or advancement. In the U.K., for instance, the vast majority of McDonald's 97,000 workers are on zero-hours contracts – employment contracts with neither guaranteed hours nor work schedule stability.

While McDonald's poor working conditions are well-known, this report is the first to shed light on the company's tax record. It relies on primary data drawn from the financial accounts of the company and its subsidiaries as well as press and research reports.

While transnational corporations like McDonald's are avoiding taxes in Europe, public sector workers are having their wages slashed, and nurses and social carers are facing layoffs. In fact, more than 56,000 tax inspectors have been cut throughout the E.U. at precisely the moment they are most needed to investigate companies like McDonald's. This report provides further ammunition to encourage governments, parliaments, and the European Commission to shine a light on these practices, hold corporate tax avoiders accountable, and begin a real democratic dialogue that results in deep reforms and restores confidence in a fair, progressive, transparent, and effective tax system.

Since 2005, Change to Win has advocated on behalf of workers and the general public for consumer protections, healthcare access, tax fairness, and other safeguards to rebuild the middle class. We are grateful to the team of researchers at Change to Win for compiling these data and hope this report will help put tax justice on the menu at McDonald's.

**EPSU, EFFAT, SEIU, and War on Want**

*Brussels, 24 February 2015*



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# Executive Summary

McDonald's is one of the world's most recognised brands, with 36,000 stores serving approximately 69 million customers every day.<sup>1</sup> The McDonald's system employs 1.9 million people, making it the second largest private sector employer in the world.<sup>2</sup> McDonald's opened its first store in Europe in the Netherlands in 1971. Since then, McDonald's has grown to become the largest fast food company in Europe, with 7,850 stores<sup>3</sup> and €20.3 billion in systemwide sales in 2013.<sup>4</sup> McDonald's European division is also an important source of profits for McDonald's, accounting for nearly 40 percent of the company's operating income in 2013.<sup>5</sup>

In 2009, McDonald's restructured its business with the effect of extracting billions in royalties from its Europe operations. This restructuring involved:

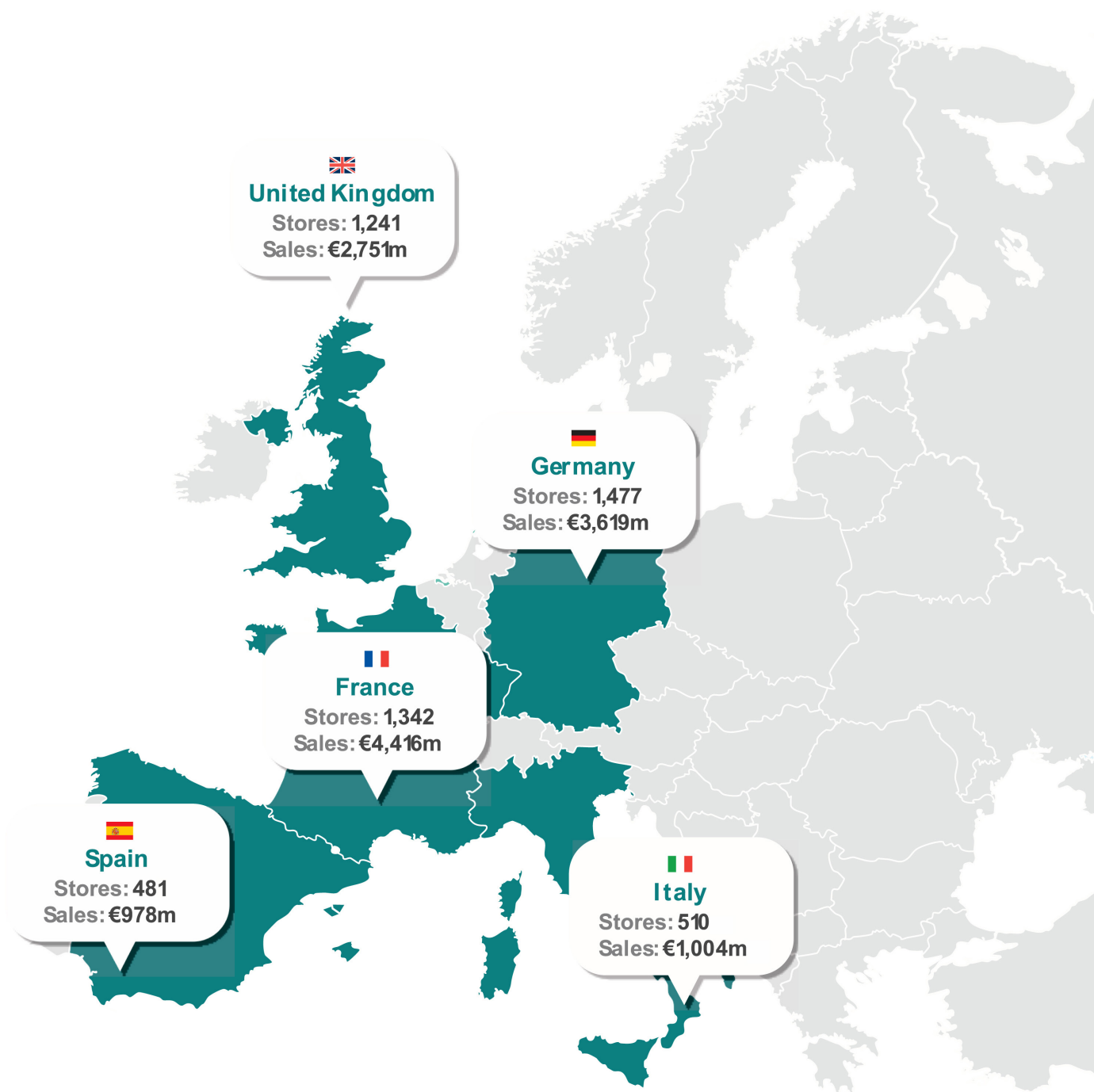
- Establishing McD Europe Franchising Sàrl, a Luxembourg-resident intellectual property holding company with a Swiss branch, immediately after a tax policy change in Luxembourg allowing companies to benefit from significant reductions of their tax rate on income earned from intellectual property;
- Shifting McDonald's European headquarters from London to Geneva, which was reported as being for tax purposes; and
- Routing billions in royalties from its European operations to McD Europe Franchising Sàrl.

As a result, McDonald's engaged in aggressive and potentially abusive optimisation of its structure which has led to the avoidance of significant amounts of tax across the continent. These tax optimisation strategies have potentially cost European governments over €1 billion in tax revenue over the five years from 2009 to 2013.

This report outlines in detail the tax avoidance strategies adopted by McDonald's in Europe and assesses their impact on tax savings for the company, both throughout Europe and in major markets like France, the U.K., Italy, and Spain. It also recommends steps that could be taken by the European Commission and Member States to investigate the potential unlawfulness of McDonald's tax scheme in Europe and to encourage transparency and tax compliance by transnational corporations.

# McDonald's Largest European Markets

This map features systemwide sales, store counts and rankings for McDonald's top five European markets.  
*2013 systemwide sales in millions of euros. Store counts as of January 2015.*



# Introduction

Since the global financial crisis of 2007-08, McDonald's sales in Europe have grown nearly 20 percent.<sup>6</sup> Meanwhile, Europe is on the verge of falling into its third recession in six years. In most European Union countries, GDP per capita is still lower than pre-crisis levels and unemployment remains high across Europe, with the eurozone unemployment rate in December 2014 at 11.4 percent and youth unemployment in excess of 20 percent.<sup>7</sup> To reduce debt and deficits, many European countries have instituted severe austerity measures, including significant cuts to essential public services that have placed the burden of balancing public budgets on the poorest and most vulnerable members of society.<sup>8</sup> At the same time, transnational corporations like McDonald's have implemented schemes enabling them to avoid paying a fair share of tax.

The recent disclosure of hundreds of documents from Luxembourg – documents that reveal a previously undisclosed set of mechanisms transnational companies have used to avoid taxes – has reignited the debate on corporate tax avoidance across Europe. These leaked documents, published by the International Consortium of Investigative Journalists (ICIJ), illustrate the complex corporate structures and secret tax deals that more than 300 companies like Pepsi, IKEA, and FedEx secured from Luxembourg in order to slash their tax bills and save billions of euros.<sup>9</sup>

These revelations come on the heels of ongoing investigations by the European Commission into these types of secret deals. In June 2014, the Commission opened formal investigations into tax deals signed between Italian automotive company FIAT and Luxembourg.<sup>10</sup> Earlier this year, the Commission also released preliminary findings of its investigation into the global online retailer Amazon, suggesting the company's tax deal in Luxembourg may breach European Union competition rules.<sup>11</sup> In December 2014 the Commission enlarged its inquiry into national tax rulings, especially with regard to intangible property regimes, to all Member States.<sup>12</sup>

McDonald's has already faced regulatory scrutiny over its tax practices since it altered its European corporate structure to one that is widely suspected to have the purpose of minimising taxes. In late 2013, French authorities launched investigations against McDonald's for avoiding corporate taxes in France,<sup>13</sup> and press reports suggest that the European Commission is also investigating the company for using Luxembourg subsidiaries to minimise taxes on European earnings.<sup>14</sup> In its third quarter 2014 corporate filings, McDonald's has had to acknowledge the increased scrutiny of its tax practices and report additional tax expenses of €204 million as a result of unfavourable tax rulings and a tax audit progression in international markets, suggesting that these tax investigations are beginning to translate into real consequences for the company.<sup>15</sup>



# Franchising and Royalties

## McDonald's franchising model


McDonald's profitability depends on its franchising model, in which significant income is derived from royalty and rental payments from franchisees rather than through direct corporate operation of stores. In Europe, over 73 percent of McDonald's stores are operated by franchisees.<sup>16</sup>

Franchising is a system in which separate undertakings – a franchisor and its franchisees – sign an agreement allowing franchisees to purchase the right to use the franchisor's concept, trade name, know-how, and other industrial or intellectual property. Franchisors also provide ongoing commercial and technical assistance to their franchisees.<sup>17</sup> Franchisees typically pay franchisors up-front fees to participate in a franchise system. They also pay ongoing royalties, sometimes called service fees, which are usually based on a percentage of sales.

## McDonald's royalties from franchising

McDonald's appears to uniformly charge its European franchisees a royalty fee of five percent of franchisees' sales.<sup>18</sup> McDonald's also routinely controls the real estate for its franchised stores, with franchisees paying rent to the company in addition to royalty payments. In some countries in Europe, McDonald's also extracts royalty payments from its corporate stores, effectively charging its own country-level subsidiaries for the right to operate McDonald's restaurants.<sup>19</sup>

By contrast, in the U.S., McDonald's franchisees pay a four percent royalty to McDonald's USA, LLC; this entity then pays a royalty of only two percent to the McDonald's group for use of the McDonald's system and brand by its franchisees and corporate stores.<sup>20</sup> McDonald's USA, LLC retains the residual two percent of sales, allowing it to reinvest in the market and provide crucial ongoing support services to franchisees. The equivalent country-level operating subsidiaries in Europe seemingly pass through a full five percent royalty on behalf of their franchisees and corporate stores to foreign McDonald's subsidiaries, likely in low-tax jurisdictions. They do not appear to retain any of the royalties they collect from franchisees to support services for those franchisees.<sup>21</sup>



If the two percent royalty fee paid by McDonald's USA, LLC is paid to another U.S. company as the ultimate holder of the intellectual property, the entire four percent royalty amount will ultimately be subject to income tax in the U.S. In Europe, however, none of the five percent royalty is likely subject to corporate income tax in the country in which it was generated. If it is paid to a foreign subsidiary in a low-tax jurisdiction, it ultimately may be taxed at a very low rate, or may not be taxed anywhere.

These royalty payments are an important component of McDonald's aggressive tax optimisation strategy. McDonald's has used royalties to significantly lower its tax bills across Europe, allowing it to maximise the profits it extracts with very low tax rates.

### **Tax implications of royalty payments**

Royalty payments are commonly used by transnational corporations to limit tax obligations. 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. This is known as "profit-shifting," as it shifts taxable profits from a high-tax jurisdiction to low- or no-tax jurisdictions.<sup>22</sup>

Many low-tax jurisdictions provide significant tax breaks on investment in intellectual property and royalties derived from intellectual property. In Luxembourg, a tax feature called an "intellectual property box" reduces the normal corporate tax rate on most royalties from 29.2 percent to 5.8 percent of taxable income.<sup>23</sup> In Switzerland, effective corporate tax rates for companies deriving most of their income beyond Swiss borders are between zero and twelve percent.<sup>24</sup> Given these tax regimes, one common structure used by transnational corporations is a Luxembourg holding company with a Swiss branch. This joint structure allows companies to take advantage of both countries' favorable tax arrangements.<sup>25</sup>

In many cases, companies are able to further lower their tax rates in Luxembourg or other countries by negotiating tax rulings or Advance Pricing Agreements with those countries.<sup>26</sup> As noted above, these types of secret tax deals are already under investigation by the European Commission as potential violations of European competition rules.<sup>27</sup>

# Luxembourg Structure

In 2008 and 2009, McDonald's made two significant changes to its European corporate structure which resulted in the aggressive optimisation of its tax arrangements in Europe.

Firstly, in late 2008, 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. This created a likely artificial structure with limited real economic activity. Despite receiving €833.8 million in royalties in 2013, the company had only 13 employees, and provides no indication in its Annual Accounts of ongoing investment in research and development.<sup>28</sup>

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. It was widely reported in the press that this move was tax-related and part of an ongoing trend to access lower tax rates. McDonald's stated through a spokesperson 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."<sup>29</sup>

This appears to be part of a broader strategy which has the effect of limiting McDonald's U.S. tax liabilities on foreign earnings. McDonald's discloses that it retains €12.6 billion of undistributed earnings that are considered permanently invested in operations outside the U.S. for which it does not record tax liabilities, up from €4.9 billion in 2008, meaning the company has retained an additional €7.7 billion in foreign operations from 2009 through 2013.<sup>30</sup> McDonald's has delayed repatriating these billions in foreign earnings, thereby not paying taxes on those earnings in its home country.<sup>31</sup>

## By the Numbers

2009 - 2013

### McD Europe Franchising Sàrl

- Turnover: **€3,708 million**
- Estimated taxes saved across Europe: **€1,060 million**
- Taxes paid in Luxembourg: **€16 million**
- Employees: **13**

## McDonald's Supposed European Corporate Structure

▲ Royalty    ▼ License    ▲ Royalties and Rent

### Pre-2009

McDonald's Corporation  
Delaware, USA

McDonald's Subsidiaries  
in Some European  
Countries

Corporate-owned Stores    Independent Franchisees

### Post-2009

McD Europe Franchising Sàrl  
Luxembourg

McDonald's Subsidiaries  
in Some European  
Countries

Corporate-owned Stores    Independent Franchisees

# Tax Impact

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.<sup>32</sup>

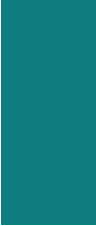
Despite receiving billions in royalties since its establishment, McD Europe Franchising Sàrl and its branches in the U.S. and Switzerland reported only €3.3 million in total taxes in 2013. In fact, the portion of the taxes reported by McD Europe Franchising Sàrl as payable to Luxembourg – the entity's country of incorporation – was an astonishingly low €3,235.<sup>33</sup>

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 from 2009 to 2013.<sup>34</sup> Table 1 details the potential taxes that McDonald's would have paid to European governments if the company had retained the funds to invest in the communities in which it operates instead of extracting them to low-tax jurisdictions.

**Table 1: McD Europe Franchising Sàrl royalties received, tax reported, and estimated Europe-wide taxes saved 2009-2013, millions of euros<sup>35</sup>**

	2009	2010	2011	2012	2013	Cumulative
<b>Total royalties received</b>	587.8	703.4	766.8	816.1	833.8	<b>3,707.9</b>
<b>Estimated taxes if royalties were retained in European countries as profit</b>	161.8	193.6	211.1	244.6	229.5	<b>1,060.1</b>
<b>Tax reported</b>	2.8	3.8	3.5	2.6	3.3	<b>16.00</b>

It is important to note that both the royalties received and profits reported by McD Europe Franchising 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.<sup>36</sup>



There is limited financial information available for many McDonald's European subsidiaries because of the corporate structure choices made by the company combined with the lack of required detailed financial disclosures in many European countries. Hence, the amount of unpaid tax is an estimate based on available financial documents. It is clear, however, that McD Europe Franchising Sàrl is only paying a tiny fraction of the taxes that would otherwise have been paid had royalties been retained to invest in McDonald's operating markets.

### **Tax rates suggest a tax ruling**

By 2013, McD Europe Franchising Sàrl's effective tax rate had fallen to 1.4 percent.<sup>37</sup> This rate is significantly below those that appear to be available under the standard Luxembourg tax regime, even taking into account Luxembourg's generous tax rate of 5.8 percent on royalties and intellectual property income. This suggests that these extremely low tax rates are likely to be the result of a preferential tax deal with Luxembourg that would be similar to those revealed by the ICIJ leaks in late 2014.

When considered in the context of the entire amount of royalties the company receives, McD Europe Franchising Sàrl's reported taxes are even smaller. The company's taxable income is reduced by a few significant costs that make up a large proportion of total royalties received. The main costs reported by the company are cost sharing expenses, royalty expenses, and management fees, which are largely intercompany payments.<sup>38</sup> These types of intercompany payments are commonly the subject of tax rulings or Advance Pricing Agreements.<sup>39</sup> In addition to the low and stable tax rate, the nature and size of these costs may provide further indication of the presence of a tax ruling or Advance Pricing Agreement with Luxembourg.

# *Recovery by the European Commission*

European institutions play a critical role in combatting tax avoidance across Europe. The European Parliament has the power to scrutinise Member States' tax behaviours and solicit the E.U.'s intervention in favour of more transparency and compliance to E.U. competition rules. The Competition Directorate-General of the European Commission has the power to investigate and regulate matters related to state aid. According to the Treaty on the Functioning of the European Union, any aid – including subsidies such as favourable tax treatment – granted by a European Union Member State which distorts competition by favouring particular companies is in breach of the common market rules.<sup>40</sup> There are certain exemptions to this rule relating to general economic development, innovation, research and development, social or environmental policy, and activities serving the general interest, none of which appear to apply to McDonald's in this case.<sup>41</sup>

As noted above, the European Commission is already investigating the tax practices of certain countries (including Luxembourg, Ireland, the Netherlands, and Belgium) and some companies' tax schemes (including Apple, FIAT, and Amazon).<sup>42</sup> The European Commission's commitment to this effort has been tangible and crucial, but there is more that can be done in order to concretely dismantle tax avoidance schemes across Europe. If the Commission decides that a Member State has provided anti-competitive state aid to companies in the form of secret tax deals, it can order the said Member State to recover the aid with interest from the companies that received it. If the Member State refuses to comply, the Commission can refer the case to the European Court of Justice.

Given McD Europe Franchising Sàrl's low tax rate and high levels of cost sharing expenses, it is likely that the company reached a secret tax deal with Luxembourg. Therefore, McDonald's case should be included in the scope of both the ongoing investigations launched by the European Commission and the analysis to be carried out by the European Parliament's Special Committee on Tax Rulings launched on February 12, 2015. This would give the Commission the power to determine whether the potential deal provides special, preferential treatment to McD Europe Franchising Sàrl and therefore should be considered as anti-competitive state aid. If so, the Commission could potentially order Luxembourg to cease providing special tax treatment to McDonald's and to recover the taxes that should have been paid on that income in Luxembourg.

Under the conservative assumption that McD Europe Franchising Sàrl would be taxed at Luxembourg's IP Box rate of 5.8 percent, the Commission could order Luxembourg to recover up to €194.0 million in unpaid tax for the 2009 to 2013 period.<sup>43</sup> Due to Luxembourg's generous tax treatment of royalties, this is only a fraction of the taxes the company would have paid throughout Europe had it not utilised this Luxembourg structure.

In the European Commission's view, special tax regimes for IP rights are 'supposed to stimulate innovation and investments in new technologies.' Recently, the Commission has seen evidence that such regimes do not in fact trigger significant additional research and development activity, and benefit only highly-mobile businesses. Given that McD Europe Franchising Sàrl does not report any research and development investment costs, any benefit it receives under the IP box may also be questionable under state aid rules.<sup>44</sup> If Luxembourg were ordered to recover the full amount of potential unpaid taxes at the full standard corporate rate, the total amount could be as high as €1,050.3 million between 2009 and 2013.<sup>45</sup>

**Table 2: McD Europe Franchising Sàrl's maximum potential taxable income and tax owed to Luxembourg 2009-2013, millions of euros<sup>46</sup>**

	2009	2010	2011	2012	2013	Cumulative
Maximum potential taxable income	584.1	664.9	775.4	800.1	819.4	<b>3,643.9</b>
Potential tax owed to Luxembourg if IP Box rate applied	30.6	34.2	41.1	43.5	44.6	<b>194.0</b>
Potential tax owed to Luxembourg if full corporate rate applied	167.0	190.1	223.3	230.4	239.4	<b>1,050.3</b>

# Recovery by Individual Countries

In addition to the European Commission's powers in relation to state aid, nearly all countries in Europe have general anti-avoidance or anti-abuse laws in place to assist in combatting corporate tax avoidance.<sup>47</sup> These rules are aimed at aggressive tax planning that has the effect of avoiding taxes, even when the tax benefits derive from structures or transactions that are otherwise legal. National tax authorities can investigate tax arrangements under these rules and determine whether a structure or transaction is artificial in nature and has no real purpose other than to minimise a corporation's tax bill. They can also investigate whether a foreign subsidiary actually runs a permanent establishment in that country with hidden activity that should be taxed. If those arrangements are found to be motivated solely or mainly by tax benefits, the authorities can disregard them and reissue new, higher tax bills on that basis. In many cases the authorities also have the power to levy significant penalties in addition to recovering unpaid taxes.

**Table 3: McDonald's systemwide sales, estimated royalties, estimated taxes saved, and maximum potential penalties, 2009-2013, millions**

	France	UK	Italy	Spain
<b>2009-2013 Systemwide sales</b>	€21,552.3	£11,067.8	€4,691.3	€4,494.3
<b>2009-2013 Royalties</b>	€1,077.6 - €1,987.0	£294.2	€237.8	€228.4
<b>2009-2013 Estimated taxes owed</b>	€386.2 - €713.6	£75.7	€74.7	€68.5
<b>2009-2013 Maximum potential penalties</b>	€308.9 - €570.9	No penalties	€149.3	€102.8

The following is a summary of McDonald's operations in some key markets where national tax authorities have general anti-avoidance or anti-abuse rules that could be used to investigate and potentially reassess McDonald's tax obligations if McDonald's scheme were found to infringe applicable tax law.



## France

France is McDonald's largest market in Europe by systemwide sales and is among McDonald's most profitable countries in the world. From 2009 through 2013, McDonald's and its franchisees had €21.6 billion in sales in France.<sup>48</sup> As noted above, the French government launched an investigation in late 2013 regarding McDonald's potential tax avoidance.<sup>49</sup>

McDonald's largest subsidiary by turnover in France is McDonald's France SA. When McDonald's restructured its European operations in 2009, McDonald's France sold significant intellectual property assets to McD Europe Franchising Sàrl in Luxembourg. After the transaction, McDonald's France's profit margin fell precipitously. The impact on McDonald's France's profit was so significant that despite an increase in its turnover by 37 percent between 2008, the last year before the restructure, and 2013, its profit actually declined 14 percent during the period. This change was due to a significant increase in expenses after the sale of intellectual property to McD Europe Franchising Sàrl.<sup>50</sup>

“

*The impact on McDonald's France's profit was so significant that despite an increase in its turnover by 37 percent between 2008, the last year before the restructure, and 2013, its profit declined 14 percent during the same period.*

As indicated by these inflated costs, between 2009 and 2013 the company made offshore royalty payments that could be as high as €1,987.0 million, and which are likely at least €1,077.6 million. Hence, the amount of unpaid taxes McDonald's could owe ranges from €386.2 to €713.6 million.<sup>51</sup> In addition, France could levy additional penalties ranging from €308.9 to €570.9 million.<sup>52</sup>

## Italy

Italy was one of McDonald's fastest growing markets in the European Union in the past decade. McDonald's now has over 500 stores in the country and earned over €1 billion in systemwide sales in 2013.<sup>53</sup>

McDonald's Development Italy, Inc., a U.S.-registered company operating via a branch in Italy, is the main operating subsidiary of McDonald's in Italy. This company has disclosed that it paid royalties equivalent to approximately five percent of systemwide sales for corporate and franchised stores in the period from 2011 to 2013. Hence, total royalty payments by McDonald's Development Italy, Inc. between 2009 and 2013 are estimated at €237.8 million.<sup>54</sup>

If royalties from McDonald's branch in Italy are directed to McD Europe Franchising Sàrl, and if these arrangements are found to be abusive under the general abuse of law principles outlined by the Italian Supreme Court in 2008,<sup>55</sup> McDonald's could owe as much as €74.7 million in unpaid taxes for the period from 2009 to 2013.<sup>56</sup> Paying taxes on the amount extracted in the form of royalties would have more than doubled the tax bill of McDonald's Development Italy, Inc. in the years from 2011 to 2013.<sup>57</sup> In addition to collecting the unpaid tax, Italy can levy penalties of up to 200 percent. In McDonald's case, this could result in up to €149.3 million in additional penalties.<sup>58</sup>



*Paying taxes on the amount extracted in the form of royalties would have more than doubled the tax bill of McDonald's Development Italy, Inc. in the years from 2011 to 2013.*

## Spain

Since opening its first store there more than thirty years ago, McDonald's now has over 480 restaurants in Spain.<sup>59</sup> In 2013 McDonald's and its franchisees earned €977.6 million in systemwide sales in the country.

McDonald's Sistemas de España, Inc., a U.S.-registered company operating via a branch in Spain, is the main operating subsidiary of McDonald's in Spain. The company has disclosed that between 2009 and 2013 it paid royalties equivalent to a rate of five percent of systemwide sales for corporate and franchised stores each year. Based on these disclosures, royalty payments by McDonald's Sistemas de España, Inc. during the period from 2009 to 2013 totaled €228.4 million. Additionally, the Spanish subsidiary indicates that these royalties are paid to McDonald's Corporation.<sup>60</sup>

However, McD Europe Franchising Sàrl indicates that its turnover derives from royalties generated from European operations and that it has the rights to use and develop the McDonald's system across Europe.<sup>61</sup> If royalties from Spain are actually directed to McD Europe Franchising Sàrl, and if tax authorities in Spain found these royalty payments to constitute tax avoidance under the general anti-abuse rule embedded in the tax code,<sup>62</sup> McDonald's could owe as much as to €68.5 million in unpaid taxes over the past five years.<sup>63</sup> Additionally, Spain can levy underpayment penalties of up to 150 percent, which could lead to €102.8 million in additional penalties, should it be found that the Luxembourg company actually runs a permanent establishment in Spain with hidden activity that should be taxed.<sup>64</sup> By comparison, in 2013, McDonald's Sistemas de España had negative taxable income, and as such did not have corporate income tax expenses for the year.<sup>65</sup>

## United Kingdom

In 2013 McDonald's and its franchisees earned £2,335.5 million in systemwide sales in the United Kingdom. Since opening its first store there more than forty years ago, there are now more than 1,200 McDonald's restaurants in the U.K.<sup>66</sup>

McDonald's Restaurants Ltd., which is located in the U.K., is the main operating subsidiary of McDonald's there. The company has disclosed that between 2009 and 2013 it paid £294.2 million in franchise rights fees offshore.<sup>67</sup> If these franchise rights fees were subject to taxation in the U.K. at the prevailing corporate tax rate, McDonald's would owe an additional £75.7 million in unpaid taxes over the past five years.<sup>68</sup>

Perhaps more strikingly, the U.K. has been significantly impacted by the decision of McDonald's management to relocate the company's European headquarters to Switzerland in 2009. As discussed above, this change was part of a pattern of companies abandoning London for Geneva, reportedly in order to access lower tax rates.<sup>69</sup>

If McDonald's had maintained its European headquarters in London and paid U.K. tax on royalties earned from its European subsidiaries,<sup>70</sup> the royalties that have since been received by McD Europe Franchising Sàrl would have been subject to a much higher rate of tax. If all of the royalties actually received by McD Europe Franchising Sàrl between 2009 and 2013 were taxed in the U.K. instead, McDonald's would have owed up to £818.7 million in tax.<sup>71</sup>

While it is unlikely that McDonald's would have paid this amount of tax had it maintained its European headquarters in London, these calculations show the potential scale of the impact that McDonald's decision to relocate to Switzerland has had on the finances of a country which is both one of its largest and most important markets and its former European home.

# Conclusion

McDonald's is structured to extract billions of euros in royalties from its European operations. McDonald's has engaged in aggressive and potentially abusive optimisation of its structure which appears to have led to the avoidance of significant amounts of tax. Based on the royalties received by McD Europe Franchising Sàrl this structure is likely to have cost European governments over €1 billion in lost tax revenues between 2009 and 2013 should standard corporate tax rates have been applied to the said royalties in the country where they were generated.

Given the scale and seriousness of the potential tax avoidance identified in this paper, the lawfulness of McDonald's tax scheme should be questioned by competent authorities at the national and European levels, backed up by the necessary political will and sufficient investment in human and material conditions in tax enforcement authorities.

## **1. The lawfulness of McDonald's tax scheme should be questioned**

McDonald's tax scheme should be included within the scope of the ongoing investigation launched by the European Commission to determine the cause of its extremely low tax rate and decide whether anti-competitive state aid has been received by the company. Such an investigation would be the simplest way to determine whether state aid has been provided in breach of common market rules. If so, Luxembourg should be ordered to recover the funds.

## **2. Tax authorities in European countries should investigate McDonald's tax arrangements**

Member States that have anti-avoidance or anti-abuse rules should investigate McDonald's for aggressively optimising its corporate structure to avoid paying taxes in those countries. Where McDonald's would be found to have breached anti-avoidance rules, countries should pursue McDonald's for the full amount of taxes owed. Due to the scope, egregiousness, and apparent intention of the avoidance practices identified in this report, tax authorities that may identify unlawful avoidance practices should levy the maximum penalties allowable under national laws.

### **3. European countries should disclose their secret tax rulings**

All European Union countries should immediately disclose secret tax rulings with transnational corporations, including McDonald's. These rulings allow companies to avoid billions of euros in taxes every year. Full disclosure would allow a frank and public debate about the appropriateness of the massive tax breaks these arrangements provide to transnational corporations, as well as making governments accountable for their decisions regarding taxation and state aid. In particular, a European public register for tax rulings should be created. Concrete measures are expected to emerge from the European Parliament's new Special Committee on Tax Rulings.

### **4. McDonald's should fully disclose key elements of its tax optimisation strategy**

McDonald's should immediately open its books in Europe. The company should justify the way in which it has structured its affairs to minimise the taxes it pays in major European markets. Specifically, it should disclose the amount and recipient of all payments made by subsidiaries in European countries to related parties. In addition, it should identify the business reasons for those payments. Finally, McDonald's should disclose any taxes paid on such payments in either the origin or destination country.

### **5. Country-by-country reporting should be mandatory across the economy**

As called for by the European Parliament, all transnational corporations should be required to report key financial information including turnover, staff numbers, profit or loss before tax, tax expense, cash taxes paid, and public subsidies received in every country of operation. Such reporting is essential in assisting tax administrations in investigation of complex cases. It is also critical for trade unions and civil society to anticipate the social implications of corporate practices.

### **6. A public registry of company structures**

As this report reveals, the transparency of McDonald's corporate structure is insufficient. Earlier this year, the E.U. Council agreed, in the context of the revised anti-money laundering directive, to the creation of national, public registers of the ultimate ownership and control of companies. This is yet another tool that will facilitate the work of tax authorities to track potential cases of tax fraud or avoidance. It is crucial that all E.U. Member States establish such registries and make them available to the public.

# Endnotes

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- <sup>2</sup> Ruth Alexander, "Which is the world's biggest employer?" Mar. 19, 2012 <http://www.bbc.com/news/magazine-17429786>
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- <sup>4</sup> McDonald's reports franchised and corporate sales by region in its Annual Report. McDonald's Corporation, Annual Report 2013, Form 10-K, February 24, 2014, pp.15-16; McDonald's reports earnings in U.S. dollars. In all cases where figures in U.S. Dollars have been translated to other currencies, these figures have been translated using average annual exchange rates as reported by the U.S. Internal Revenue Service. The EURUSD exchange rates used in this report were as follows: 2014, 0.784; 2013, 0.783; 2012, 0.809; 2011, 0.748; 2010, 0.785; 2009, 0.748; and 2008, 0.711. IRS tables available here: <http://www.irs.gov/Individuals/International-Taxpayers/Yearly-Average-Currency-Exchange-Rates> (accessed Feb. 4, 2015); and <https://web.archive.org/web/20140331061456/http://www.irs.gov/Individuals/International-Taxpayers/Yearly-Average-Currency-Exchange-Rates> (archived Mar. 31, 2014)
- <sup>5</sup> McDonald's Corporation, Annual Report 2013, Form 10-K, Feb. 24, 2014, p.18
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- <sup>7</sup> "The euro zone: The world's biggest economic problem" *The Economist*, Oct. 25, 2014 <http://www.economist.com/news/leaders/21627620-deflation-euro-zone-all-too-close-and-extremely-dangerous-worlds-biggest-economic>; Joseph Stiglitz, "Europe's economic madness cannot continue" *The Guardian*, Jan. 9, 2015 <http://www.theguardian.com/business/2015/jan/09/europe-economic-madness-cannot-continue-greece-elections>; and European Commission, "Unemployment statistics" Eurostat (accessed Feb. 3, 2015) [http://ec.europa.eu/eurostat/statistics-explained/index.php/Unemployment\\_statistics](http://ec.europa.eu/eurostat/statistics-explained/index.php/Unemployment_statistics)
- <sup>8</sup> Ian Traynor, "Austerity pushing Europe into social and economic decline" *The Guardian*, Oct. 10, 2013 <http://www.theguardian.com/world/2013/oct/10/austerity-europe-debt-red-cross>; Paul Krugman, "Europe's Austerity Madness" *The New York Times*, Sept. 27, 2012 <http://www.nytimes.com/2012/09/28/opinion/krugman-europes-austerity-madness.html>
- <sup>9</sup> Leslie Wayne, et al., "Leaked Documents Expose Global Companies' Secret Tax Deals in Luxembourg" *The International Consortium of Investigative Journalists*, Nov. 5, 2014 <http://www.icij.org/project/lux-embourgleaks/leaked-documents-expose-global-companies-secret-tax-deals-luxembourg>
- <sup>10</sup> European Commission, "Aide d'Etat SA.38375 (2014/C) (ex 2014/NN) (ex 2014/CP) – Luxembourg, Aide présumée en faveur de FFT" June 11, 2014 [http://ec.europa.eu/competition/state\\_aid/cases/253203/253203\\_1582635\\_49\\_2.pdf](http://ec.europa.eu/competition/state_aid/cases/253203/253203_1582635_49_2.pdf)
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- <sup>13</sup> Emmanuel Paquette, "McDonald's dans le viseur du fisc français pour une évasion de 2,2 milliards d'euros" *L'Express*, Jan. 21, 2014 [http://lexpansion.lexpress.fr/entreprise/mcdo-dans-le-viseur-du-fisc-francais-pour-une-evasion-de-2-2-milliards-d-euros\\_424781.html](http://lexpansion.lexpress.fr/entreprise/mcdo-dans-le-viseur-du-fisc-francais-pour-une-evasion-de-2-2-milliards-d-euros_424781.html)
- <sup>14</sup> Gaspard Sebag and Aoife White, "Gibraltar Sees Spanish Bias as EU's Almunia Probes Tax" *Bloomberg*, Oct. 1, 2014 <http://www.bloomberg.com/news/2014-10-01/gibraltar-tax-practices-come-under-eu-scrutiny-amid-apple-probe.html>
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The total amount of tax saved in operating countries by McDonald's through the use of McD Europe Franchising Sàrl was estimated by multiplying the annual turnover of McD Europe Franchising Sàrl by the weighted average tax rate for Europe of 28.6 percent. This weighted average was weighted by McDonald's systemwide sales in ten markets: France, Germany, the United Kingdom, Italy, Spain, the Netherlands, Sweden, Austria, Poland, and Denmark. These are McDonald's largest ten markets in the European Union, accounting for nearly 80 percent of systemwide sales in Europe in 2013. All standard tax rates in this report were sourced from KPMG, "Corporate

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36 McD Europe Franchising Sàrl’s pretax income was calculated by adding tax expenses to the profit for the financial year. McD Europe Franchising Sàrl’s effective tax rate was calculated by dividing the income taxes reported in the Profit and Loss Account by the pre-tax income. McD Europe Franchising Sàrl, Annual Accounts 2010-2013, Profit and Loss Account

37 McD Europe Franchising Sàrl’s effective tax rate was calculated by dividing the income taxes reported in the Profit and Loss Account by the pre-tax income. McD Europe Franchising Sàrl, Annual Accounts 2013, Profit and Loss Account

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43 Estimated by adding McD Europe Franchising Sàrl’s pre-tax income, ‘other external charges’ and depreciation associated with intellectual property for 2009-2013, then multiplying that figure by the Luxembourg IP Box tax rate of 5.8 percent. This is the maximum amount potentially owed; the actual amount could be lower. ‘Other external charges’ are described as consisting of cost sharing expenses, royalty expenses and management fees. The deductibility of such cost sharing expenses is often the subject of tax rulings or Advance Pricing Agreements. This assumes that an investigation shows that many of McD Europe Franchising Sàrl’s costs, in particular its royalty and cost sharing arrangements, are not tax deductible. It is likely that some costs would continue to be tax deductible, and the ultimate amount of tax recoverable would be lower. McD Europe Franchising Sàrl, Annual Accounts 2010-2013, Profit and Loss Account; IP Box rate sourced from Peter R. Merrill, James R. Shanahan Jr., et al., “Is It Time for the United States to Consider the Patent Box?”, p. 1667

44 European Commission, “State aid: Commission orders Luxembourg to deliver information on tax practices” Mar. 24, 2014 [http://europa.eu/rapid/press-release\\_IP-14-309\\_en.htm](http://europa.eu/rapid/press-release_IP-14-309_en.htm)

45 Estimated by adding McD Europe Franchising Sàrl’s pre-tax income, ‘other external charges’ and depreciation associated with intellectual property for 2009-2013, then multiplying that figure by the full corporate tax rate in Luxembourg. Luxembourg’s tax rate was slightly different for some years across the period.

46 McD Europe Franchising Sàrl, Annual Accounts 2010-2013, Profit and Loss Account; see Note 43 for methodology used to calculate estimated taxes figure under the IP Box rate; see Note 45 for methodology used to calculate estimated taxes figure under the full corporate rate

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<sup>65</sup> McDonald's Sistemas de España, Inc. Annual Accounts, 2013, Cuenta de Pérdidas y Ganancias Normal

<sup>66</sup> McDonald's Europe, "A Quick Snapshot" (accessed Feb. 4, 2015) <http://www.mcdpressoffice.eu/aboutus.php>

<sup>67</sup> McDonald's Restaurants Ltd. annual accounts, 2009-2013, Profit and Loss Accounts

<sup>68</sup> The total franchise rights fee payments for 2009-2013 were multiplied by the standard corporate tax rate in the U.K. by year: 28 percent for 2009, 28 percent for 2010, 26.5 percent for 2011, 24.5 percent for 2012, and 23.25 percent for 2013.

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<sup>71</sup> See Note 4 for currency translation methodology. Turnover reported by McD Europe Franchising Sàrl was multiplied by the standard corporate tax rate in the U.K. by year. See Note 68 for annual tax rates.





***Tax Avoidance on the Menu at McDonald's***