Alliance Boots – Disclosure and Taxation

Complaint to the UK NCP under the Specific Instance Procedure of the OECD Guidelines for Multinational Enterprises

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Alliance Boots – Disclosure and Taxation

I. Introduction

This complaint summarises violations by Alliance Boots GmbH of the OECD Guidelines for Multinational Enterprises, in particular the Guidelines relating to Disclosure and Taxation, that stem from a series of transactions with related parties. During 2011, 2012 and 2013, Alliance Boots engaged in a series of transactions with related parties, involving over £400 million. As described below, entities owned and/or governed by the company's executive chairman may have sometimes profited richly at the expense of Alliance Boots.

Alliance Boots has made insufficient disclosures in 2011, 2012 and 2013 about its related party transactions and governance procedures related thereto. During those years, Alliance Boots made unknown interest payments to related parties. The transactions potentially involved serious conflicts of interest, the disclosure of which would be in the public and stakeholders' interest. In failing to make necessary disclosures about these transactions, Alliance Boots has violated Chapter III (Disclosure) of the OECD Guidelines for Multinational Enterprises.

In addition, over the previous four years, these same transactions with related parties have shifted profits from the United Kingdom to tax havens, resulting in avoided taxes at a great cost to the UK public. The transactions with related parties involved transfer of hundreds of millions of pounds between Alliance Boots and entities apparently controlled, directly and indirectly, by the executive chairman of Alliance Boots, Stefano Pessina and located in Luxembourg. Thus these transactions also violated Chapter XI (Taxation) of the OECD Guidelines for Multinational Enterprises.

The company's failures have created, and continue to create, lasting harm for UK citizens by depriving them of social services and other government functions that would have been paid for with the avoided taxes. The company's use of transactions with related parties to shift profits from the UK also undermines the rule of law and public trust in the fairness of the tax system. The public and civil society must be able to assess the behaviour of corporations to determine whether the present legal regime is adequate and serves the public interest. Adequate corporate disclosure allows the public to be informed on issues that have a substantial bearing on the national economy and the democratic system in the UK.

This complaint:

(a) identifies the authors of the complaint and their interest in the case;
(b) describes the multinational enterprise that is the subject of the complaint and provides relevant background information about the company's financial situation and related parties;
(c) outlines the reasons that the UK NCP is the proper NCP to review this specific instance;
(d) provides detailed information and evidence establishing that the company has breached chapter III of the OECD Guidelines for Multinational Enterprises; and
(e) provides detailed information and evidence establishing that the company has breached chapter XI of the OECD Guidelines for Multinational Enterprises.

II. Complainants

War on Want is a UK charity that campaigns against the root causes of poverty and human rights violations as part of the worldwide movement for global justice. Our vision is a world free from poverty and oppression, based on social justice, equality and human rights for all. War on Want believes that poverty is political. The decisions of politicians in rich countries can mean life or death for people in poorer countries. War on Want's Tax Justice Now campaign works to challenge the abuse of the world's tax systems by multinational companies and the structures that enable them, to ensure all countries can collect tax revenues effectively and equitably.

Change to Win is a partnership of American unions founded in 2005 that pursues initiatives to strengthen workers' rights and consumer protections, core pillars to rebuild the American middle class. CtW works in coalition with trade unions globally on cross-border issues affecting workers, consumers and the public good. Change to Win affiliates represent workers in the pharmacy sector.

Within the UK, complex tax avoidance schemes cost HM Treasury an estimated £32 billion to £120 billion each year.[1] At a time of ongoing austerity and economic uncertainty, the effects of tax avoidance are extremely serious. The British public has an interest in knowing the extent to which companies are engaging in such behaviour. Indeed, over the last several years, large numbers of UK citizens have engaged in public demonstrations and boycotts targeted at flagrant tax avoiders. HM Revenue and Customs ("HMRC") and the Government have also acknowledged the depth of the problem of tax avoidance and have stated that they are taking measures to address this important issue. Complainants believe that increased corporate transparency, coupled with strong corporate governance regimes, can help to curb tax avoidance and other destructive practices.

Complainants seek mediation that results in a reform of company disclosure practices, tax risk assessment, and related corporate governance policies.

III. The Multinational Enterprise: Alliance Boots

Alliance Boots GmbH (hereafter "Alliance Boots," "AB" or "the company" or "the group") is a multinational enterprise with significant operations in the UK and 35% of the group's revenue is generated in the UK. The group's headquarters and registered office is in Bern, Switzerland.[2] The company describes itself as a "leading international, pharmacy-led health and beauty group delivering a range of products and services to customers."[3] It operates in two sectors: retail pharmacy and pharmaceutical wholesale distribution. In recent years, the company has expanded into offering healthcare services such as clinical homecare.

Boots the Chemist was founded in 1849 in Nottingham, England. Boots expanded to become one of Britain's best-known brands and a ubiquitous high street chemist. In 2006, Boots merged with European

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[1] HM Revenue & Customs, Measuring Tax Gaps 2012: Tax gap estimates for 2010-11; Tax Research UK, Tax Briefing: Why HM Revenue & Customs have got the Tax Gap wrong, June 2010.
[2] Alliance Boots Annual Report (2012-2013). See Appendix A.
[3] *Id*. at 2.

wholesaler Alliance UniChem Plc, to form Alliance Boots Plc. One year later, the company went private in a £11.1 billion management-led buyout, with equity capital supplied by executive chairman Stefano Pessina, private equity funds controlled by Kohlberg Kravis Roberts (KKR) and additional minority investors, along with £9.02 billion in debt guaranteed by a UK subsidiary. The deal was the first leveraged buyout (LBO) of a FTSE 100 company and the largest ever LBO in Europe. Upon going private, AB relocated its headquarters to the low-tax canton of Zug in Switzerland while removing ultimate ownership to a holding company located in Gibraltar.

The company has over £22 billion in turnover, employs more than 108,000 workers and operates in 25 countries, according to its most recent annual report. The company maintains significant operations and management in its former headquarters in Nottingham. The company also maintains a corporate office in London.

A. Background facts: Alliance Boots' debt

The related party transactions that are the subject of this complaint involved debt issued by Alliance Boots to fund its 2007 leveraged buyout. As noted above, the LBO was financed predominantly through debt. The money was originally lent by a consortium of banks: Bank of America, Barclay's Capital, Citigroup, Deutsche Bank, JP Morgan, Merrill Lynch, Royal Bank of Scotland and Unicredit Group. The banks subsequently collateralised the loans and sold them to investors. The finance costs related to this debt wiped out the company's profit entirely for the first year following the LBO and have continued to consume a large percentage of the company's trading profit.[4] Within a month of going private, the company's new directors "declared and paid interim dividends during the period totalling £1,550 million."[5]

The company chose to allocate most or all of its debt in the UK, which allows the company to deduct the interest paid from its UK taxes.[6] The UK is the company's most profitable jurisdiction and generates more than two-thirds of total profits by our estimates, but only 35% of revenue. The interest deductions within the UK significantly reduce the taxes owed by the company.[7]

B. Background facts: Parties related to Alliance Boots

Following the 2007 leveraged buyout, Alliance Boots was owned by a holding company in Gibraltar half controlled by Alliance Boots' executive chairman, Stefano Pessina, and half controlled by KKR. In June 2012, Alliance Boots announced a two-step transaction with the U.S. retail pharmacy operator Walgreen Co. In August 2012, Walgreen closed on the first step of the transaction and now owns 45% of Alliance

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[4] Additionally, the finance costs related to this debt wiped out the company's profit from operations entirely for two years following the LBO. *See* Alliance Boots consolidated financial statements for years 2008-2013.
[5] Press Release, Alliance Boots Ltd., Half-yearly financial report for the six months ended 30 September 2007 (Nov. 30, 2007).
[6] See Appendix C. A set of schedules of the interest deductions from UK trading profit is attached as Appendix D.
[7] *Id*.

Boots. Walgreen has an option to buy the remaining 55% of AB in 2015. At present, that majority stake remains in the hands of the Gibraltar holding company, which is owned in equal shares by certain KKR funds and Stefano Pessina.[8]

Stefano Pessina appears to control a number of finance entities located in Luxembourg and the Cayman Islands that hold direct and indirect ownership stakes in Alliance Boots or have engaged in transactions with the company. In transactions with Alliance Boots, entities apparently controlled by Stefano Pessina have achieved exceptionally profitable results, sometimes at the expense of Alliance Boots. The conflict of interest between the company and its executive chairman is not addressed at any point in the public disclosures made by Alliance Boots. These transactions are outlined below.

Pessina's related entities include:

- ❖ AF Lux Finance S.A. – a Luxembourg-registered company. The sole shareholder is Alliance Finance Ltd.[9] Stefano Pessina is a director.
- ❖ Dascoli Finance S.A. – a Luxembourg-registered company; Stefano Pessina is the sole shareholder and a director.
- ❖ Alliance Santé Participations S.A – a Luxembourg-registered company that jointly controls AB Acquisitions Holdings Limited, the Gibraltar-based holding company that owns 55% of Alliance Boots.
- ❖ Alliance Finance Ltd. – a Cayman Islands-registered company with unclear ownership; full owner of AF Lux Finance S.A.

IV. The UK NCP is the proper NCP to assess this specific instance.

As outlined above, Alliance Boots derives roughly two-thirds of its profit from the UK, has a major part of its operations in the UK, and has deep roots in the UK. And, as the complaint will explain below, the conduct giving rise to this complaint and the harm created by such conduct have occurred within the UK.

The Commentary on the Implementation Procedures of the OECD Guidelines for Multinational Enterprises instructs: "Generally, issues will be dealt with by the NCP of the country in which the issues have arisen."[10] Thus, a complaint should be adjudicated in the jurisdiction in which the complained-of action and resulting harm took place. This complaint centres on Alliance Boots' actions in the UK and the resulting harm to the UK public. Thus, the UK NCP should conduct the initial assessment and subsequent proceedings under the NCP procedures.

V. Alliance Boots has violated Chapter III (Disclosure) of the OECD Guidelines for Multinational Enterprises by failing to disclose information about its transactions with related parties.

[8] For more information about the KKR funds and structure of KKR ownership, see Appendix F.
[9] AF Lux Finance S.A. Extraordinary General Meeting, May 19, 2009, Minutes. See Appendix G for more information about Pessina-controlled entities and for related corporate documents.
[10] Para. 23, Commentary on the Implementation Procedures of the OECD Guidelines for Multinational Enterprises.

Alliance Boots' transactions with entities apparently controlled by Pessina raise serious questions about whether the terms of the transactions were fair and transparent, whether the company properly handled significant conflicts of interest, and the adequacy of its corporate governance policies. Its 2011, 2012 and 2013 disclosures about the transactions have been skeletal and have done nothing to lessen the opacity of the transactions. They fail to include material information about the terms of the transactions and include no information about the procedures for handling conflicts of interest among board members and executive level employees.

A. The Disclosure Guideline

Chapter III of the OECD Guidelines for Multinational Enterprises instructs:

> "Enterprises should ensure that timely and accurate information is disclosed on all material matters regarding their activities, structure, financial situation, performance, ownership and governance. This information should be disclosed for the enterprise as a whole, and, where appropriate, along business lines or geographic areas. Disclosure policies of enterprises should be tailored to the nature, size, and location of the enterprise, with due regard taken of costs, business confidentiality and other competitive concerns."[11]

Chapter III specifies that disclosure policies should include, among other things, material information about related party transactions, foreseeable risk factors and "governance structures and policies, in particular, the content of any corporate governance code or policy and its implementation process."[12]

The commentary explains that "[t]he purpose of this chapter is to encourage improved understanding of the operations of multinational enterprises. Clear and complete information on enterprises is important to a variety of users ranging from shareholders and the financial community to other constituencies such as workers, local communities, special interest groups, governments and society at large."[13] The commentary also notes that the OECD Principles of Corporate Governance are an important touchstone and that the Disclosure Guideline "should be construed in relation to them."[14]

The OECD Principles of Corporate Governance provide relevant guidance with respect to the Guidelines' call for disclosure of related party transactions: "Transactions involving the major shareholders (or their close family, relations etc.), either directly or indirectly are potentially the most difficult type of transactions."[15] As a result, the board is directed to engage in "[m]onitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions."[16]

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[11] Ch. III, Para. 1, OECD Guidelines for Multinational Enterprises.
[12] Ch. III, Para. 2, OECD Guidelines for Multinational Enterprises.
[13] Para. 28, Commentary on Disclosure, OECD Guidelines for Multinational Enterprises.
[14] Para. 29, Commentary on Disclosure, OECD Guidelines for Multinational Enterprises.
[15] Ch. V., Para. 5, Annotations to the OECD Principles of Corporate Governance.
[16] Pr. VI, Para. D(6). OECD Principles of Corporate Governance.

B. Background information about the related party transactions

The company has failed to disclose material information about two separate sets of related party transactions, detailed here. While the transactions began prior to the enactment of the 2011 OECD Guidelines for Multinational Enterprises, the transactions have been ongoing and the failures of disclosure have continued to the present day and thus are covered by the 2011 Guidelines.

The first set of transactions involves related parties Walvis Limited and Walvis 2 Limited (hereinafter "Walvis Companies"), Irish companies controlled by Stefano Pessina's Luxembourg-based finance company, Dascoli Finance. These entities purchased approximately £227 million of AB's senior and subordinated facility bank loans between 2009 and 2012. Alliance Boots does not disclose in its annual reports how much it has paid in finance income to Dascoli Finance via the Walvis Companies.

The purchase of Alliance Boots' debt by the Walvis Companies occurred at or about the same time as Alliance Boots purchased profit participating notes from the Walvis Companies. Profit participating notes are hybrid financial instruments that combine elements of a loan with elements of an equity stake. While the terms of participation vary from note to note, they generally involve a loan, in which the note holder is entitled to both a set interest rate and a percentage of the profits of the issuer.

Beginning in Fiscal Year 2010, AB began acquiring profit participating notes issued by Walvis Limited. By Fiscal Year 2013, AB held £154.9 million in profit participating notes issued by Walvis Limited and Walvis 2 Limited. These notes were valued at £171.6 million, including rolled-up interest, with an additional £11.1 million in interest receivable. As detailed below, although both parties profited from this transaction, the Walvis companies likely received the lion's share of profits.

The second set of transactions involve related party AF Lux Finance S.A., which purchased £30 million worth of Alliance Boots' senior facility bank loans in 2009. Over the next four years, the total finance income on these loans paid to AF Lux Finance S.A. by Alliance Boots was £4.4 million. According to Alliance Boots' 2013 Annual Report, the company repurchased its loans at market value from AF Lux Finance S.A. on March 21, 2013.[17] While the company has not disclosed the precise nature of Pessina's relationship to AF Lux Finance S.A. except to state that Pessina is a director of the finance company, it does disclose these transactions as "related party transactions."

In both sets of transactions, the repurchases came after the bond market had mostly rebounded from the global financial crisis; had AB repurchased the loans earlier, in all likelihood it would have paid a much lower price for them.

C. Failure to disclose material information about related party transactions

Alliance Boots' 2012-2013 Annual Report discloses the following information about these related party transactions: (1) the amount of company debt held by related parties at a set date; (2) in certain

[17] Alliance Boots Annual Report (2012-2013), at 116.

transactions, the amount paid by the company to re-purchase its own debt; and (3) the face value of the profit participating notes purchased by the company, as well as the carrying value. The full text of these disclosures is included as Appendix H.

These bare-bones disclosures do not provide the public and stakeholders with enough information to gauge the extent to which a management insider may have profited from self-dealing and tax avoidance through related party transactions. Nor is it possible from these disclosures to assess whether the company has sufficient corporate governance measures in place. Rather, these minimal disclosures raise the question of the extent to which tax avoidance, insider enrichment and/or the off-shoring of wealth may have been the main or sole purposes of the transactions.

At the most basic level, these disclosures omit numerous material facts about the terms underlying the notes bought by the Walvis Companies and AF Lux Finance S.A. They do not disclose the rates, purchase price or other terms of the loans that were purchased by Dascoli (via the Walvis Companies) and AF Lux Finance S.A.[18] They do not disclose the total finance income received by Pessina's finance companies, nor do they report the profit made by the related parties on the sale of the debt in 2013, after the bond market had rebounded.[19] These figures are material information because they would allow the public to assess whether these transactions may have involved the result of arm's length negotiations or, by contrast, the result of self-dealing and the inappropriate use of insider information.

The company also failed to disclose in its annual report and consolidated financial statements how it accounted for the interest paid to the Walvis Companies and AF Lux Finance S.A., in particular whether the payments were deducted from taxable income in the UK as a business expense or whether they were treated (for tax purposes) as dividend payments.

The disclosures about Alliance Boots' purchase of profit participating notes from the Walvis Companies are similarly inadequate. These entities appear to have funded their purchase of Alliance Boots loans mostly through issuing profit participating notes, which were purchased in turn by Alliance Boots. When Alliance Boots redeemed the notes in Fiscal Year 2013, it earned a 9% profit (£13.9 million). In contrast, Pessina-related entities likely kept the bulk of the return on the linked transactions, which came from the sale of AB loans, and which may have returned more than 65% on the purchase price if the loans

[18] The debt issued by Alliance Boots was issued as private loans by banks; the banks subsequently repackaged these loans and marketed them as collateralized loan obligations ("CLOs"). CLOs are traded on a secondary market, and are typically only purchased by large institutional buyers. Information about the loans is thus difficult to come by for the public. If the debt had been issued as bonds, the market would have been more transparent, making it easier for members of the public to obtain information about the debt, including the covenants on the debt, and the marketing materials. Complainants have attached, as Appendix B, the only information publicly available about the CLOs, which they obtained from Bloomberg.

[19] The Walvis Companies purchased the Alliance Boots debt at a time when it was trading for a deep discount; they sold it back to the company at a time when the bond market had rebounded so they likely sold it at, or close to, par. In addition to the general recovery of the bond market, the Walgreen transaction caused Alliance Boots loans to trade closer to par, according to media reports. Chris Burritt, *Walgreen to Buy 45% Stake in Boots for $6.7 Billion*, BLOOMBERG, June 19, 2012.

were sold at par.[20] Full disclosure of material facts would have included substantial information about the profit participating notes, including what the terms and rates were, whether Alliance Boots was the only purchaser of the notes, whether there was any obstacle to Alliance Boots simply repurchasing its loans when they were trading at a significant discount (rather than funding another entity to do so, at a profit to that entity), and whether the transaction was negotiated with board oversight and following proper procedures. This information would allow the public and stakeholders to assess whether and to what extent these transactions may have involved self-dealing, profit shifting or avoidance of taxation.

Perhaps most importantly, the company does not disclose whether either set of transactions was discussed and approved by the board, and if so, whether the interested directors participated in this discussion. Given the conflict of interest between the company and its interested directors, the procedures followed to ensure that the conflict of interest did not taint the transaction are material and should have been disclosed to the public.[21] While the company has a general conflicts of interest policy that applies to employees, there is no indication if it applies to board members and, if it does, what procedures and principles the board follows to address conflicts of interest.[22] Moreover, the board's actions since 2007, including the dividend re-capitalisation, raise the question of whether the board has engaged in self-dealing that benefitted the company's private equity owners while risking the firm's ongoing financial health, and whether the board has a meaningful policy with respect to conflicts on the board.[23]

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[20] The market price of the Alliance Boots loans could have been as low as 50-65% of par during the first half of 2010, based on reported pricing for CLOs during that period. If the Dascoli entities purchased the AB debt at 60% of par in 2010 (£136.2 million) and sold at par in 2013 (£227 million), the return would have been 67%. While the company repurchased the debt at £247.6, this price included rolled up interest. We thus assume that the company repurchased at or near par. For CLO pricing information see: Jody Sheen, *CLO Price Drop Exacerbated as Wall Street Banks `Flooded' Market, RBS Says*, BLOOMBERG, June 3, 2010, available at http://www.bloomberg.com/news/2010-06-03/clo-price-drop-exacerbated-as-wall-street-banks-flooded-market-rbs-says.html.

[21] Pr. V, Para. A(8), OECD Principles of Corporate Governance (disclosure should include information about governance policies and process of implementation); Ch. VI., Para. D(6), Annotations to the OECD Principles of Corporate Governance (emphasizing the importance of the board's role in managing potential conflicts of interest).

[22] See Alliance Boots, Code of Conduct and Business Ethics (March 2012), available at http://www.allianceboots.com/corporate-governance/code-of-conduct.aspx.

[23] Much has been written about best practices for handling a conflict of interest on the board. One commentator has explained: "A director who acts with a conflict of interest may breach his or her duty of loyalty to the company and its stockholders. . . As a director, should you perceive a conflict of interest on the part of any board member, you should insist on full, prompt disclosure of the conflict to the board prior to any action on the issue. You should also insist on a process that assures that only the disinterested directors will make the required decision based on full information and with the help of any independent expert advice needed." Thomas J. Dougherty, THE DIRECTORS' HANDBOOK at 6 (CSC 2013). Indeed, the Companies Act (2006) imposes a duty on company directors to "promote the success of the company," which includes "(a) the likely consequences of any decision in the long term, (b)the interests of the company's employees, (c)the need to foster the company's business relationships with suppliers, customers and others, (d)the impact of the company's operations on the community and the environment, (e)the desirability of the company maintaining a reputation for high standards of business conduct, and (f)the need to act fairly as between members of the company." Section 172 of the Companies Act (2006). Additional sections of the law require directors to avoid conflicts of interest. Section 175 of the Companies Act (2006).

Finally, the company's annual reports do not disclose crucial facts about the related parties themselves, such as up-to-date information about beneficial ownership and management structures. The related parties have chosen to locate themselves in jurisdictions with legal regimes that require no disclosure of beneficial ownership of a company or the officers and directors of a company.[24] This material information would, if disclosed, allow stakeholders and the public to assess the nature of the relationship between these parties, whether the transaction could truly have been at arm's length, and whether any patterns of corporate opportunism or unfair allocation of profits are evident.[25]

VI. Alliance Boots has violated Chapter XI (Taxation) of the OECD Guidelines for Multinational Enterprises by shifting profits from the UK to Luxembourg.

From 2009 to 2013, Alliance Boots' transactions with the Walvis Companies and with AF Lux Finance S.A. appear to have lawfully shifted profits to related parties, via finance companies located in Luxembourg. Alliance Boots and related parties structured the transactions so that the company was paying money to related parties to enable them to buy up company debt, even as the company continued to pay interest to the related parties. The company thus used opacity and complex financial transactions to achieve a net economic effect that belies the outward appearance of the transactions. By treating a payment to a related party as interest, rather than dividends, the company may deduct the payment from its taxable income. Shifting profits in this way erodes the British tax base, to the detriment of the British public, and undermines the public's trust in a fair and impartial tax system.

A. The Tax Guideline

Chapter XI of the Guidelines emphasises a broad-based approach to corporate tax compliance: "enterprises should comply with both the letter and spirit of the tax laws and regulations of the countries in which they operate."[26] The Guidelines identify tax compliance as an essential component of strong corporate governance: "Enterprises should treat tax governance and tax compliance as important elements of their oversight and broader risk management systems. In particular, corporate boards should adopt tax risk management strategies to ensure that the financial, regulatory and reputational risks associated with taxation are fully identified and evaluated."[27]

The commentary to Chapter XI clarifies that, to comply with the "letter and spirit" of relevant tax laws, "[t]ransactions should not be structured in a way that will have tax results that are inconsistent with the underlying economic consequences of the transaction unless there exists specific legislation designed to

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[24] Financial Secrecy Index – Luxembourg, Narrative Report on Luxembourg, available at http://www.financialsecrecyindex.com/PDF/Luxembourg.pdf; Financial Secrecy Index – Cayman Islands, Narrative Report on Cayman Islands, available at http://www.financialsecrecyindex.com/PDF/CaymanIslands.pdf.

[25] Indeed, Prime Minister Cameron has obtained agreements from British Overseas Territories that they will take steps to institute a registry of beneficial ownership of companies, and is pushing for other countries in the G8 to do the same. See Press Release, HM Treasury, G8 2013: Concrete action agreed on tax transparency (June 17, 2013), available at https://www.gov.uk/government/news/g8-2013-concrete-action-agreed-on-tax-transparency.

[26] Ch. XI, Para. 1, OECD Guidelines for Multinational Enterprises.

[27] Ch. XI, Para. 2, OECD Guidelines for Multinational Enterprises.

give that result."[28] The Guidelines instruct that "[a]n enterprise complies with the spirit of the tax laws and regulations if it takes reasonable steps to determine the intention of the legislature and interprets those tax rules consistent with that intention in light of the statutory language and relevant, contemporaneous legislative history."[29]

The commentary also instructs that corporate boards should play an active role in developing "appropriate tax policy principles" and in establishing "internal tax control systems so that the actions of management are consistent with the views of the board with regard to tax risk" and that these systems should reflect "commitments to co-operation, transparency and tax compliance."[30]

Included in the commentary is also discussion of the issue of the improper methods to shift profits or losses.[31] The OECD has recently issued additional guidance on the issue of profit shifting to avoid taxes, namely its report "Addressing Base Erosion and Profit Shifting." This report clarifies much of the commentary in the Taxation Guideline, emphasising, for example, that strategies involving the use of excessive leverage, related party debt financing, and similar methods "may be technically legal" but "erode the corporate tax base of many countries in a manner that is not intended by domestic policy."[32] Thus, certain forms of base erosion, especially when they are implemented as a part of broader aggressive tax avoidance schemes, may involve transactions that violate the spirit of tax laws and thus run afoul of the Tax Guideline.

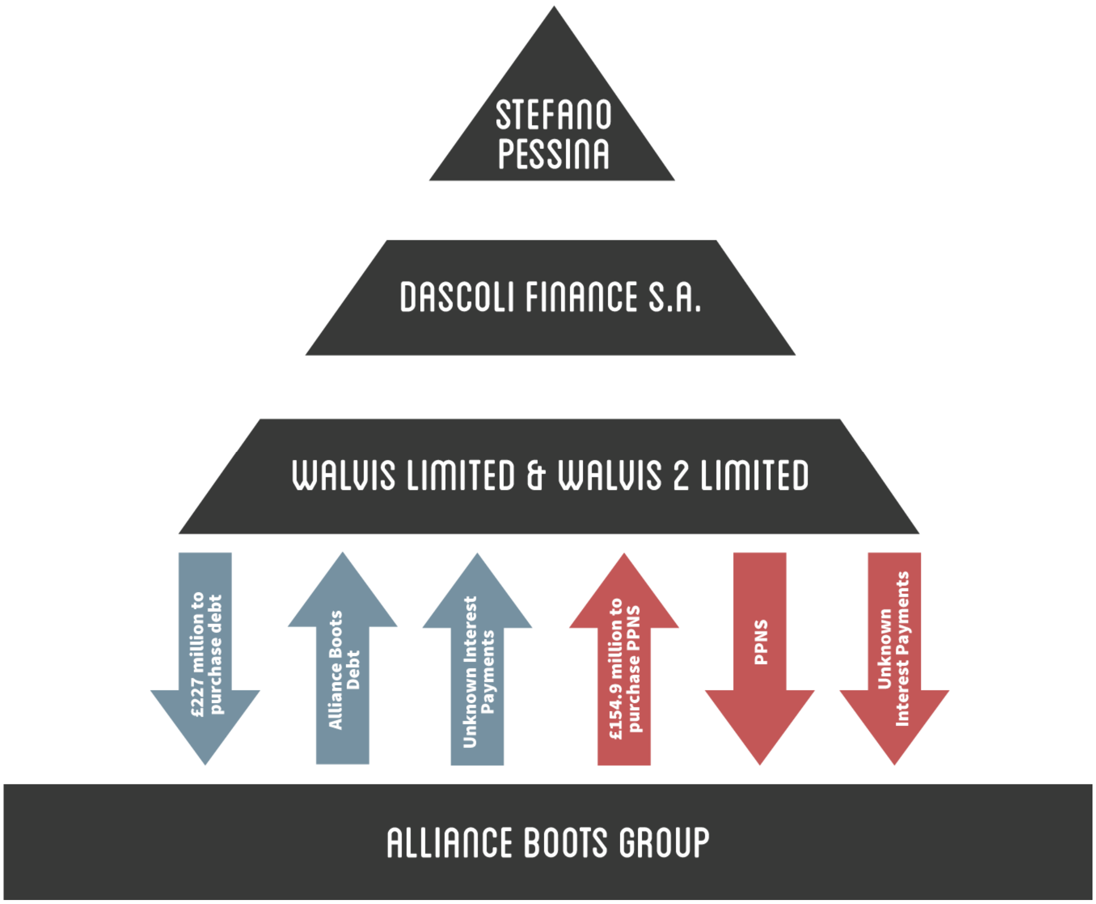
B. The related party transactions

The related party transactions described above resulted in the company paying interest to entities located in Luxembourg on debt worth well over £200 million. It appears that AB treated the payments as interest payments for accounting and, presumably, tax purposes. As such, the payments would have been deducted from the company's total taxable income. In contrast, if the payments had been treated as dividends, they would not have been deducted from the company's taxable income. Thus, it appears that these interest payments should be understood as shifted profits – instead of paying them out as dividends, the company treated them as a "business expense," deducted them and sent it to Luxembourg.

The company did not technically break the law by treating an interest payment to a related party as an interest payment. However, complainants believe that there is a strong case to demonstrate that the company has violated the spirit of the tax laws by structuring these transactions in a way that avoided payment of taxes to the UK, especially where the recipient was a related party that benefited at the expense of the company. These transactions were almost entirely funded by Alliance Boots: (1) Alliance Boots purchased profit participating notes issued by the Walvis Companies; (2) the Walvis Companies, funded in part by these profit participating notes, purchased collateralised loans issued by Alliance

[28] Para. 100, Commentary on Taxation, OECD Guidelines for Multinational Enterprises.
[29] Para. 100, Commentary on Taxation, OECD Guidelines for Multinational Enterprises.
[30] Para. 102, Commentary on Taxation, OECD Guidelines for Multinational Enterprises.
[31] Para. 104, Commentary on Taxation, OECD Guidelines for Multinational Enterprises.
[32] Organization for Economic Co-Operation & Development, Addressing Base Erosion and Profit Shifting, at 45.

Boots; (3) the Walvis Companies sold the loans at a profit on top of previous interest payments; and (4) Alliance Boots redeemed the profit participating notes, at a profit, while the Walvis Companies likely retained the bulk of the profits made on these transactions.



The transactions described above give rise to interest payments that the company deducts from its taxable income; however, these transactions are structured so that the company that has issued the loan is paying another company to buy up its debt, and then deducting the interest payments made on debt that it has paid to have purchased. This is a textbook example of a transaction "structured in a way that will have tax results that are inconsistent with the underlying economic consequences of the transaction," according to the Guidelines.[33] This scheme makes use of complex financial instruments, shell financial companies in Luxembourg, and payments from one party to finance the purchase of company debt in a circular manner that benefited the related parties. The opacity and complexity of the scheme serves to obscure the company's actions, but the outcome – shifting profits abroad – is clear. The transactions are structured to transfigure profits and avoid taxes in a manner that violates the Guidelines.

[33] Para. 100, Commentary on Taxation, OECD Guidelines for Multinational Enterprises.

The initial harm of this transaction was the shifting of profits abroad, via interest payments to related parties along with the gains from the transaction that should have accrued to the company but went instead to the related parties, thus eroding the UK tax base. However, the ongoing harms of these transactions are broader. First, the transactions undermine public confidence in the fairness and transparency of the taxation system. The UK public has been shocked by a series of scandals involving companies that shirk their UK tax obligations through transactions with related entities in tax havens. In response the Government has undertaken investigations of corporate tax avoidance and taken steps to implement a General Anti-Avoidance Rule. Second, this series of transactions creates significant tax benefits and thus unfairly disadvantages locally held businesses that pay their fair share and cannot engage in the complex financial transactions and multinational manoeuvring that the company has used.[34]

Finally, the existence of this series of apparently abusive transactions suggests that the company's tax compliance regime and related corporate governance regimes are insufficient. This failure constitutes a separate violation of the Guidelines' directive that "corporate boards should adopt tax risk management strategies to ensure that the financial, regulatory and reputational risks associated with taxation are fully identified and evaluated."[35] As stated above, the company's disclosures regarding these transactions are inadequate, and the company has given no indication that it has revised, updated, or improved its governance regimes to better identify and react to risks associated with the company's tax planning.

In summary, the transactions between Alliance Boots and entities apparently controlled by Pessina violated the OECD Guideline on Taxation. They have shifted profits abroad, through a series of complex transactions, the net effect of which differs from that suggested by the outward form of the transactions. The very complexity of these transactions also serves to obfuscate the economic consequences, the tax implications and the lack of apparent corporate purpose of the transactions. Finally, these transactions suggest that Alliance Boots has insufficient corporate governance and tax governance measures in place, insomuch as the board appears to have approved a series of transactions that potentially involve self-dealing, at the expense of the company, for no justifiable economic reason.

VII. Remedies sought

The complainants seek, through mediation, concrete reforms of the company's governance and disclosure procedures to bring them in line with the Guidelines' requirements, to be implemented in a timely manner. In particular, the complainants seek disclosures of the material aspects of related party transactions, including information about beneficial ownership of the related parties and material information about the terms of the transactions. And, complainants seek public explanation and disclosure of the tax implications of the related party transactions described above, along with the

[34] House of Lords, Select Committee on Economic Affairs, "Tackling corporate tax avoidance in a global economy: Is a new approach needed?," 2013-4, H.L. 48, at 8.
[35] Ch. XI, Para. 2, OECD Guidelines for Multinational Enterprises.

creation of a company policy concerning related party transactions that prohibits the types of abusive transactions outlined above.