International Comparative Study of telecom operators' taxation and tax optimization schemes of Over-The-Top players

Summary presentation

FÉDÉRATION FRANÇAISE DES TELECOMS

Greenwich Consulting

I – Specific taxation: The assessment of tax arrangements applied to telecom operators in the 6 studied countries showed 4 key learnings for France

1. France has the highest level of taxes in the telecom sector, reaching 2.98% of the total turnover of operators in 2011 (x40 vs. UK)
2. The telecom sector in France and Spain is taxed in favor of cultural industries (film industry, TV) and local authorities
3. Telecom taxes account for 20% of the French telecom operators investments in 2011
4. The Telecom taxation combined with the deterioration in operators' cash flows may cause an increase of the tax burden in the coming years

__Reminder__ of the tax system specific to the telecom sector in France

In 2011, French telecom operators paid € 1.2 billion of specific telecom taxes, which represents 2.98% of operators revenues*

Main taxes, royalties and fees specific to telecom operators

m€ 1 211

m€	Tax	Type of tax
235	Tax to fund public broadcasting called "Cope's tax"	Funding the cessation of advertising on public TV broadcaster
150	TST / COSIP	Funding TV and cinema via the CNC
41	Private copying, VOD	Funding rights holders and cinema
253	Management fees (spectrum)	Government / ARCEP
127	IFER antennas	Departments and municipalities
405	IFER copper	Regions

Analysis

- **French telecom operators paid € 1.2 billion of specific telecom taxes in 2011**
- **This level of taxation accounts for 2.98% of the total revenue of telecom operators***
- **These taxes do not benefit the telecom sector:**
  - 80% of taxes fund other industries or local authorities
  - 20% fund the telecom industry (ARCEP)
- **45% of taxes (IFER antennas and copper)** are fixed and do not take into account the economic situation of the operators

Source: FFTélécoms, Reuters, Durieux Report, Upnext Research survey, press, ADL analysis

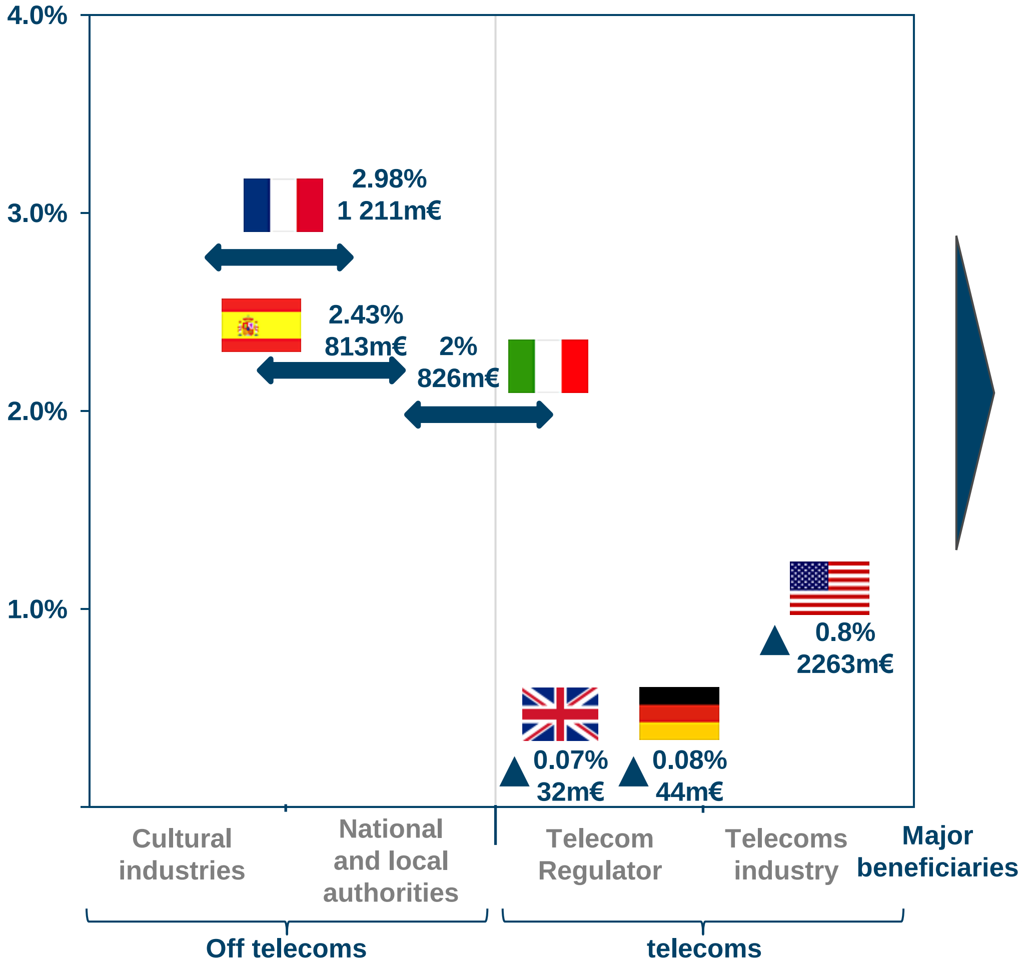
* Members of the FFTélécoms

The specific telecom taxes range from 0.07% to 2.98% of operators revenues, funding the telecom industry as well as the government budget and other industries

Tax rates and destinations of taxes

Benchmark FR, UK, SP, IT, USA, GER - 2011

Specific telecom taxes rates



Beneficiaries of specific telecom taxes

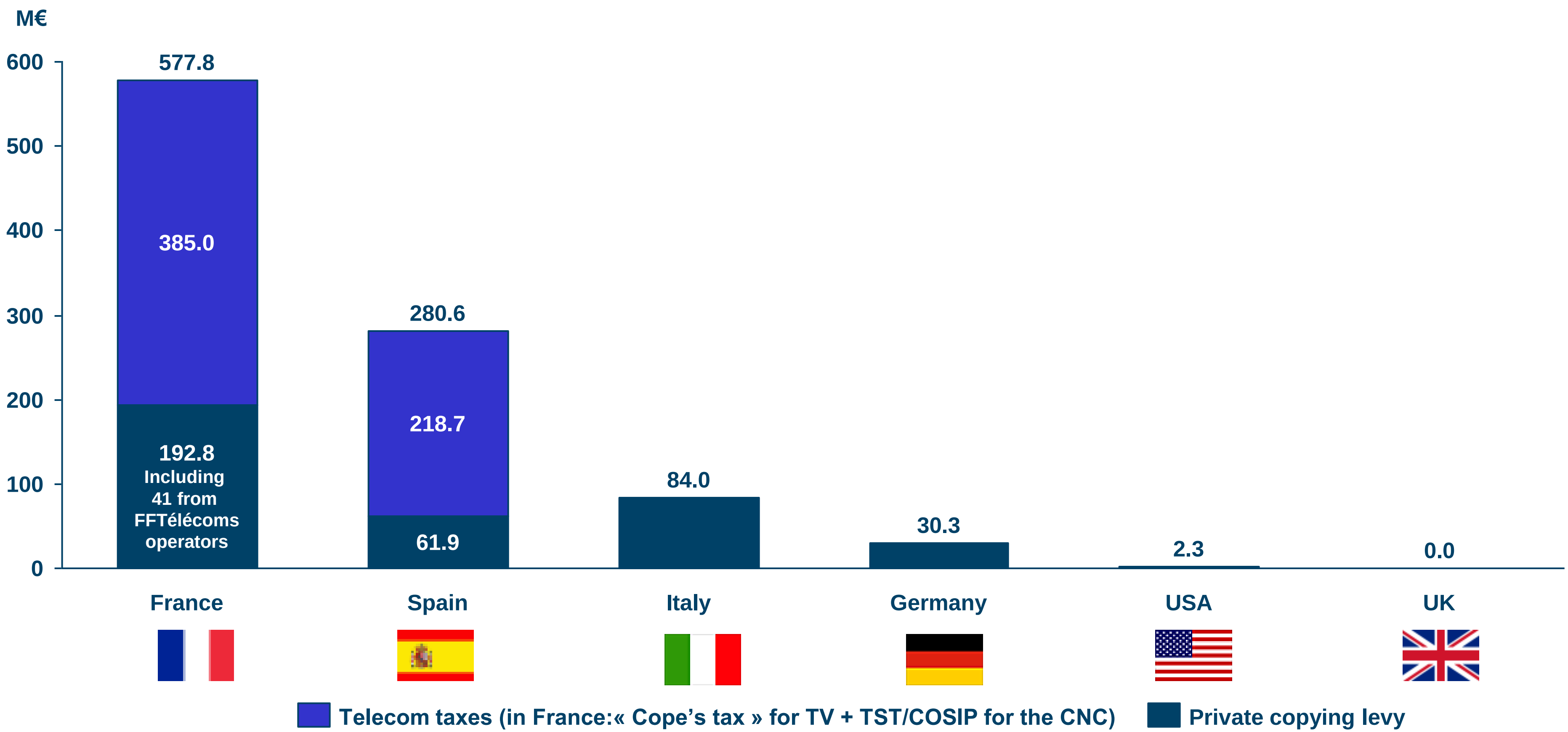
Telecom industry	• **Supply of local or public telecom services (USA)**
Telecom Regulator	• **Operating costs of telecoms regulators (all countries except the USA)**
National and local authorities	• **Funding of communities' budgets (France, Spain)** • **State funding during crisis (Greece, Hungary)** *outside the scope of this benchmark*
Cultural industries	• **Funding of public broadcasting, following the cessation of advertising (France and Spain)** • **Funding Cinema and culture (France, Spain)**

Note: Greenwich analysis on the basis of FFTélécoms members in France
Source: Redtel, ADL-FFTélécoms survey, CMT, AETA, CTIA, Wireless Association, USAC Annual report, IRS, Census Bureau, Ofcom, IE Market Research, Bundesnetzagentur AGCOM

Multiple funding **Simple funding**

France is the largest contributor to the funding of the cultural sector through the compensation for private copying levy and telecom taxes ("Cope's tax" and TST - COSIP for CNC as well as levy to compensate for private copying)

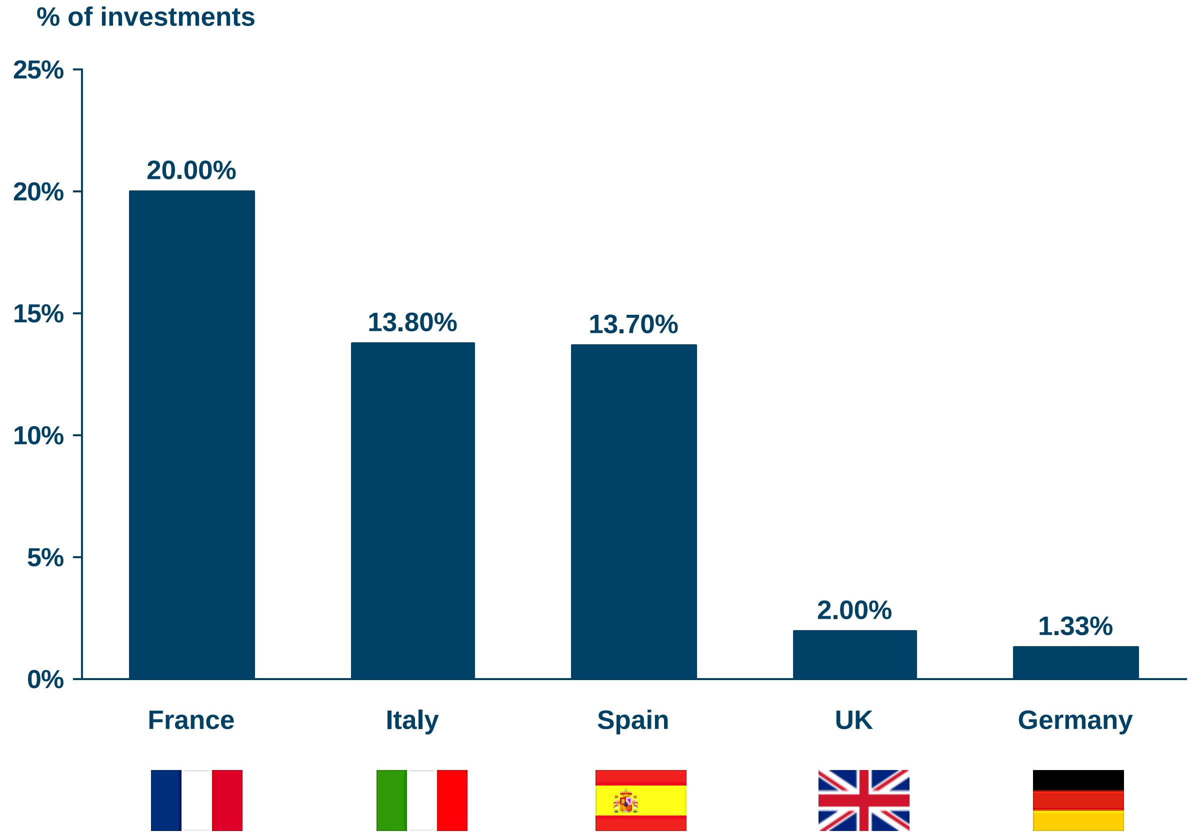
International comparative study of the funding of the cultural sector



Sources: International Survey on Private Copying, Wipo 2012, FFTélécoms, Reuters, Redtel, Spain media
Notes: Telecom taxes calculated onthe basis of FTTélécoms members in France
Notes: British law does not recognize the exception for private copying, additional copies are part of the exclusive right of exploitation

In France, specific telecom taxes account for 20% of total CAPEX of telecom operators in 2011 and therefore limit their investment capacities

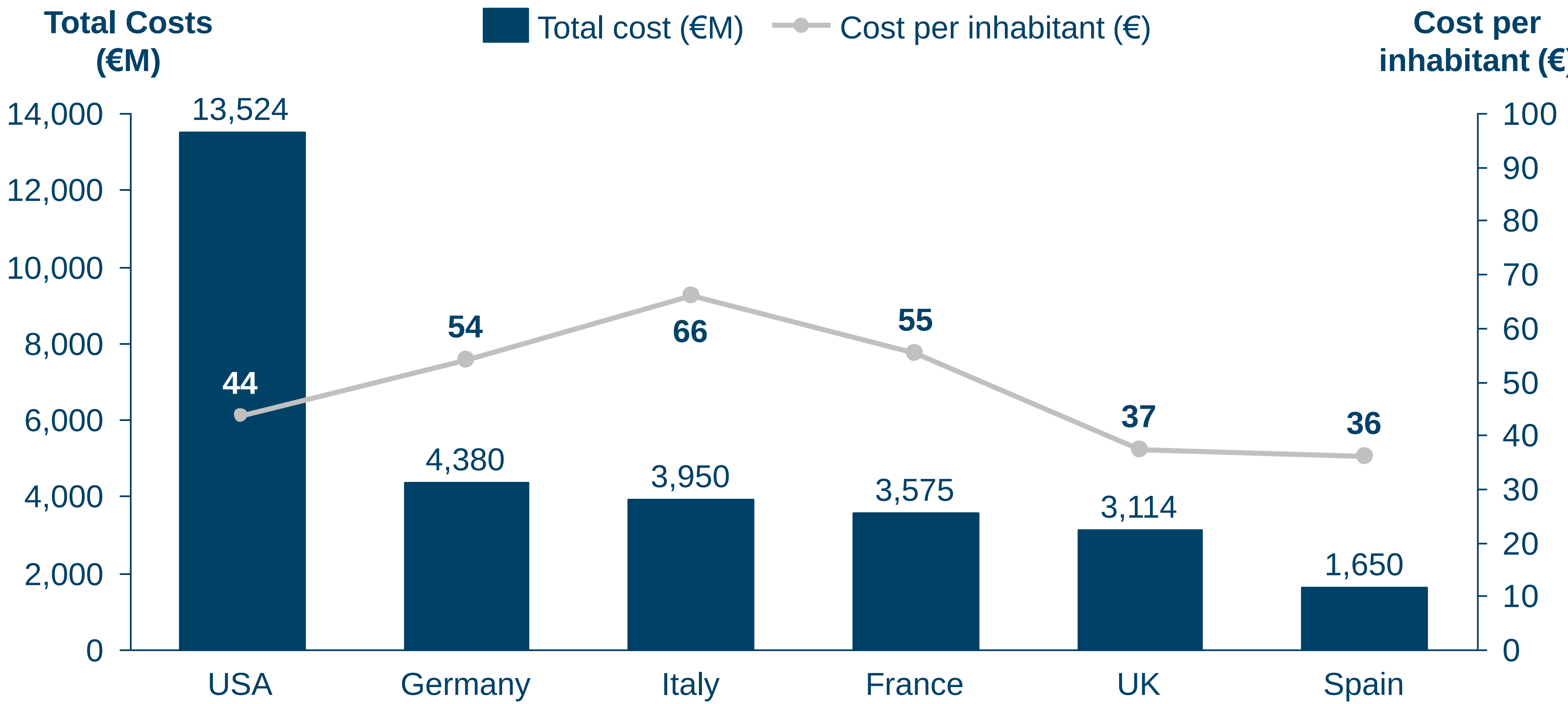
Specific taxes as a percentage of the total amount of investments



Sources: Thomson Reuters, annual reports, Redtel, Yankee Group, IE Market Research – onthe basis of FFTélécoms members in France

In addition to the € 6/7-billion annual, recurring investment, French operators acquired their 4G licenses at a high cost per inhabitant

Sums raised for the awarding of 4G licenses in the USA and Europe



*$/€ conversion rate on 01/01/2008
Source: GSMA, *European Mobile Industry Observatory 2011* - November 2011, Bernstein 2013 (UK), 2011 census for UK population

II – Fiscal optimization of "OTT players"*: An analysis of the main "Over-The-Top" players highlighted six key learnings

*OTT = Over-The-Top (Google, Apple, Facebook, Amazon, Microsoft,…)

1. **The optimization schemes of OTT players rely on tax distortions of national and European legislations as well as transfer prices between subsidiaries**

2. **Ireland, hosting many OTT headquarters in Europe, compensates the shortfall, due to its attractive tax policy regarding royalties and its low corporate taxes, by direct and indirect economic earnings** (added value, employment & growth, economy expenditures, foreign direct investments)

3. **On intangible products such as online music or digital books, Apple and Amazon pay back their entire VAT to Luxembourg, another European tax heaven**

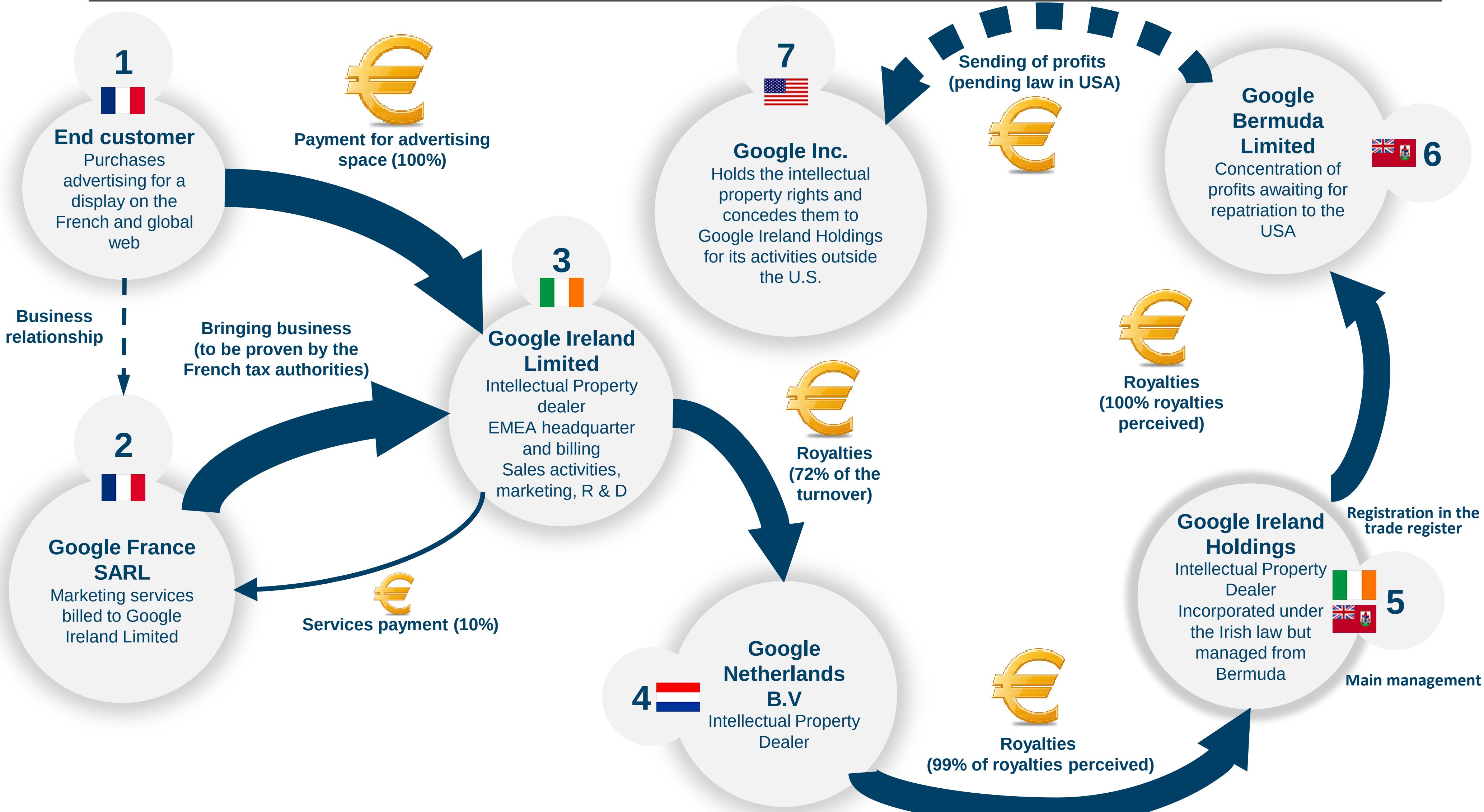
4. **These optimizations are interesting for OTT players thanks to the historic permissiveness of the U.S. federal government, particularly to encourage the international success of these champions** (Homeland Investment Act of 2005)

5. **In 2011, OTT players would have paid more than € 800m of taxes and between € 400m and € 700m of VAT in France, if their production activities had been subject to the local market rules (without any optimization) – compared to tens of millions euros actually paid in taxes**

6. **OTT players are neither the only economic players, nor the most important ones using tax optimization schemes in Europe (e.g. General Electric, Starbucks, Tesco,…)**

Corporate income taxes: Google optimizes its taxes by funneling profits through Holland and Bermuda in the form of royalties for the use of intellectual property

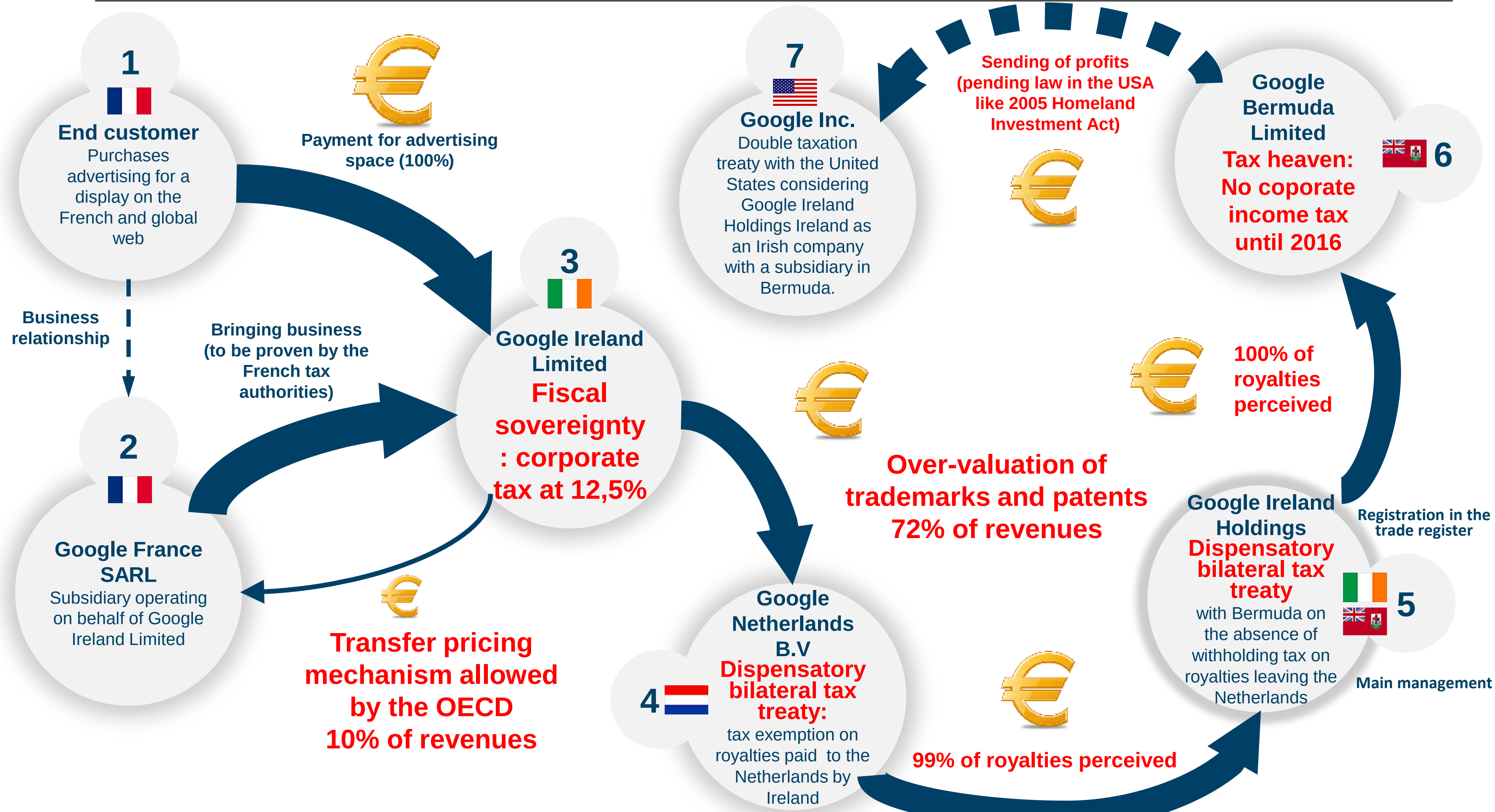
Fiscal optimization scheme: “Double Irish” & “Dutch Sandwich”



Source: New York Times, Bloomberg, The Guardian, DueDil.com, Dublin’s courts

To achieve this tax optimization scheme, Google benefits from several specific requirements and tax treaties implemented by the various countries involved and allowed by the OECD or the EU

Basic conditions making both the “Double Irish” and the “Dutch Sandwich” possible

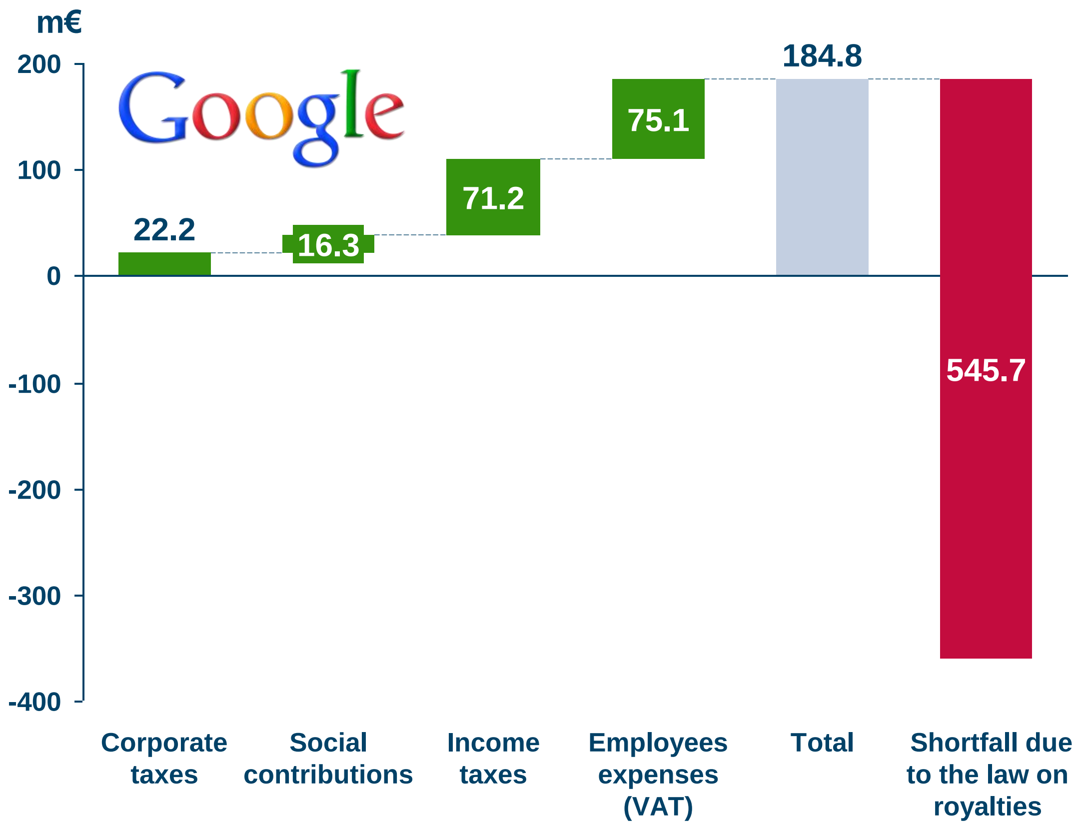


Source: New York Times, Bloomberg, The Guardian, DueDil.com, Dublin’s courts

Ireland upholds that the indirect benefits to its economy are more important than the shortfall due to its attractive taxation system

The Google case study

Comparison of direct accounting gains for the Irish State and the shortfall due to the taxation on royalties



Analysis

- **Ireland, by the presence of Google on its soil, has a significant shortfall in terms of tax revenue:**
  - 545 m€ due to the exemption from the payment of royalties
  - 1,453 m€ due to the corporate tax at 12.5% (Vs. 33.3% in France)
- **However, Ireland upholds that the following indirect gains compensate this shortfall:**
  - Added value created by employees
  - Indirect jobs related to the presence of Google in Ireland
  - Created value and spending in the economy generated by the indirect jobs (taxes and spending in the economy)
  - Real estate investments
- **Indirect gains compensating the shortfall are still to be demonstrated**
- **Ireland has an attractive fiscal and economic policy that enables tax optimization:** corporate tax rate at 12.5% and tax exemption on royalties paid to EU countries

Sources: Deloitte study “Measuring Facebook’s economic impact in Europe”, Eurostat 2009, PWC 2011, The Household Budget Survey 2009, BusinessandFinance.ie
Notes: This chart does not include indirect impacts created by B2B trade between Google and its subcontractors (spending in the economy, added value created by employees of subcontractors). Standard gross margin reported by the group in their global income statement applied to the turnover declared by Google Ireland Limited and submitted to the corporate tax at 12.5%

In 2011, the OTT players paid € 37.5 M in corporate taxes in France, 22 times less than what they would have paid, if their production activities were located and taxed in France

	Reported revenues in France	Estimated made revenues in France	Corporate income taxes paid by the OTT in France		Corporate income taxes that OTT players would have paid in France	Average annual growth rate of worldwide income
Google	138 M€	1.4 bn€	5.5 M€		162 M€	42%
Apple Inc.	257 M€	3.2 bn€	6.7 M€		317.5 M€	38%
facebook	ND	140 M€	50 k€		21.2 M€	123%
amazon.com	110 M€	890 M€	3.3 M€		10.9 M€	32%
Microsoft	584 M€	2.5 bn€	22 M€		317 M€	8%
TOTAL	1.09 bn€	8.13 bn€	37.5 M€	x22	828.7 M€	

Sources: Paris commercial court, Income statement of companies - 2011
Notes: Estimates based on Facebook UK data. Apple data based on the assumption that the majority of Apple physical products sold by third-party distribution networks are in fact sold by Apple Sales International, domiciled in Ireland and not paying corporate tax in France
Assumptions: activities charged in France with standard gross margin reported by the group in their global income statement and submitted to a corporate tax of 33.3%

The Luxembourg-based iTunes service enables Apple to benefit from a reduced VAT rate on its sales and to avoid paying VAT in France

iTunes optimization scheme

1

- Sale and download of music, videos, movies, eBooks, games and applications
- Dematerialized products sold by iTunes SARL

Payment for the purchase of dematerialized products

2

iTunes S.A.R.L

- A Luxembourg-based company, subsidiary of Apple Inc. (based in USA)
- Employs an average of 15.7 employees
- Centralizes sales of Europe, Africa and Middle East

Filiale à 100% d'Apple Inc

3

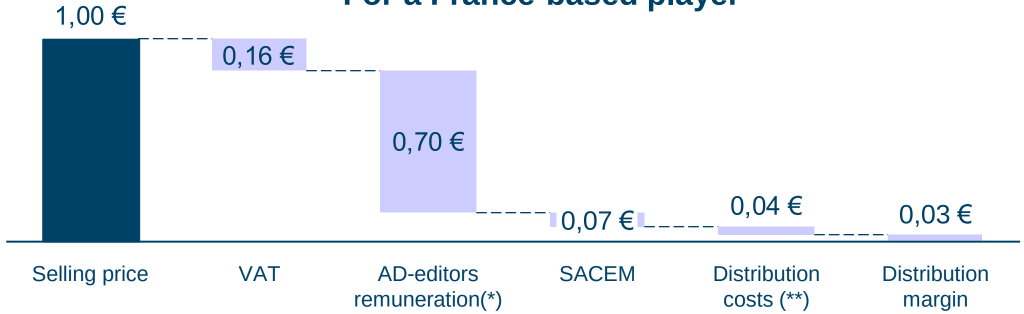
Apple Inc.

- Company based in California, USA
- Parent company of iTunes SARL

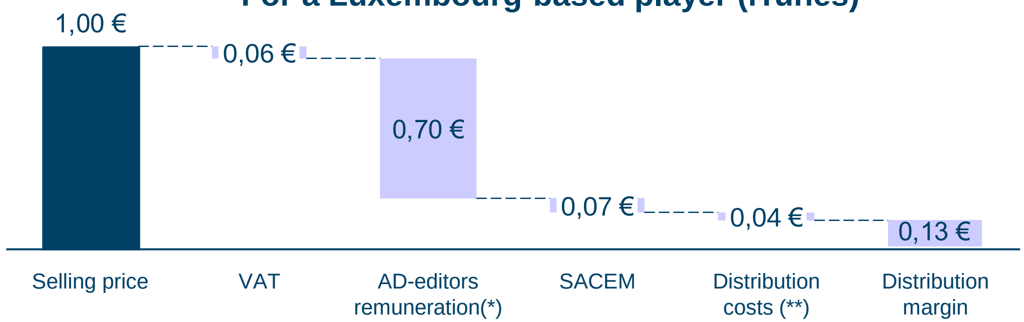
Sources: French Senate Report « Impact of the Internet growth on French State's public finances », Greenwich Consulting – October 2009

Decomposition of the value for the digital distribution (song)

For a France-based player



For a Luxembourg-based player (iTunes)

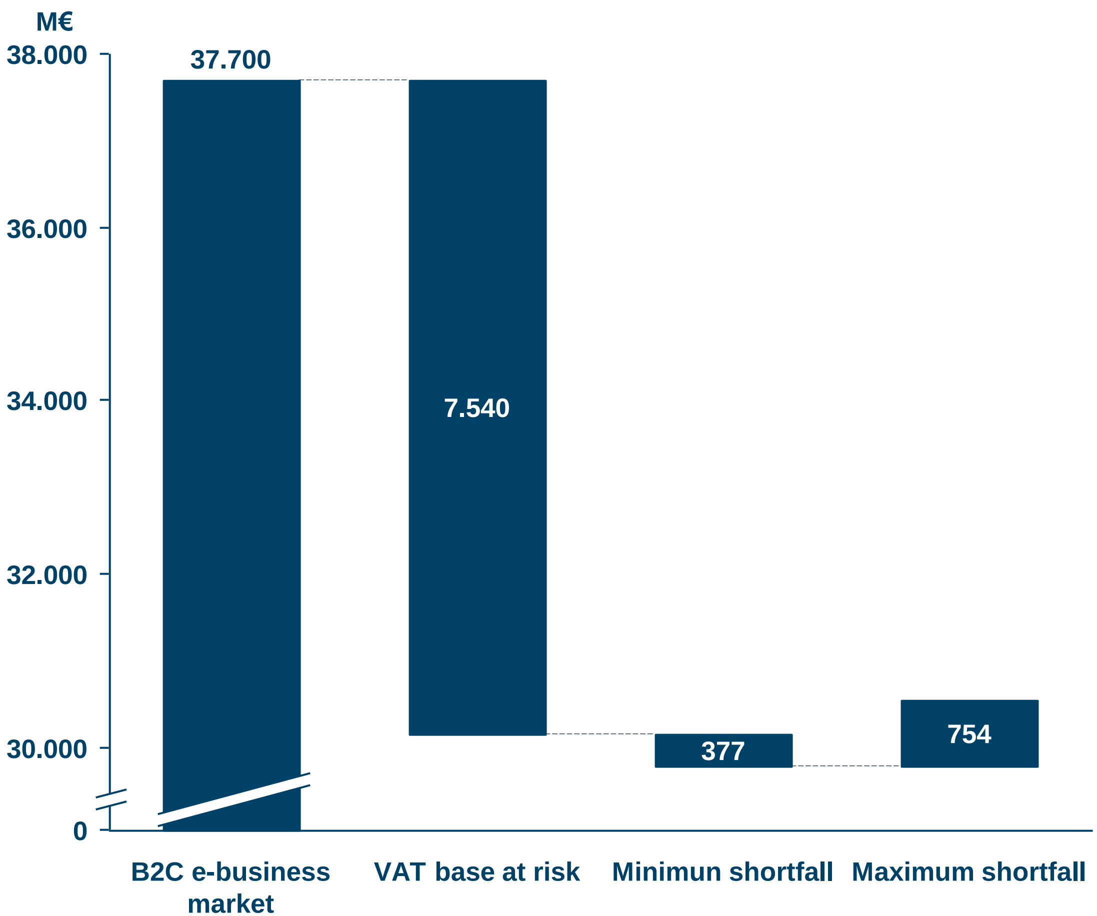


- **The real benefit of being in Luxembourg is based on the deduction of 80% of the profits from intellectual property in the calculation of the corporate taxes**
- **iTunes has a VAT rate of 6% in Luxembourg against 19.6% in France**
  - 75% of the price consists of copyright, with a VAT rate at 3%
  - 25% of the price is taxed at the standard VAT rate of 15%

Notes: Luxembourg price reported to 1€

In 2011, the shortfall in VAT due to optimizations in the e-business in France is estimated between 5% and 10% of the at-risk tax base and reached between € 377 M and € 754 M

Estimated shortfalls in VAT revenues on B2C e-business



Comments

- **The e-business market in France is € 37.7 billion in 2011, according to the French professional organisation of the sector (FEVAD)**
- **The at-risk VAT base only includes:**
  - **Dematerialized cultural products** (digital music, digital video, digital books, etc.)
  - **Some travel services***
- **The share of this tax base at risk represents approximately 20% of the French e-business, or € 7.5 billion**
- **In 2011, the shortfall is estimated between € 377 M and € 745 M** (because tax optimization in the e-business would account for 5% to 10% loss of VAT for European economies, on this at-risk tax base of € 7.5 billion)

Sources: FEVAD annual report 2012, French Senate Report « Impact of the Internet growth on French State's public finances », Greenwich Consulting – October 2009

* intangible travel services such as e-ticketing