

SOMO



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Executive summary and key findings

A cache of files, **known as the Shell Files**, which came to light following a hack on the oil company's servers in 2020, **shines a spotlight on how the process known as “transfer pricing” operates.**



Transfer pricing is a phenomenon peculiar to multinational corporations (MNCs). These companies often consist of hundreds, sometimes thousands, of separate subsidiary companies registered in different countries. The majority of the subsidiaries in a multinational group are considered separate legal entities, although overall control usually rests with the parent company.

Transfer pricing refers to how the companies within an MNC price transactions between themselves, such as when one company in the group sells goods or services to another. This matters because companies in different countries face very different tax rates. If costs are high in higher-tax jurisdictions and an MNC maximises profits in lower- or no-tax jurisdictions, then the MNC overall pays less tax, retains more after-tax profit, and can return this to shareholders.

Transfer pricing – or, rather, the abuse of transfer pricing – facilitates corporate tax avoidance. To combat this abuse, the Organisation for Economic Co-operation and Development (OECD) has developed international guidance on transfer pricing: the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2022). Tax authorities worldwide use this guidance.

The Shell Files include thousands of documents, but are nonetheless only a snapshot of Shell's tax practices. However, within the documentation, which includes transfer pricing reports that are not usually made public, we can see how the company applies the OECD Transfer Pricing Guidelines. This report is based on three case studies that emerge from the Shell Files.

The first case study focuses on Shell Western Trading and Supply (SWST) in The Bahamas. SWST undertakes all Shell's oil trading for Latin America and West Africa. In the period covered in this report (2018–23), the tax rate in The Bahamas was 0 per cent. SWST made \$ 6.2 billion in profit in that time, none of which was taxed.

Using data from the Shell Files and a basic metric (profit per employee) to compare different corporate entities and their profits, SOMO found that SWST in The Bahamas was a staggering 104 times more profitable than the average Shell operation. Much of the oil trading that SWST carried out was with other Shell companies, buying oil from Shell in Nigeria and Brazil among others and selling to Shell trading companies in the UK and Singapore. Transfer pricing is therefore a key element of how SWST operates.

At the core of the OECD Transfer Pricing Guidelines is the idea that related companies in a corporate group should, when trading with each other, act as if they were unrelated and pursue their own economic interests. This fiction, known as the 'arm's length principle' ('ALP'), is difficult to sustain, given it involves simulating a reality that is largely counter to the way MNCs work.

The OECD provides methods ostensibly intended to allow companies like Shell to achieve the ALP. One of these is a 'functions, assets, and risks' ('FAR') analysis. The Shell Files show how Shell allocates functions (such as governance) and risks (such as arbitrage risk) to each of its subsidiaries involved in oil and gas trades with SWST. The process allows Shell to decide which subsidiary bears most risk and contributes most value to the trade. This ultimately leads to decisions on

which subsidiary captures the most profit (with, in SWST's case, one of them located in a 0 per cent tax jurisdiction).

Shell denies that its subsidiary in The Bahamas is there for profit shifting reasons, but can provide no other explanation. The Bahamas has no logical role in the trading of crude oil.

The second case study looks at Shell Brands International (SBI) in Switzerland, where Shell holds much of its intellectual property (IP). This case study puts a spotlight on how companies can use different methods over time to justify tax and transfer pricing arrangements. Prior to 2017, Shell used a process that referenced a discredited rule of thumb called the 25 per cent rule. Initially when SOMO asked Shell to explain how it could justify using a rule that has been described as junk science, the company said it did not use it. On being pressed, Shell said it used the rule only to test assumptions. These assumptions, based on the transfer pricing documents in the Shell Files, were that SBI should get 25 per cent of profits on IP licensing.

Shell no longer uses this approach. Since 2017, Shell says, it has “utilized various third-party licensing agreements as benchmarks”. This means Shell looks at what third-party licensees pay for using SBI's trademarks. It then uses these royalty rates as comparators for what Shell's subsidiaries should pay to SBI. This appears reasonable. But, as the case study notes, empirical studies simulating transfer pricing benchmarking have found a 200 per cent or greater difference between the lowest and highest profit margin achieved in comparable transactions. Under the OECD Guidelines, any figure in the benchmarking range is acceptable. And it is the company itself, with its clear self-interest in after-tax profits, that makes the choice of where to position itself against the benchmarked transaction.

The third case study looks at the UK and Netherlands and Shell's provision of services ‘at cost’ (meaning the companies providing the services aim to make no profit). Within the Shell Files, and in subsequent correspondence with SOMO, Shell has provided several justifications for at-cost service provision. The case study shows how a range of OECD processes can be mixed and matched, with opaque results. First, in its tax reports, Shell refers to ‘cost contribution arrangements’ (CCAs). These allow companies to provide services at cost within formal arrangements where the same companies stand to benefit from the agreement. Costs and benefits are shared, so a company could provide a service at cost because it would benefit from the profits made by the companies to which it provided the service. However, there is no evidence that Shell's UK and Dutch subsidiaries that provide a range of services such as IT to the wider Shell group benefit from CCAs.

Shell also refers to joint ventures (JVs) and production sharing agreements (PSAs), common arrangements in the oil and gas industry, where a subsidiary of Shell has agreements with other actors involved in oil and gas extraction in a specific country. Within such agreements, the partners may not be able to charge for services. But, again, the UK- and Netherlands-based Shell companies are not extraction companies and not known to be involved in JVs or PSAs.

Shell stated to SOMO that the at-cost arrangements “are embedded in cost contribution arrangements (CCAs), under which costs are allocated based on expected benefits in line with OECD guidance”. But being embedded in CCAs is not the same as being party to a CCA, and Shell’s response raises more questions than it answers.

Indeed, the partial illumination of the murky world of transfer pricing that the Shell Files enable raises many questions, of which many go unanswered due to the opacity of companies on this issue.

The Shell Files also allow us to look anew at the OECD Transfer Pricing Guidelines and how this guidance, far from addressing transfer pricing abuse, can be used to facilitate it and, as a consequence, enable aggressive tax avoidance.¹

The OECD Guidelines almost completely disregard the self-interested intentions of MNCs. They are a technical tool that, although frequently cited in relation to addressing MNCs’ tax avoidance, are not intended for this purpose at all. They frame themselves as a tool for companies and tax authorities to assess how best to account for the tax payments of MNCs working across a range of jurisdictions, and specifically how to avoid double taxation.

The fact that the OECD Guidelines are not set up to address tax avoidance, despite transfer pricing being a cornerstone of this problem, largely explains why they have been so lacking in positive impact in this regard. However, the guidelines have a more insidious effect. Because so many companies, governments, and

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even civil society groups refer to them as part of the solution to tax avoidance, they have become a sort of smokescreen. Based on the Shell Files, it is easy to see why.

A central limitation is that the OECD Guidelines ignore the role of subsidiaries as tax avoidance structures. The guidelines start from an unwritten assumption that anywhere a company has a subsidiary is legitimate, and they proceed to provide guidance on how transactions should be priced between related subsidiaries. The OECD has no concern about why Shell has a trading office in The Bahamas, where the tax rate was 0 per cent before the country adopted the global minimum 15 per cent tax rate in 2024.

What the OECD Guidelines offer companies is complex technical guidance on how to calculate the transfer price. They provide a smorgasbord of options for companies to work with, combined with a level of technicality that is open to manipulation.

The OECD's arm's length principle (ALP) is central to how transfer pricing – and consequently the allocation of taxable profits – is ostensibly assessed and addressed. Yet the way the guidelines explain the ALP raises questions. The OECD acknowledges a significant range of difficulties in applying the ALP by finding comparable transactions, particularly when it comes to obtaining data for comparison. Despite setting out a range of problems with the ALP, to which it offers no solution, the OECD also describes the ALP as having a sound theoretical basis.

Self-evidently, the ALP is an untenable fiction. It asks MNC groups with a clear self-interest and imperative to maximise 'shareholder value' to operate in a manner directly opposite to their natural inclination.

The OECD Guidelines exhibit no recognition of any potential conflict of interest.

This report concludes that, in terms of addressing MNCs' tax avoidance, the OECD Transfer Pricing Guidelines are unsound. All three case studies show up their weaknesses. The solution to criticism, perfected by the OECD, is to keep elaborating ever more technical details and guidance, providing a lucrative business opportunity for tax consultancies and specialists to write lengthy documents that tax authorities and tax justice advocates must wade through.

Companies' ability to manipulate and bamboozle, using tools created by the OECD, often under corporate influence, must be removed. The OECD's role in corporate tax issues is already discredited, and a United Nations process is underway. This report offers additional reasons to move tax discussions into this new space.

Fundamental changes to tax systems for MNCs are needed. Unitary taxation with formulary apportionment is the foremost proposal that has gained traction. It aims to align MNCs' reported profits with their genuine economic activity and to reduce opportunities for tax avoidance by taxing them as single entities. To achieve this, it takes an MNC's total worldwide profit and distributes this profit between the jurisdictions where the company does business, based on real-world metrics such as payroll, tangible assets, and sales. This would effectively limit profit shifting and put a halt to global corporate tax avoidance.

Introduction



While tax avoidance has been well documented over the past decades, various aspects of how companies accomplish tax avoidance remain opaque and hidden from the public. **Among the most significant of these is transfer pricing.** Transfer pricing is an accounting system whereby multinational corporate groups **price internal transactions** between their separate business entities.

A corporate group's transfer pricing practices can determine where it accounts for its profits or losses. If a group abuses the practice, it can use transfer pricing to decide whether it ends up reporting profits according to where the substance of its business occurs, or if it instead reports profits in jurisdictions where it can take advantage of the lowest tax rates. See Box 1 at the end of this Introduction for more on transfer pricing.

The Tax Justice Network estimates that transactions within corporate groups account for more than a third of all international trade, worth trillions of dollars a year.² Much of the pricing of these transactions happens through the practice of transfer pricing.³

This report exposes how one multinational corporation (MNC), the oil company Shell, uses the system of transfer pricing. The report comprises three case studies that provide insight into the essential weaknesses of transfer pricing from the perspective of tax fairness, and how MNCs can abuse transfer pricing to shift their profits to tax havens like The Bahamas and Switzerland.

The Shell Files

This report is based on analysis of documents acquired from Shell's servers. In December 2020, hackers infiltrated Shell's file sharing application.⁴ In March 2021, Shell released a statement acknowledging the hack and stating that it had "addressed the vulnerabilities".⁵ However, by then the hackers had posted the data to the dark web,⁶ from where Distributed Denial of Secrets (DDoS),⁷ a non-profit organisation that specialises in publishing leaked and hacked datasets in the public interest, retrieved it. DDoS made the documents available to download, after which the Organized Crime and Corruption Reporting Project (OCCRP) authenticated and indexed them and made them available for analysis.

The Shell Files hack comprises approximately 200,000 documents, including emails, confidential transfer pricing reports (which Shell usually shares only with tax authorities), millions of transactions described on Shell's general ledger, and much more.

SOMO has decided to use data obtained through hacking because we believe that what the Shell Files expose is of significant public interest. An additional consideration is the persistent opacity of MNCs like Shell about their transfer pricing arrangements. There is no publicly accessible way to find out what is disclosed in the Shell Files.

While the scope of global corporate tax avoidance is well documented – costing societies approximately \$ 350 billion per year⁸ – the methods corporations use to avoid paying their fair share of tax are often unknown. The Shell Files provide unprecedented insight into how Shell uses – and can abuse – transfer pricing to shift its profits to low-tax jurisdictions.

Tax avoidance and the means by which it is accomplished have serious implications for the public in all affected countries, as the practice denies governments revenues needed to fund vital public services. Exposing the mechanics of transfer pricing will help close loopholes that have enabled unjust corporate enrichment at the expense of society for too long.

SOMO informed Shell in advance of publication that we would use the data obtained from its servers. We also gave Shell the opportunity to review the findings in this report, and we put additional clarifying questions to the company. Shell's response did not answer most questions we posed but is nevertheless reflected in this report.

Publication of underlying documents

To accompany this report, SOMO is publishing three of the transfer pricing reports that underlie our findings, both to be transparent about the evidence supporting our analysis and because of their public interest importance. We have taken care to publish only what is needed to support our analysis and conclusions and to redact all personal and non-essential information.

Tax avoidance and profit shifting explained

MNCs that use tax havens to avoid taxes generally do so by shifting their profits to these low-tax jurisdictions, away from subsidiaries in jurisdictions that levy higher taxes. Corporate groups shift profits by creating financial flows between affiliated subsidiaries. To do this, MNCs often establish subsidiaries in low- or no-tax jurisdictions where there is no clear business rationale for the subsidiary to be there. This is the case with subsidiaries in well-known tax havens such as the British Virgin Islands and The Bahamas. MNCs may also have subsidiaries in low-tax jurisdictions where there are legitimate and defensible business operations and then shift additional profits to these subsidiaries to reduce the tax liabilities of subsidiaries in higher-tax jurisdictions.

In either case, the core mechanics of tax avoidance involve subsidiaries in higher-tax countries making payments to entities located in low-tax jurisdictions, thereby reducing their tax liabilities. These payments usually take the form of interest on loans, royalties for intellectual property (IP) rights, and payments for goods and services.

Since these transactions occur between subsidiaries of the same corporate group, the parent corporation can structure and price them to shift profits to whichever subsidiary is taxed at a lower rate. The outcome is that the corporate group as a whole, which owns all the subsidiaries, pays less tax overall.⁹ Total resulting global corporate tax avoidance currently amounts to an estimated \$ 347.6 billion a year.¹⁰

The main sign of profit shifting to a low-tax jurisdiction is high profits that do not appear to relate to real economic activity in that jurisdiction. Generating profits through loans, the licensing of IP rights, and provision of services does not require many personnel or significant production facilities. The subsidiaries MNCs use to avoid taxes often employ relatively few people and own limited fixed tangible assets. Their profits are often self-evidently out of proportion to the size of their operations.

The three case studies in this report refer to the average profit specific Shell subsidiaries generate per employee. We compare this metric to the average profit per employee of the Shell group overall. The underlying assumption is that, while profits generated per employee will vary, significant outliers – such as cases where average profit per employee of a subsidiary is over 100 times greater than the average for the group – indicate artificial profit shifting.

The ‘profit per employee’ metric is widely used in tax justice work to assess whether the profit an MNC reports aligns with the actual work it undertakes in a specific jurisdiction, or whether it is artificially shifting profits to avoid tax. Profit per employee is a useful metric because employment data is generally a reliable indicator of economic reality and not easily manipulated; also, since the start of country-by-country reporting in the European Union,¹¹ high-quality information on this is now publicly available.¹²

There are variations on the ‘profit per employee’ metric, and it is often used alongside other indicators in tax justice analysis that seeks to establish whether profit is being reported where it is really generated.¹³

Tax avoidance and the climate crisis

The erosion of public finance through corporate tax avoidance is especially significant today, considering the global climate crisis. Shell has played a significant role in creating the climate crisis. The Carbon Majors database ranks Shell ninth among 180 companies and governments in terms of total historic CO₂ emissions.¹⁴ Shell is estimated to account for approximately 2 per cent of all global CO₂ emissions relating to fossil fuels and cement since 1751.¹⁵

The climate crisis is having a devastating impact on human life. To mitigate climate change, and to adapt to the damage it has already brought about, governments need to raise substantial public finance. The 2024 UN Climate Conference agreed that governments will need to raise \$ 1.3 trillion per year to tackle the crisis, representing a 13-fold increase compared to current commitments.¹⁶

Putting an end to the tax avoidance schemes this report identifies, and ensuring that companies like Shell pay their fair share of tax, can play an important role in closing the climate finance gap.

Report structure and approach

This report consists mainly of three case studies describing different transfer pricing issues within the Shell group of companies. All three cases are based on analysis of the Shell Files dataset. Each case study contains a description of the methodological approach specific to it.

The first case study considers how Shell shifts profits to its oil trading subsidiary in The Bahamas, likely to the detriment of tax revenues for Brazil and Nigeria. The second case describes how Shell has located the IP rights to its trademarks within a low-taxed Swiss subsidiary. The third case provides insight into how Shell subsidiaries in the Netherlands and the United Kingdom have provided services to the Shell group at cost.

Following the case studies, a further chapter considers the efficacy of the OECD Transfer Pricing Guidelines, and the report's Conclusions sum up our findings and make recommendations concerning unitary taxation with formulary

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apportionment that we commend to national governments, the European Union, and the OECD – which has been the main institution involved in setting up international rules and guidance on transfer pricing.

Box 1. Transfer pricing in more detail

MNCs – business organisations that own and control the production of goods and/or delivery of services in more than one country – are major actors in the global economy. They are responsible for over 30 per cent of the world's gross domestic product and a quarter of global employment.¹⁷

MNCs operate in an integrated manner, as single organisations with a shared corporate strategy and economic direction under common ownership. Yet although they function as a concerted economic group, each MNC comprises **legally separate entities** that often trade goods and services with each other. Such trades are known as **intra-group transactions** between **related parties**.

The prices and conditions of transactions between **unrelated parties** – entities that have their own independent economic interests and belong to different corporate groups – are set based on market dynamics and the self-interest of each entity involved. Related parties engaging in intra-group transactions, however, operate differently. They ultimately have the same shared economic self-interest, as they are part of the same MNC. This means that the pricing of transaction between them is not based on standard commercial considerations and can be established based on how the MNC group as a whole will benefit.

In an attempt to regulate intra-group transactions, governments developed and gradually adopted **transfer pricing** guidance during the second half of the twentieth century. Today, under the aegis of the OECD, the transfer pricing system comprises **rules and methods for pricing intra-group transactions** that most of the world's major economies broadly apply.

The system relies on comparing intra-group transactions with transactions between unrelated parties, with the view that that the price agreed between related parties should be the same as, or similar to, the price agreed in a **comparable transaction** between unrelated parties. From the perspective of an MNC, the transfer pricing system in effect establishes rules for allocating profits within the group among the different countries in which its business activities take place.

This approach to transfer pricing – based on trying to get related subsidiaries to price intra-group transactions as if they were unrelated – is known as the **arm's length principle (ALP)**.

The ALP seeks to identify comparable transactions in the open market and use them as **benchmarks** to price intra-group transactions. This approach ignores fundamental aspects of how MNCs operate that make comparisons to open market operations unfeasible or unrealistic – such as shared functions between group subsidiaries, economies of scale, and synergies resulting from integration. The transfer pricing system's efforts to address these issues has led to a complex set of processes and rules.

The ALP prescribes that, to identify a comparable transaction approximate to the intra-group transaction, the MNC needs a detailed overview of the functions performed, assets used, and risks assumed by the different entities in an intra-group transaction. This is known as a **functional analysis** and seeks to assess the exact conditions of the transaction and define the most appropriate approach to identifying a benchmark transaction.

To identify and select comparable transactions for use as benchmarks, the OECD has established **five methods** through its **Transfer Pricing Guidelines**.¹⁸ The OECD Guidelines have had wide influence and been incorporated into some national laws. The five methods fall into two categories:

- Traditional transaction methods rely on actual transactions and directly compare the terms and conditions of the intra-group transaction with those of unrelated parties in comparable transactions. This category comprises the comparable uncontrolled price (CUP) method, the cost-plus method, and the resale price method (RPM).
- Transactional profit methods rely on assessing net operating profits of intra-group transactions and comparing them to those of unrelated parties in comparable transactions. This category comprises the transactional net-margin method (TNMM) and the profit-split method (PSM).

Irrespective of these methods, the transfer pricing system is unable to provide a fair solution to intra-group allocations related to shared functions – including research and development, finance, and central services like IT and human resources. This is best exemplified by hard-to-value intangible assets, such as intellectual property and industrial patents. Due to their unique nature and ease of mobility, and the use of group synergies for their development, intra-group transactions involving these assets have no natural comparable equivalent in the open market.

While the system can at times deliver clear comparables for simple transactions, its application becomes increasingly challenging as the complexity of transactions rises. Currently the ALP often delivers a scope of acceptable prices instead of a single answer in such complex scenarios. This presents MNCs with a choice of approaches for allocating profits among subsidiaries in line with their overall fiscal strategy. In effect, the transfer pricing system encourages MNCs to create complex structures and transactions that enable them to plan and control how much tax they pay and where, and thereby to minimise their tax liability.

1. Shell's Bahamian oil trade



Most people know Shell – formerly called Royal Dutch Shell – **as one of the world’s largest oil producers**. Shell extracts petroleum around the world, refines it, and then sells it to consumers through its nearly 50,000 petrol stations.¹⁹ What fewer people know is that Shell **also runs a large trading operation**, which buys and sells oil and gas produced by Shell and its competitors.

Shell’s trading operations are spread around the world. According to its website and its transfer pricing reporting, Shell’s traders operate mainly out of its offices in Houston, London, Dubai, Rotterdam, and Singapore.^{20, 21} This case study provides information on one of the trading operations Shell does not highlight on its website: Shell Western Supply and Trading (SWST) based in The Bahamas.²²

SWST has operated in The Bahamas since 2018, when it moved there from Barbados.²³ Between 2018 and 2023, the company employed an average of 37 staff, who cover “all the crude trading activities related to West Africa and Latin America”.²⁴ These regions include significant jurisdictions for Shell in terms of oil production, most prominently Brazil and Nigeria. Shell’s fields in Brazil have become its single largest source of oil in recent years.²⁵ Once SWST has acquired Shell’s oil from West Africa and Latin America, it sells it on to Shell’s refineries and to third parties. Shell’s refineries process the crude oil and then sell it back to a Shell trading company like SWST. The trading companies then sell the refined oil to third parties or to Shell subsidiaries that either market it or use it to develop chemical products.²⁶

In oil industry terms, The Bahamas is not an important jurisdiction. In 2022, the country imported approximately \$ 3.9 billion in refined petroleum and re-exported \$ 1.3 billion’s worth.²⁷ The country does not produce crude oil, and Shell has no refining or manufacturing operations there.²⁸ So why is SWST based in The Bahamas?

There is one clear benefit to operating in The Bahamas: tax. The Bahamas is widely recognised as a tax haven, a jurisdiction that provides foreign corporations with tax benefits and a high level of secrecy. It ranks eleventh in the Corporate Tax Haven Index, which is a ranking of countries most complicit in helping MNCs underpay corporate income tax.²⁹ Until 2023, The Bahamas’ corporate income tax rate was 0 per cent.

Shell claims that it does not use tax havens to avoid taxes on activities that take place elsewhere. It states that its entities based in low-tax jurisdictions exist for substantive and commercial reasons. Shell did not respond to SOMO’s request for

information on what substantive or commercial reasons led the company to place an oil trading subsidiary in The Bahamas.

Profit per employee in the Bahamas: an indicator of profit shifting

Between 2018 and 2023, SWST's 37 employees managed to generate \$ 6.2 billion in profits, roughly \$ 168 million per employee, or approximately \$ 28 million per employee per year.³⁰ By comparison, the average annual profit per employee across the Shell group was \$ 270,000. Even in 2020, when the economic impacts of COVID-19 led to Shell overall declaring a \$ 21.5 billion loss,³¹ SWST still generated an average \$18.6 million profit per employee. This means that, between 2018 and 2023, Shell's Bahamian employees have been 104 times more effective at generating profits than their colleagues abroad. Shell paid \$ 0 in corporate income taxes on its \$ 6.2 billion Bahamian profits during those years.

We can compare this situation with the profit per employee data for other Shell companies that SWST directly traded with. The general ledger that is part of the Shell Files shows that, within the Shell group, SWST trades oil primarily with oil-producing subsidiaries in Brazil and Nigeria and with trading subsidiaries in the UK and Singapore. In these jurisdictions, the profit per employee ratio was significantly lower than in The Bahamas.

Over the same period, as we saw above, Shell's average profit per employee was \$ 270,000 per year. In Singapore – itself generally regarded as a tax haven³² – profit per employee was \$ 615,000, about 2.3 times the average across the Shell group. Shell's Brazilian subsidiaries reported losses in 2018–23, despite Shell's fields in Brazil having become one of its largest sources of oil in recent years.

In the UK, average profit per employee was \$ 158,000 per year over 2018–23, amounting to 0.6 times the Shell average. In Nigeria, profit per employee was \$ 439,000, or 1.6 times the average. Thus, profit per employee at SWST, at 104 times the average, was significantly higher than at Shell's subsidiaries involved in oil trading in other jurisdictions, which come out at between 0.6 and 2.3 times the average.

This difference in profitability provides a clear indication that Shell shifted profits to The Bahamas from operations in other jurisdictions. In SOMO's view, it is implausible that SWST's small operation could generate such staggering profits had it traded on an open market with unrelated trade partners.

However, SWST's trading is not with unrelated companies. Its main trading partners are also part of the Shell corporate group. In this context, the Shell group's overall tax considerations could be sufficient motivation to accept unfavourable terms for trades with SWST. We explore below what such unfavourable conditions look like, and which Shell subsidiaries are likely to have participated in these trades.

Shell's general ledger data shows which Shell entities SWST does most of its trading with. In 2020, the available records show that SWST purchased crude oil primarily from Shell subsidiaries in Brazil, Nigeria, Singapore, and the UK, before

selling much of that oil to Shell trading entities in Singapore and the UK. According to the available data, approximately 60 per cent of SWST's crude oil purchases and 88 per cent of its crude oil sales by value were conducted with related companies in these jurisdictions.

Having identified SWST's main intra-group trading partners, we can now consider what incentive each of these Shell companies has to shift its profits, depending on whether they are located in higher- or lower-tax jurisdictions.

Shell Eastern Trading in Singapore, a major trading partner of SWST, enjoys tax benefits under Singapore's Global Trader Programme, which allows companies to pay as little as 5 per cent in corporate income tax on trading income.³³ Although not as low as The Bahamas' 0 per cent, Singaporean's tax rate arguably diminishes the incentive to shift profits from Singapore to The Bahamas.

Looking at the other Shell entities with which SWST trades, however, there is a clear incentive for profit shifting. Shell Trading International in the UK paid approximately 20 per cent in corporate income tax in 2020.³⁴ The Shell Files do not contain information on effective tax rates for Shell's Brazilian and Nigerian subsidiaries. However, in 2020, the statutory corporate income tax rate in Brazil was 34 per cent and in Nigeria upwards of 50 per cent.³⁵

How much profit did Shell shift to SWST?

Shell describes SWST as a risk-taking entrepreneur that is compensated accordingly.³⁶ This designation is linked to the OECD Transfer Pricing Guidelines, which allow corporate groups to attribute certain characteristics to companies involved in intra-group trading. In the context of SWST, this appears to mean that Shell has defined oil trading as a high-risk activity, and as a consequence SWST is able to capture more profit in intra-group trading. However, given that a substantial part of SWST's business is trading oil (a commodity that may experience price volatility but is in demand and generally profitable) with sister companies, the level of risk SWST takes is questionable. We address this issue later in the report.

SOMO has analysed the average profit per employee of some of Shell's other trading subsidiaries for comparison with SWST. These companies are presumably also "risk-taking entrepreneurs", since they carry out much the same work. Shell's main trading subsidiaries are in the Netherlands, Singapore, the UK, the United Arab Emirates, and the United States.³⁷ Based on the available data, SOMO has looked at Shell's trading offices in the Netherlands and the UK.

For Shell Trading Rotterdam in the Netherlands, financial information was available for 2015–18. During this period, average profit per employee for Shell's Dutch subsidiary was \$ 1.5 million per year, which is approximately 10 times the Shell average for the same period (\$ 155,000).³⁸ For Shell Trading International in the UK, annual accounts were available for 2015–2020. Over this period, average annual profit per employee was US\$277,000, around three times the Shell group average for the same years (US\$94,000).³⁹

To shed light on how much profit may have been shifted to SWST, we can consider a range of scenarios based on profits per employee. While a relatively crude

metric, this provides a way to compare different Shell subsidiaries. One reasonable assumption would be that SWST's profit per employee ratio would be similar to that of its Dutch trading subsidiary, that is, 10 times the Shell average. This would mean that SWST's 37 employees would have generated about \$600 million in real profits between 2018 and 2023. Following this assumption, the remaining \$5.6 billion in profit reported by SWST was actually generated by other Shell entities and shifted to SWST in the Bahamas, where it paid no tax.

Even if we made a far more generous (and yet inexplicable) assumption that SWST's profit per employee was 30 times a greater than the Shell global average, this would lead to \$ 1.8 billion in profits attributed to SWST, and mean Shell had shifted \$ 4.4 billion in profits to The Bahamas.

There is no legitimate reason or logical explanation for why a Bahamas-based trader would be so much more profitable than a Dutch-based trader in the same commodity. In communication with Shell, SOMO stated that we believe SWST is located in The Bahamas for tax reasons. Shell denied this but offered no explanation for either the choice of The Bahamas as a location or the scale of profits. The company stated that the other trading companies we used for comparison were materially different in function, portfolio, cost structure, and commercial role, and that the comparison did not reflect how value is generated in crude oil trading markets.

Our analysis does not suggest that crude markets generate value based on an employee metric, only that a comparison of profits per employee across a corporate group highlights questions about the different profitability of entities involved in the same business. SOMO is asking the questions. Shell has not provided any answers on the substantive points.

The cost of SWST's tax avoidance

Based on Shell's general ledger data, any profits shifted to SWST are likely to have come from its intra-group trading partners in Brazil, Nigeria, and the UK. In the 2018–23 period, the statutory tax rates applicable in these jurisdictions varied substantially. The corporate income tax rate in Brazil was 34 per cent, in Nigeria 50 per cent, and in the UK 19 per cent or 25 per cent depending on the year.

If we assume that SWST could legitimately claim its profit per employee was 10 times the Shell average, then, as noted above, this would mean an estimated \$5.6 billion in profit shifted to SWST. If this amount had been taxed at the prevailing UK rate (the lowest rate in the three affected jurisdictions), Shell would have incurred a \$ 1.2 billion tax bill. Had the profit been taxed in Nigeria (highest tax rate of the three), Shell would have had to pay \$ 2.8 billion in tax.

While these assumptions are imperfect, they are more credible than the suggestion that a small subsidiary in The Bahamas achieved profits per employee 104 times higher than Shell's average. The illustration provides an indication of the scale of tax avoided: between \$ 1.2 billion and \$ 2.8 billion, lost collectively by Brazil, Nigeria, and the UK.

Box 2. The source data: Shell's WONA Crude Trading & Supply Report

One of the primary sources of information for this case study is a 2019 transfer pricing report SOMO encountered in the Shell Files. Its full name is the WONA (which stands for World Outside North America) Crude Trading & Supply Global Transfer Pricing Report, and it details how Shell has structured its pricing of crude oil in intra-group trades everywhere outside North America.

The report describes how Shell priced a set of transactions between group companies, following the OECD's Transfer Pricing Guidelines.

For this case study, we have supplemented findings from the WONA report with general ledger data from the Shell Files and with publicly available data from Shell's country-by-country reporting and Shell subsidiaries' annual accounts.

Orchestrated profits for Shell's traders

Shell describes in its transfer pricing documentation how its oil production companies and refineries do not interact with oil markets directly. Instead, Shell's trading companies, including SWST, buy all the oil they produce (crude and refined) and then sell this oil to downstream Shell subsidiaries or on to international markets. Its trading companies, Shell argues, have the expertise and capacity to profit from price differences between markets ('arbitrage' opportunities), hold on to oil when prices are low, sell oil when prices are high, and improve oil blends, all to maximise profits for Shell.

Shell reports that its trading companies maximise their profit margins when operating on global oil markets and when engaging in intra-group oil trades.⁴⁰ This is in line with the arm's length principle (ALP), which requires affiliated companies to treat one another as though unrelated when they enter into commercial transactions. Their trading counterparts – Shell's oil-producing and oil-refining subsidiaries – supposedly also aim for profit maximisation.

The way Shell structures its intra-group trade, its oil production and refining companies – which Shell refers to as its operating companies ("OpCos" in the language of its transfer pricing reports) – are compensated for the oil they produce when Shell's traders acquire it at an adjusted market price.⁴¹ The traders then generate profits by identifying opportunities to resell that oil at a higher price. Within this dynamic, the traders possess all relevant supply chain and market expertise, and decide when oil needs to be bought from or sold to the OpCos.

Although this may sound reasonable at face value, oil markets are volatile, as Shell notes in its transfer pricing documentation.⁴² Therefore, identifying the correct time to buy or sell oil has an important impact on the profit margin a company can achieve. Information on oil markets and on how prices are expected to develop is essential for any company in the sector intent on maximising its profit margin.

In trades between Shell's trading subsidiaries and its OpCos, however, Shell has organised its operations so that only the traders are deemed to possess this

information. Therefore, instead of simulating a situation of two companies trading in an open market, Shell's structuring appears to empower its traders to set up trades to benefit their profit margin at the expense of its oil production and refining companies. These latter depend entirely on their trading partners to determine the timing and pricing of transactions.

In an open market, no company looking to sell crude or refined oil would allow its trading partners to unilaterally prescribe the terms of trade, nor would they depend on their trading partners' information in determining acceptable conditions for the sale of their oil. This practice therefore seems entirely unlike

Nassau, The Bahamas. Photo by Yash Mannepalli via Unsplash.



business taking place at arm's length in an open market. Any oil producer dependent on its buyers to determine when and at what price it should sell its oil is unlikely to generate significant profits. In this intra-group arrangement, limiting profits for its oil-producing and refining companies and increasing profits among its traders appears to be exactly what Shell has orchestrated.

This has the added advantage for Shell that, while oil production is immobile because it must take place where the resources are found, trading activities can be located almost anywhere. This enables MNCs like Shell to attribute very high levels of profit to trading affiliates located in jurisdictions with low or zero tax, like The Bahamas.

Transfer pricing: you ask, we deliver

In its transfer pricing documentation, Shell describes how it prices intra-group trade in oil. It uses the comparable uncontrolled price (CUP) method, one of five transfer pricing methods.⁴³ This requires the related companies to compare their transaction with similar transactions between companies not related to one another. In the case of SWST buying oil from a related company, it would have to compare its purchase price to a purchase of a similar amount of oil of similar quality within the same timeframe. This comparable transaction could be either between SWST and a non-Shell oil supplier or between two non-Shell companies intertrading oil.

The price that emerges from analysis of comparable transactions then becomes the starting point for assessing the price charged in the intra-group transaction. The next step is to determine how this price should be adjusted up or down based on what each party contributes to the transaction. This is done through what is called FAR (functions, assets, and risks) analysis, which assesses the functions a company performs, the assets it possesses, and the risks it bears with relation to the transaction under review.⁴⁴ FAR analysis is supposed to provide insight into the extent to which each party to the transaction creates economic value and therefore the share of taxable income it should generate from the transaction.

This is where difficulties set in – because there is no objective way to assess what leads to the creation of economic value, or of how such economic value should be attributed to contributing parties. Through FAR analysis, the OECD asks companies to assign to their own subsidiaries the economic value they create. By assessing the number of functions, assets, and risks each party carries to a transaction, and then assessing the economic significance of each of these, MNCs supposedly can divide profits flowing from the transaction between the trading subsidiaries.

Functions, assets, and risks are hard to compare. For example, what is the relative value of a function like 'governance and assurance' when compared with, say, 'arbitrage risk' (that is, the risk that oil prices in the destination market are not significantly higher than the purchase price of the oil)?

These are just two of the 22 functions and risks Shell ascribes to its oil-trading subsidiaries. Following the logic of FAR analysis, Shell needs to determine the

economic significance of each of these, then do the same for the OpCo involved in the trade, after which it can compare the relative economic value of each party's set of functions, assets, and risks. Once it has done this, the relative economic value of each party's contribution to the transaction would allow it to determine the price of the transaction, and the resulting division of profits. At each step of the way, the outcome of FAR analysis depends on assessments made by the company that will pay tax in the relevant jurisdictions. There is clear potential for conflicts of interest in how the FAR analysis is done. In effect, FAR analysis's subjective nature means MNCs have substantial discretion to assign profits where they are taxed the lowest.

Shell's transfer pricing report provides a FAR analysis that distributes functions and risks between its trading companies and its OpCos.⁴⁵ The assets of commodity trading parties are, according to Shell, irrelevant to the transaction. Shell describes how in most intra-group oil trades its trading companies operate as "proprietary traders". When they do, all functions performed and risks assumed related to the oil transaction are attributed to them, and none appear to be attributed to the oil-producing and refining companies they trade with.

Essentially, Shell argues that SWST's market insight, and its capacity to sell oil of the right blend in the right place at the right time, are what generate the most value for the Shell group as a whole.⁴⁶ Through this FAR analysis, the company attributes much less economic value to the production of the crude oil. In a short text below Shell's attribution matrix (Figure 1), the company mentions how OpCos will also "perform certain functions and bear certain risks in regard to these crude transactions".⁴⁷ However, none of these functions or risks are specified, and none are included as part of the FAR analysis. Judging from the transfer pricing report, this would mean that, in crude oil transactions, the vast majority of profits would accrue to the traders.

This lopsided attribution of economic value aligns with the profitability figures described above. If Shell attributes all functions and risks to SWST instead of to its oil-producing companies in Brazil and Nigeria, it is no surprise that its profits are likewise attributed predominantly to SWST. This would explain why SWST is so immensely profitable, while the oil-producing and refining companies it trades with are not.

While Shell states that its trading companies generally operate as "proprietary traders", under some specific circumstances they can also act as "service providers". In these cases, the trading companies do not take a leading role in setting up transactions, but instead act as an intermediary for trades mandated by Shell oil-producing or refining subsidiaries.⁴⁸ In these cases, both parties perform functions relevant to the transaction.⁴⁹ Risks are said to be borne primarily by the OpCos, which assume all risks involved with the trade (including market, shipping, contract performance, and price risks), except for foreign exchange risk, which is shared evenly between the trading partners.⁵⁰ However, Shell's transfer pricing report indicates that in most of Shell's intra-group oil trades⁵¹ its traders operate as proprietary traders. As noted above, given the attribution of functions and risks,⁵² most profits likely accrue to the traders.

Figure 1. Screenshots of Shell's proprietary trading functions and risks matrix and its service provider functions and risks matrix⁵³

Table 2: STC's Proprietary Trading Function and Risk Matrix for crude transactions

FUNCTIONS PERFORMED	STC
Establish and review risk and position limits	X
Market research, establish and continually review the markets	X
Sources crude oil internationally	X
Negotiate and execute buy or sell trades	X
Risk Management	X
Compliance with regulatory requirements	X
Governance and assurance	X
Contracting strategy, advice and documentation	X
Planning and co-ordination	X
Settlement, middle and back office functions (including Letters of Credit, credit and debtor control)	X
Support functions (IT, HR, Finance and Treasury etc.)	X
Procures and pays for storage if required	X
Shipping and logistics (depending on contract terms)	X
RISKS ASSUMED	STC
Market risks – e.g. crude demand or supply falls with an impact on STC's revenues	X
Price risks – e.g. risk of low or negative margins on buy/sell deals or adverse oil price movements on inventory.	X
Arbitrage risks e.g. where export price in supply country is not sufficiently higher than that in demand country	X
Contract Performance risk and other contract risks – e.g. risks that counterparty may not deliver or take the volume contracted, delays, contract specifications not met	X
Exit risk – risk of not able to sell all stock and cost of closing out exposures	X
Less than optimal risk management (or logistics depending on trade terms)	X
Credit risk – risk that the buyer might not pay or that the seller might be in breach and cannot pay damages	X
Foreign exchange risk – e.g. cost base not denominated in USD	X
Shipping risks e.g., demurrage and oil loss risk (physical trades only, potential liability will depend on terms of trade for buy or sell transaction.)	X

Table 3: Services Provider Function and Risk Matrix – Crude Transactions

FUNCTIONS PERFORMED	STC	OpCo
Procurement of crude		
Specifies refinery requirements for crude		X
Supplies information crucial to the evaluation of crude cargoes		X
Liaison potential crude cargoes to be supplied	X	X
Advises market-related transfer prices for crude	X	
Mandates cargoes to be purchased		X
Sources, negotiates and enters into (term or spot) procurement contracts with suppliers (related or unrelated) with approval of OpCo	X	
Crude quality monitoring e.g. check API (American Petroleum Institute gravity) and sulphur levels at load port; check for oil losses at disport (depending on contract terms)	X	X
Arranges for freight, insurance	X	
Sells crude to OpCo under back-to-back arrangement including crude price and other costs	X	
Buys crude from STC under back-to-back arrangement including crude price and other costs		X
Crude Storage		
Provides crude storage facilities at the refineries/depots and pays for storage (post acquisition)		X
Other Services		
Hedging activities in respect of the crude supplied		X
Determines the need for hedging activities in respect of the crude acquired and other stocks		X
RISKS ASSUMED	STC	OpCo
Market risks – e.g. crude demand or supply falls		X
Price risks – e.g. risk of low or negative margins on buy/sell deals or adverse oil price movements on inventory		X

The two different models for attributing functions and risks in Shell's intra-group oil trades show the malleable nature of the transfer pricing system. There is a substantial element of 'pick and choose', with limited logic for why one approach is used over another. Shell's transfer pricing report is the primary document that should explain its approach to tax authorities, yet it provides no clear rationale for which circumstances warrant the use of one model over the other. The company merely notes that sometimes an OpCo will mandate a transaction, requiring the trader to act as a service provider, while in all other transactions the traders operate in a proprietary manner.

Responding to SOMO's request for comment on this research, Shell stated that SWST bears risk in the oil trading it does, and is remunerated accordingly, in line with the OECD Transfer Pricing Guidelines. The company states that it has transparently discussed this with relevant tax authorities, although it does not specify which tax authorities.

The OECD Guidelines: open to interpretation

As noted above, Shell defines its traders sometimes as "proprietary traders" and sometimes as "service providers". The choice has significant implications. However, the OECD Transfer Pricing Guidelines do not provide any meaningful guidance on this.

Shell's interpretation of the OECD Guidelines allows it to attribute outsized portions of the group's economic value and profits to SWST. This gives rise to the question: what is economic value and how is it created? Judging from Shell's attribution of profits, it would seem that SWST's 37 employees and their trading activities are how the group's oil business creates economic value. But what about the oil fields, the refineries, and the many employees who work there? Would SWST be able to generate \$ 28 million of profit per employee per year in the absence of the market information and expertise the rest of the Shell group provides? In the OECD's parlance, such contributions would be 'synergy benefits' arising from synergies between members of the same corporate group.

In a forthcoming publication, professor and tax law expert Jan van de Streek reviews Shell's tax practices as exposed by the Shell Files.⁵⁴ He asks whether Shell ignores contributions of other Shell companies in attributing such a large portion of its profits to SWST, and whether in doing so Shell runs afoul of the OECD Guidelines, which require concerted group action that creates synergy benefits to be compensated properly.

The fact that the OECD Guidelines provide space for alternative interpretations that can result in significantly different outcomes from a tax perspective is a critical shortcoming. It also means that the guidelines can be used to give an *imprimatur* of legitimacy to profit shifting and tax avoidance. In the case of SWST, SOMO considers that the core facts – the immense apparent profitability of a small subsidiary located in a tax haven – speak for themselves. What the Shell Files reveal is the complex mechanics and justifications that allow a company like Shell to claim it has acted in line with the OECD Guidelines.

How far has Shell's interpretation of the OECD Transfer Pricing Guidelines enabled it to shift profits to The Bahamas? Nobody can say for certain. But, by unpacking the approach visible in the Shell Files and running hypothetical scenarios grounded in Shell group data, we see that Shell may have shifted up to \$ 5.6 billion in profit from its subsidiaries in higher-tax jurisdictions to SWST in The Bahamas, which had a zero per cent tax rate in the period under review.

In its response to SOMO's findings, Shell stated that SWST's tax position has been discussed with relevant tax authorities. Shell also denied that the location of SWST in The Bahamas is for tax planning reasons and also noted that The Bahamas adopted the global minimum tax rate of 15 per cent in 2024.

2. Shell's Swiss trademarks



Shell has done business in Switzerland for over a century. Today, **the company operates hundreds of petrol stations there,**⁵⁵ and markets bitumen and aviation fuels.⁵⁶ Shell has also **centralised some general corporate functions in Switzerland,** including its self-insurance services and intellectual property (IP) management.⁵⁷ This case study details the workings of Shell's IP management in Switzerland, and **the tax avoidance questions it raises.**

Much of Shell's IP – its trademarks and patents – is held and managed by Shell Brands International AG (SBI), a subsidiary set up in the Swiss canton of Zug in 2003.⁵⁸ In 2005, Shell initiated 'Project Prince', an effort to centralise its IP in one location. Before then, ownership of its IP was spread over various operational subsidiaries, which Shell claims led to a lack of focus in its brand management. Shell therefore moved the rights to most of its IP – all except that held in South Africa, Turkey, and the USA – to Switzerland.⁵⁹

SBI currently controls the registration for 21 patents and over 6,000 trademarks.^{60, 61} These include trademarks separately registered in many countries, likely to ensure their legal protection in each. For example, SBI has registered the trademark for Shell's V-Power fuel in 30 jurisdictions, ranging from the European Union to Cambodia and Mozambique.

Although SBI controls substantial IP, Shell did not develop much, if any, of its IP in Switzerland. Only 0.1 per cent of its staff are employed in the country,⁶² and the corporation's approximately 19 research and development centres, which are the main sources of its innovation, are all located outside of Switzerland.⁶³ This gives rise to the question: why did Shell move ownership of its patents and trademarks to Switzerland?

Box 3. The role of intellectual property and royalties

Generally, when individual companies possess IP they can choose to use it themselves – such as by marketing a product with a brand name they have the rights to – or license the rights to that IP to other companies. When IP owners license the rights to a brand or patent to another company, that company usually pays royalties in return. The size of these royalty payments is supposed to reflect the value of the brand or patent to its user.

In the case of Shell's brands, this value could be, for example, the difference between a petrol station selling diesel branded as V-Power versus diesel of the same quality sold without a brand name. IP licensing transactions take place both within corporate groups like Shell, and between different corporate groups.

Switzerland as a tax haven

Switzerland ranks as the world's fourth largest enabler of corporate tax abuse, according to the Tax Justice Network's Corporate Tax Haven Index.⁶⁴ Like most tax havens, Switzerland offers extensive tax benefits to MNCs willing to incorporate there. In particular, its effective corporate income tax rate is less than 8 per cent. Together with cantonal and local taxes, the total tax rate ranges between 11.5 per cent and 20.5 per cent.⁶⁵ Switzerland also provides businesses with opportunities to conceal their financial dealings through financial secrecy provisions and ranks second on the Financial Secrecy Index.⁶⁶

The country is divided into cantons, all of which have their own tax rules. Among these cantons, Zug offers some of the lowest corporate income tax rates. Within this canton, the city of Baar, where SBI is located, is said to be the most tax friendly, charging companies only 11.85 per cent in corporate income tax.⁶⁷

This is reflected in Shell's Swiss tax figures. Between 2018 and 2023 – the years for which Shell has published tax data per country – the company paid an average of 8 per cent in corporate income tax on its profits attributed to Switzerland.⁶⁸

Box 4. The source data: Royalty Fees Transactions local transfer pricing reports

Some of the analysis in this case study is based on local transfer pricing reports called Royalty Fees Transactions, which SOMO encountered among the Shell Files. Each report describes these transactions for a year in the 2014–17 period. These reports, which are usually shared only with tax authorities, detail royalty payments made by two Malaysian Shell subsidiaries – Shell Timur Sendirian Berhad and Shell Malaysia Trading Sendirian Berhad – to Shell's Swiss subsidiary, SBI.

These 90- to 120-page documents are written largely in legal jargon and provide an expansive description of different aspects of the royalty transactions between the Malaysian and Swiss subsidiaries. SOMO has published the latest available report (from 2017) in redacted form on its website.

This low tax rate appears to have served Shell's Swiss operations well. Over the 2018–23 period, Shell employed an average of 117 staff in Switzerland in numerous different subsidiaries,⁶⁹ the two most prominent being SBI and Solen AG – Shell's self-insurance firm.⁷⁰ Over the same period, Shell's Swiss operations accounted for \$ 9.7 billion in profits, on which it paid \$ 808 million in corporate income tax. The average annual profit per employee in Switzerland for the same period was about 51 times higher than Shell's global average. This difference in

profitability indicates that Shell may be structurally shifting profits to Switzerland to make use of the low tax rate it is subject to there.

Shell Brands International's royalty income explained

In 2017, a year before it started publishing annual Tax Contribution Reports, Shell's transfer pricing report stated that SBI received \$ 477 million for the use of its intellectual property (IP) rights. Of this, \$ 256 million came from different Shell subsidiaries from around the world, excluding South Africa, Turkey, and the USA. The 2017 transfer pricing report shows that, of this \$ 256 million, \$ 34 million was paid by two Malaysian subsidiaries, namely Shell Timur and Shell Malaysia Trading.⁷¹ There is no information on which other Shell subsidiaries paid SBI for use of IP.

The remainder of SBI's \$ 477 million (\$ 221 million) came from third parties. These could be franchise holders running Shell petrol stations, or other third-party companies employing Shell brands.⁷²

In addition to paying SBI for the right to use the brands it holds, companies also paid for using the wider Shell brand.⁷³ However, while SBI owns the rights to most of Shell's trademarks, Shell explains that the group's subsidiaries collectively own the rights to the wider Shell brand – including the group's name and its signature seashell logo.⁷⁴ This raises questions: if the group collectively owns the Shell brand, why are payments being made to this Swiss subsidiary for their use? And if, according to the OECD Transfer Pricing Guidelines, SBI would need to redistribute these profits among the rest of the group, is it doing so?

While it makes sense for royalties to go to one subsidiary, the fact that Shell is allowed to select SBI in low-tax Switzerland to be the receiver of these royalties is an example of how, even within global tax rules, companies have considerable opportunity to allocate profit to low-tax jurisdictions. The vast majority of SBI's IP was not developed in Switzerland, and the rights to the wider Shell brand do not belong to SBI, so why is this royalty income accruing in Switzerland?

According to the OECD Guidelines, subsidiaries can become the legal owners and economic beneficiaries of IP despite not having created it, as long as they compensate group subsidiaries.⁷⁵ In Shell's case, subsidiaries could be compensated by SBI, where SBI would function as a conduit for royalties within the Shell group. Yet Shell has stated that SBI "is not a royalty pass-through entity".⁷⁶ Alternatively, compensation could have come in a form that did so, with an arm's-length-compliant purchase price for the IP SBI acquired from other Shell subsidiaries. Shell told SOMO that "the intellectual property exploited by Shell Brands International (SBI) has been developed or acquired by SBI in line with applicable accounting standards and arm's length principles". The Shell Files do not contain data that allows payments made for the IP to be analysed.

Based on available information concerning Shell moving its IP to a country where it had relatively little economic substance, combined with the country's status as

a tax haven, the location of Shell's IP in Switzerland is a red flag for profit shifting and tax avoidance.

Benchmarking royalty rates

Since 2017, Shell says it has “utilized various third-party licensing agreements as benchmarks”.⁷⁷ This means Shell looks at what third-party licensees pay for the privilege of using SBI's trademarks. It then uses these royalty rates as comparators (comparable equivalents) for what Shell's own subsidiaries should be paying SBI. Third-party royalty payments seem like a good comparator for intra-group royalty pricing, but how does this work in practice?

Zug, Switzerland. Photo by Tim Meyer via Unsplash.



In general, the process involves analysing a sample of similar transactions, or the profitability of companies that are similar to the parties undertaking the transactions. This similarity is generally characterised by operating in the same geographic area and the same industry. For example, an IT services provider operating in the Netherlands would ideally compare its transactions to other IT service providers in the same country. Because corporations do not communicate publicly about the outcomes of their benchmarking practice, limited information is available about the extent to which benchmarking manages to produce real arm's length prices.

However, economist Andrew Hughes has undertaken extensive empirical studies simulating transfer pricing benchmarking, providing insight into the range of arm's length prices this produces.⁷⁸ Reviewing 11 of these studies, academic and former director of the US Inland Revenue Service Michael C. Durst looked at the differential between the lowest and highest values in the range of prices identified by each study.⁷⁹ He shows that, in most of the transfer pricing simulations Hughes analysed, there was at least a 200 per cent difference between the lowest and highest profit margin identified by benchmarking comparable transactions.

This means that, if a range of similar transactions by similar companies are compared, and the least profitable company transaction generated a profit of \$ 10 million, the most profitable one would make a profit of \$ 30 million. This is clearly a very wide range that raises questions about the effectiveness, from a tax justice perspective, of such third-party benchmarking processes. We discuss this in more detail in Chapter 4.

Durst argues that a range with more than 25 per cent difference between the lowest and highest values is already too wide to provide tax authorities with reliable information about a taxpayer's reasonable arm's length range.⁸⁰ However, the OECD Transfer Pricing Guidelines accept that any value in a benchmarking analysis's range satisfies the arm's length principle.⁸¹

While the opacity around transfer pricing practices makes proper assessment of benchmarking impossible, the process is clearly open to broad interpretation by companies. Where a company has red flags for tax avoidance, the way it may abuse benchmarking requires more in-depth analysis. And this means companies must be required to make transfer pricing processes and data public.

Box 5. Shell's royalty pricing before 2017

Until 2017, Shell used a different approach to determine the royalties that other companies should pay to SBI. According to its transfer pricing reports reviewed by SOMO, Shell expected to secure 25 per cent of the profits of licensees as payment for use of Shell's IP. Shell refers to this as a "profit split of 25%".⁸²

The reports show that in negotiations with third-party IP licensees, such as Shell franchise holders, Shell aimed for a royalty rate equivalent to 25 per cent of the licensee's profits.⁸³ To be clear: this 25 per cent royalty rate was not the outcome of negotiations with third-party licensees but rather Shell's own negotiating target, which it hoped third-party licensees would agree to. Shell's transfer pricing reports also show

that the company used a 25 per cent rule of thumb as part of its process to assess the profit split it expected from affiliated and non-affiliated companies:

*"The Shell approach for valuing intellectual property is a commonly referred to approach for identifying ranges of royalty rates for the license of intellectual property. As most typically stated, the rule maintains that the licensor of intellectual property should receive a royalty equal to approximately 25% to 33.3% of the profits that derive from any product utilising the intellectual property."*⁸⁴

The 25 per cent rule prescribes that on average 25 per cent of the profits any individual company generates are the result of the brands and patents the company uses. Expert criticism of the 25 per cent rule abounds. It has been referred to as "junk science",⁸⁵ and the 25 per cent figure has been described as having been "seemingly pulled out of thin air".⁸⁶

Put together, Shell's transfer pricing reports argued that these two metrics – Shell's negotiating objective and the 25 per cent rule – provided support for pursuing a 25 per cent intra-group royalty rate. As far as SOMO could identify, the OECD Transfer Pricing Guidelines do not mention using negotiating objectives as suitable comparators to determine an arm's length price. The guidelines explicitly state that general rules of thumb – like the 25 per cent rule – do not provide an adequate substitute for a complete transfer pricing analysis.⁸⁷

Having used 25 per cent as the starting point for its royalty rates, Shell then adjusts it down to 15 per cent to align with the nature of its business:

*"The 10% difference between the starting point of 25% and the Retail [segment] profit split weighting of 15% appears consistent with the contribution of the trademarks to profitability, the activities performed by the business with respect to the use of the trademarks and observed differences in assets functions and risks between the [different licensing] arrangements."*⁸⁸

Shell provides no further explanation in the transfer pricing reports of what these contributions entail or how it reaches this conclusion.

Responding to SOMO's questions about the discredited 25 per cent formula, Shell has tried to distance itself, stating in July 2025: "We did not employ a rule of thumb for the profit split of 25%."⁸⁹ However, as noted above, the 25 per cent rule is mentioned prominently in the transfer pricing reports for the years 2014–17; and, together with Shell's negotiating objective of 25 per cent, the rule is presented as the foundation for assessing intra-group royalty rates in the respective years. When SOMO asked Shell to clarify the mismatch between its claim that it did not use a rule of thumb and the content of its reports, the company stated: "The rule of thumb was a concept used to test the profit split."⁹⁰ This is the profit split Shell decided should be 25 per cent, with no known basis.

In a final exchange with Shell, the company stated:

*"References to a '25% rule' reflect a commonly cited valuation concept used as a sense check within broader transfer pricing analyses, rather than a pricing method. Final royalty outcomes are determined based on the specific facts and circumstances and are adjusted to remain proportionate and conservative."*⁹¹

It is hard to reconcile Shell's most recent (March 2026) comments with its original denial that the company used the 25 per cent rule.

Origins of royalty income: Canada, Germany, the UK, and many other countries

Two main questions arise with regard to transfer pricing and the royalty income SBI gains as the legal owner of much of Shell's IP. First, are the Shell entities that pay SBI for the use of IP paying a fair, arm's length price? Second, as SBI did not create much of the IP, how does SBI compensate the Shell entities in other countries that did so?

Judging from the transfer pricing reports, it appears that Shell subsidiaries that control the group's petrol stations have been the primary payers of intra-group royalties to SBI. There are 47,000 petrol stations globally branded as Shell, of which third-party franchise holders manage an unknown proportion.⁹² In many major markets, Shell appears to both own petrol stations and license its brand to franchise holders.⁹³

The main countries that host Shell petrol stations are, in descending order: Germany, Canada, the UK, the Philippines, Malaysia, Australia, Argentina, Thailand, Pakistan, and the Netherlands (as noted above, the USA, Turkey, and South Africa do not obtain licences from SBI).⁹⁴ The Shell subsidiaries that control its petrol stations in these countries are likely to be the source of much of SBI's intra-group royalty income.

If the royalty income now attributed to SBI for use of its trademarks were instead attributed to one or several Shell research and development centres – where the company develops new IP – this income would likely also be taxed at a higher rate. Shell's R&D centres are located in 11 countries, of which only one has a tax rate below 8 per cent.⁹⁵ The R&D centres most prominently listed on Shell's website are located in India, the Netherlands, and the USA,⁹⁶ with statutory corporate income tax rates of 34.9 per cent,⁹⁷ 25.8 per cent,⁹⁸ and 21 per cent⁹⁹ respectively.

Responding to SOMO's questions on the transfer of IP to SBI and Switzerland, Shell stated that "the transfer of Shell's trademarks to Switzerland, Shell Brands International (SBI), and the subsequent payments for the use of these trademarks, have been fully and transparently discussed with the relevant Tax authorities in 2005 and beyond".¹⁰⁰ Shell did not specify which tax authorities it had engaged with.

3. Shell's Dutch and UK group services



Shell has close ties to government officials in the Netherlands and the UK, the countries that gave birth to Royal Dutch Shell, and the company's headquarters have always been in one or the other of these countries.

Until 2020, the Dutch Ministry of Foreign Affairs and Shell had an employee exchange programme to increase collaboration.¹⁰¹ After Shell relocated its headquarters to the UK in 2022, the UK Foreign Secretary announced a controversial scheme to exchange staff between the Foreign, Commonwealth and Development Office and Shell (as well as arms manufacturer BAE Systems).¹⁰²

The Shell group has substantial operations in both the UK¹⁰³ and the Netherlands,¹⁰⁴ ranging from oil and gas production to petrol stations, pipelines, and research and development centres. Shell subsidiaries based in these two countries also provide significant business support services (such as IT and human resources) and technical services (such as engineering and procurement) to the wider Shell group. Shell calls these Dutch and UK service companies “ServCos”.

However, Shell does not generate much profit in the Netherlands or the UK, when compared to its operations in other jurisdictions. In 2019, Shell admitted that it had not paid corporate income tax in the Netherlands in years;¹⁰⁵ and in 2023, Shell was expected to pay UK corporate income tax for the first time in five years, following the introduction of the Energy Profits Levy when it made extraordinary profits due to high gas prices.¹⁰⁶

There are several reasons for this situation. In the Netherlands, the company made use of a generous tax rule that allowed it to deduct foreign liquidation losses from its domestic profits – a rule that has since been limited.¹⁰⁷ In the UK, the company argued that deductible investments it had made limited its profitability, resulting in zero corporate income tax.¹⁰⁸

But another reason is the way Shell has structured its intra-group services, provided from the UK and the Netherlands, in terms of profit and tax. Since at least 2002 to 2016/17, Shell subsidiaries in both countries provided their business support and technical services to other Shell companies ‘at cost’, without any profit margin. The result was that the service-providing subsidiaries made little profit and therefore paid little tax. Over the 2002–17 period, Shell’s ServCos in the Netherlands reported € 78.6 billion in revenue, but only € 678 million in profits, a profit margin of 0.9 per cent. Similarly, between 2002 and 2016, Shell’s UK ServCos reported £32.7 billion in revenue but just £85 million profit, a profit margin of under 0.3 per cent.¹⁰⁹

The first part of this case study looks at how Shell was able to justify, for years, the at-cost provision of services approach.

Since 2018, Shell has reportedly changed the way it accounts for services provided from the UK and the Netherlands. The second part of this case study examines what we know about the changes made and their impact on the amount of tax the company now pays.

Box 6. The source data: Shell's 2019 Upstream Cost Sharing Global Transfer Pricing Report

This case study is largely based on Shell's description of its intra-group pricing of services, set out in a 2019 Upstream Cost Sharing Global Transfer Pricing Report that forms part of the Shell Files. This report provides an elaborate explanation of Shell's pricing of the services its Dutch subsidiaries provide to its upstream segment of operations. It also indicates that Shell uses a similar structure to price services its UK subsidiaries provide to its downstream segment. SOMO has published this transfer pricing report in redacted form on its website.

Shell group services in the Netherlands and the UK

The services Shell provides from the Netherlands and the UK fall into four categories:

- technical services for exploration and production;
- support services;
- information technology (IT) services;
- advisory services.

SOMO has identified six Shell subsidiaries (Shell's "ServCos")¹¹⁰ as providing these services:

Shell Global Solutions International BV (SGSI BV)¹¹¹ in the Netherlands provides technical services for oil and gas exploration and production activities, including geological and geochemical research, and field development planning.¹¹² SGSI BV provides these services both to Shell's operational subsidiaries (OpCos) and to third parties around the world, either directly or through what Shell calls satellite entities, many of which are subsidiaries geographically closer to Shell's areas of operation.¹¹³ In 2023, SGSI BV had 1,908 employees.

Shell International BV (SI BV) in the Netherlands and **Shell International Ltd (SI Ltd)** in the UK provide the wider Shell group with support services such as legal, tax, and finance advice.¹¹⁴ In 2023, these Shell subsidiaries employed 813 and 1,049 staff respectively.

Netherlands-based **Shell Information Technology International BV (SITI BV)** provides the group's IT services in cooperation with three other subsidiaries in the UK and the USA.¹¹⁵ In 2023, SITI BV employed 1,005 staff.

The ServCos can charge the OpCos directly for services, or they can charge **Shell International Exploration and Production BV (SIEP BV)** in the Netherlands or **Shell International Petroleum Company Ltd (SIPC Ltd)** in the UK, which then pass the costs on to the OpCos that received the service.¹¹⁶ SIEP BV manages service provision to Shell's upstream business, including in relation to oil exploration and production, while SIPC Ltd does the same for Shell's downstream business, which includes the group's petrol stations, chemicals production, and oil trading. SIEP BV and SIPC Ltd provide services to Shell's OpCos directly, as well as passing on costs for services provided by their sister companies. For example, SIEP BV provides advisory services to OpCos, such as proposals for new business opportunities, acquisitions, and divestitures.¹¹⁷ In 2023, SIEP BV and SIPC Ltd employed 371 and 682 staff respectively (Table 1).

Table 1. Shell's Dutch and UK service companies

Company name	Country	Services provided	Staff employed (2023)	Staff employed (2002–23 average)
SGSI BV	NL	Technical services	1,908	1,989
SI BV	NI	Support services	813	1,058
SI Ltd	UK	Support services	1,049	940
SITI BV	NI	IT services	1,005	445
SIEP BV	NL	Advisory & technical services	371	1,025
SIPC Ltd	UK	Advisory services	682	868

Justifying at-cost service provision

As noted above, until 2016/17, the six subsidiaries described above provided their services to Shell's OpCos at cost, meaning they charged no mark-up and aimed to make no profit on these activities.¹¹⁸ This arrangement is described in detail in Shell's 2019 Upstream Cost Sharing Global Transfer Pricing Report. It is also referenced in the ServCos' annual accounts.¹¹⁹ Companies that generate no profit generally also pay no corporate income tax. Based on the annual accounts of the six Shell ServCos mentioned above, this at-cost service provision has been happening since at least 2002, the earliest year for which accounts were available. Between 2002 and 2016/17, five of the six ServCos had at least one year where they recorded at least limited profits. However, none of these profits were the result of a profit margin charged on intra-group service provision; they were instead due to other factors, including service provision to third parties at commercial rates, interest income, or currency exchange gains.

Generally speaking, transfer pricing rules require companies to generate profits on transactions with related companies in the same way they would when trading with third parties. As explained previously, transfer pricing rules prescribe that related parties should treat one another as though interacting in the open market, keeping one another at arm's length while attending to their own commercial interests.

The OECD Transfer Pricing Guidelines describe limited situations where provision of services at cost would be warranted, and in its 2019 Upstream Cost



Royal Dutch Shell corporate building in the Hague 2016. Photo by Mr. Documents Uploader via Wikimedia Commons.

Sharing Global Transfer Pricing Report, Shell argued that some of these apply to its own structuring.¹²⁰ In a forthcoming academic publication Jan van de Streek analyses Shell's cost sharing arrangements as described in this 2019 Upstream Cost Sharing report.¹²¹ Here we draw on that legal analysis to weigh Shell's three justifications.

First, Shell argues that the at-cost service provision arrangements are in line with what the OECD calls a cost contribution arrangement (CCA).¹²² Simply put, a CCA is an agreement between several related companies to share costs and risks borne by a subset of the group, with the expectation that all parties will benefit from subsequent profits. However, while the ServCos provide their services at cost, SOMO could find no mention of them sharing in the OpCos' subsequent profits.¹²³ When SOMO put this issue to Shell, the company referred to its Tax Contribution Reports as a source of explanation. Though the Tax Contribution Reports mention that service fees are based on the actual costs made to provide those services, they fail to explain how Shell's arrangements qualify as a CCA.

Second, Shell says that service provision at cost is common in the oil and gas industry, as it is used for joint ventures (JVs).¹²⁴ JVs are projects with shared ownership, either through incorporation of a jointly owned subsidiary or on a contract basis. When such JVs occur, it is often agreed that partners cannot profit from services they provide to the JV, to ensure no conflicts of interest arise. In such situations service provision at cost can be in line with the arm's length principle when entities providing the services are partners to the JV. In

such cases, they do not make a profit from the services they provide but stand to benefit from the profits they help the JV generate when the JV pays out dividends.

However, the specific circumstances of JVs are exactly that, specific circumstances. The services Shell's ServCos provide, as discussed here, are provided to a variety of Shell OpCos in multiple jurisdictions, not exclusively to JVs in which Shell holds a stake. And even in cases where the services are provided to Shell's JVs, the ServCos are generally not partners to these JVs and therefore do not stand to benefit from the JVs' financial returns.

Third, Shell states that the OECD Transfer Pricing Guidelines specify examples of service providers operating without profit, which it argues could justify its provision of intra-group services at cost.¹²⁵ Shell writes:¹²⁶

"The OECD Guidelines provide examples of why a service provider will not always make a profit. These include:

- The market value of intra-group services is not greater than the costs incurred by the service provider;*
- It would not be appropriate in such a case to increase the price for the service above what would be established by the CUP [comparable uncontrolled price] method just to make sure the associated enterprise makes a profit;*
- When an associated enterprise is acting only as an agent or intermediary in the provision of services, it is important in applying the cost-plus method that the return or mark-up is appropriate for the performance of an agency function rather than for the performance of the services themselves; ... and*
- Business strategy related reasons."*

The specific examples that the OECD Guidelines mention¹²⁷ – like an independent business providing a service at cost to complement other goods and services it sells – seem quite different from the services Shell's ServCos provide to other Shell entities at cost. However, the reference to "[b]usiness strategy related reasons" would seem to provide a very broad basis to operate at cost, an issue we pick up in Chapter 4 of this report.

Shell therefore provides three justifications in its 2019 transfer pricing report: (1) the ServCos are in a CCA; (2) cost sharing is common in the oil and gas industry; (3) there are specific examples where service providers operate without profit. However, these justifications do not clarify how Shell can have legitimately charged for a wide range of services at cost. On the contrary, the explanations raise questions about the potential for broad and loose interpretation of the OECD Guidelines, and about the oversight capacity of tax authorities, issues we address below.

When SOMO raised the issue of at-cost provision with Shell, the company responded by referring us to their Tax Contribution Reports, where "we explain Shell's service cost allocation system, including the proportionate allocation of costs. We expand on how it is set up and operated in accordance with the guidance provided by the OECD."¹²⁸

SOMO reviewed the explanation of cost allocation in the Tax Contribution Report for 2019. The report states that Shell's centralised service companies charge receiving entities based on the actual cost of the service (that is, at cost). But the issue is not the allocation of costs among receiving entities, but the justification of at-cost provision and how this can be referred to as being within a CCA when there is no evidence that Shell's UK and Dutch ServCos are in any CCAs for the provision of their services nor that they receive any proportionate benefits, which would show up as income and potentially profit.

The text of Shell's 2019 Tax Contribution Report is repeated, either verbatim or close to verbatim, in each of its Tax Contribution Reports from 2019 to 2024, the latest year for which a report is available at the time of writing.

SOMO pressed Shell to explain this situation. The company stated:

*"In certain jurisdictions and contractual settings, however, services are provided on an at-cost basis for commercial and legal reasons, consistent with long-standing industry practices. These arrangements are embedded in cost contribution arrangements (CCAs), under which costs are allocated based on expected benefits in line with OECD guidance."*¹²⁹

The explanation is unsatisfactory, in part because "long-standing industry practices" is a vague term that could include joint ventures (which, as noted above, service companies are not usually part of), and "embedded in" does not clarify whether the service subsidiary is a participant in a CCA or provides services at-cost to a related company that is a participant in a JV or other hydrocarbon industry construct. If the latter, this is not consistent with the OECD Guidelines.

As it was not possible to get clarity from Shell, SOMO asked the Dutch and UK tax authorities to clarify what is accepted as participation in a CCA. Neither tax authority replied to SOMO's enquiries.

Deemed profit margins and benchmarking

The 2017 and 2018 annual accounts of three of the six ServCos show signs of tax authorities intervening. Starting from 2017, SIPC Ltd reports additional tax charges from UK tax authorities relating to the company's cost sharing arrangements. Similarly, from 2018, the annual accounts of SIEP BV and SGSI BV mention ongoing discussions with Dutch tax authorities about the need to account for a potential profit margin.¹³⁰ The following years' SIEP BV and SGSI BV annual accounts mention a profit margin being accounted for, for fiscal purposes, on intra-group services provided at cost.¹³¹ It appears that, following tax authority intervention, both these companies started accounting for a deemed profit on intra-group services for tax purposes, while still providing their intra-group services at cost and not generating profit.

This means in practice that the ServCos still do not charge a profit margin on the services they provide to other Shell subsidiaries, although on their tax returns they account for such a margin. The outcome is that they can now be taxed on the putative profits that arise because of this deemed profit margin.

SOMO looked at the annual accounts of the Shell companies to try to understand how much of a ‘deemed’ profit margin Shell applied and how much tax this generated. While there was no information in the accounts of the Dutch ServCos, UK-based SIPC Ltd reported that, between 2017 and 2023, it owed an additional £ 31.4 million in corporate income tax as a result of the application of the deemed profit. By dividing the additional tax charge per year by the applicable statutory tax rate, we can estimate the profit SIPC Ltd recorded as a result of its deemed profit mark-up. Dividing that figure by the same year’s revenue¹³² provides the approximate profit margin ‘deemed’ to be applied to the services. Using this method, SOMO calculates that, for the 2017–23 period, SIPC’s deemed profit margin equates to an estimated 1.12 per cent, against which tax was charged (Table 2).

Table 2. Estimation of SIPC Ltd’s deemed profit margin

Figures in £ millions	2017	2018	2019	2020	2021	2022	2023	Total
Revenue	1,990.7	1,958.8	2,071.3	1,871.0	1,649.7	2,082.6	2,396.3	1,4020.4
Tax charged	5.7	3	4.3	4	3.8	4.5	6.1	31.4
UK corporate income tax rate	19%	19%	19%	19%	19%	19%	25%	n.a.
Deemed profit	30.0	15.8	22.6	21.1	20.0	23.7	24.4	157.6
Deemed profit margin	1.51%	0.81%	1.09%	1.13%	1.21%	1.14%	1.02%	1.12%

The annual accounts of the three other Shell ServCos featured in this case study – SI BV, SITI BV, and SI Ltd – make no mention of tax authority intervention. Their 2023 annual reports still maintain that they operate on an at-cost basis, charging no profit margin on their services to Shell affiliates.¹³³

Benchmarking profit margins

In its response to SOMO, Shell stated that its service companies in the Netherlands and the UK apply deemed profit mark-ups for the services they provide and are taxed on the resulting profits. Shell noted that this mark-up is benchmarked, and in line with the OECD Transfer Pricing Guidelines. The company also said that these arrangements have been accepted by both Dutch and UK tax authorities.

The approach of benchmarking involves looking at other companies providing similar services to similar clients and using this data to set a profit margin theoretically in line with the arm’s length principle. But how does it work in practice?

The Shell Files contain one benchmarking study that provides insight on this matter. It is a benchmarking study from 2018 for Shell Global Solutions International BV (SGSI BV) that benchmarks profit margins for engineering consultancy service providers in the Asia Pacific region.¹³⁴ Based on the operating profitability

of 13 non-Shell companies providing such services over a period of five years, the analysis establishes a range of arm's length profit margins of between 0.4 per cent and 33.8 per cent.

As noted previously, the OECD Guidelines state that any value within a benchmarking study's range would qualify as an arm's length price.¹³⁵ However, the SGSI BV study's authors removed the highest and lowest 25 per cent, leaving them with the middle 50 per cent, also known as the interquartile range in transfer pricing. The OECD describes the interquartile range as a method to increase reliability of the analysis, as it narrows the range of potential transfer prices.¹³⁶ Based on this method, the independent companies providing engineering consultancy services in the Asia Pacific region had a profit margin of between 2.2 per cent and 21.2 per cent.¹³⁷

The benchmarking exercise carried out for SGSI BV, which provides high-value-added services, offered a range running from 2 to 21 per cent. The fact that a benchmarking exercise can yield profit margins for high-value-added services that are well below the 5 per cent margin the OECD says is reasonable for low-value-added services is yet another red flag for the effectiveness, from a tax justice perspective, of the OECD's process. Under the OECD Guidelines, a company like Shell can legitimately select where its own service provision falls in this range, giving it extensive discretion in attributing more or less profit to a subsidiary like SGSI, as it sees fit.

Another relevant issue is that the OECD Guidelines distinguish between low-value-added intra-group services that are not part of the group's core business,¹³⁸ such as IT and support services, and higher-value-added services, such as technical advisory services. Since 2015, the OECD has clarified that low-value-added services could legitimately be compensated with a standardised 5 per cent mark-up on top of costs, instead of through the assessment of an arm's length price.¹³⁹ Until 2022, however, the Netherlands allowed for low-value-added services to be charged without any mark-up.¹⁴⁰

In its response to SOMO, Shell asserted that its deemed profit margin on services provided by subsidiaries in the UK and the Netherlands complies with or exceeds the 5 per cent rate that the OECD Guidelines specify for low-value-added services.¹⁴¹ As discussed above, however, Shell's annual accounts for its UK and Dutch subsidiaries appear to indicate otherwise,¹⁴² which raises questions about the exact level of these deemed profit margins.

The OECD does not suggest an appropriate profit margin for high-value-added services, meaning the value of each type of service would have to be judged individually. In his forthcoming publication, academic Jan van de Streek arrives at a range of 10 per cent to 15 per cent for the provision of advisory and technical services as appropriate.¹⁴³

As noted above, when SOMO asked Shell to explain its at-cost service provision, the company referred to its Tax Contribution Reports. These reports from 2018 to 2024 make no reference to deemed mark-ups and benchmarking when explaining how centralised costs are accounted for.

Lost tax in the UK and the Netherlands?

How much should Shell have paid in tax in the UK and the Netherlands if the services it provides to the rest of the group were profit-making? Using OECD parameters, we can give an illustration.

As noted above, the OECD considers that low-value-added intra-group services could legitimately be compensated with a mark-up of 5 per cent of the relevant costs.¹⁴⁴ The services that SI BV, SI Ltd, and SITI BV provide seem to qualify as low-value-added. SIPC Ltd and SIEP BV appear to provide a mix of low-value-added services and higher-value-added intra-group advisory and technical services,¹⁴⁵ while SGSI BV provides predominantly high-value-added technical services.¹⁴⁶

Taking a conservative approach for SGSI BV, we can assume that the low end of the range offered by van de Streek – 10 per cent – would have been an appropriate profit margin. For SIEP BV and SIPC BV, which both provide a mix of low- and high-value-added services, we can similarly take a conservative approach, and assume that a 5 per cent profit margin would have been appropriate. For the other three ServCos, we can use the same 5 per cent profit margin for low-value-added services.

We have estimated the profits the companies made over the period 2002–17.¹⁴⁷ Starting with the Netherlands and applying the suggested profit margins of 10 per cent for SGSI BV and 5 per cent for the other Shell Dutch subsidiaries, the companies should have generated approximately € 5.2 billion in profits in this period, and not the € 678 million they reported. At the statutory corporate income tax rates applicable in the Netherlands between 2002 and 2017, this would have incurred approximately € 1.4 billion in tax. Subtracting the € 262 million corporate income tax Shell's Dutch ServCos paid during this period, the Netherlands could have lost an estimated € 1.1 billion in tax.

Carrying out the same exercise for the UK ServCos, Shell should have accounted for an approximate £ 1.6 billion in profits, rather than the £ 85 million it reported. This would have led to an estimated £ 427 million in corporate income tax over the period between 2002 and 2016. Subtracting the £ 85 million corporate income tax Shell's UK ServCos paid during this period shows that the UK lost an estimated £ 343 million in tax revenue.

Table 3. Shell's ServCos: financial information

	ServCos in the Netherlands (€ million, 2002–17)	ServCos in the UK (£ million, 2002–16)
Total reported revenues	€ 78,636	£ 32,689
Reported profit	€ 678	£ 203
Income tax reported	€ 262	£ 85
Profit Shell should have made	€ 5,245	£ 1,640
Tax Shell should have paid	€ 1,365	£ 427
Estimated tax avoided by Shell	€ 1,103	£ 343

In its response to SOMO, Shell affirmed that its benchmarked mark-ups for services its companies in the UK and the Netherlands provide “comply with, and exceed, the threshold specified in Chapter VII of the OECD Transfer Pricing Guidelines”.¹⁴⁸

Victims, perpetrators, and facilitators

Different jurisdictions play different roles in the failings of the transfer pricing system. Tax havens like The Bahamas, Singapore, and Switzerland provide various tax benefits that incentivise profit shifting, while the countries where real economic activity takes place – such as Brazil and Nigeria – often have their tax base eroded and their tax revenues reduced.

Countries like the Netherlands and the UK play a more ambiguous role; in this specific case, they are almost certainly losing tax revenues through Shell’s avoidance structure, although their tax authorities seemingly consent to the arrangement. However, these countries also play a central role in facilitating global corporate tax avoidance. So much so, in fact, that the Tax Justice Network has classified the Netherlands and the UK as members of the “axis of tax avoidance” group of four countries that play a central role in facilitating global corporate tax avoidance.¹⁴⁹

Netherlands: Shell Technology Centre in Amsterdam-Noord. Photo by Marion Golsteijn via Wikimedia Commons.



4. The OECD Transfer Pricing Guidelines: smoke and mirrors



In responding to questions about, or allegations of, tax avoidance, **Shell has repeatedly claimed it operates in line with the OECD Transfer Pricing Guidelines.**¹⁵⁰ The Shell Files provide an opportunity to consider **how the company's actions relate to these international standards.** They also allow us to consider the efficacy of the guidelines themselves, at least in relation to issues exposed by the Shell Files and this report.

Transfer pricing and its implications for taxation have been on the radar of tax authorities for decades. However, only in the 1990s was a concerted international effort made, via the OECD, to have some uniform guidance on the issue. The OECD issued its first Transfer Pricing Guidelines in 1995. Since then, the guidelines have been updated several times. They are now widely used (or at least referred to) by companies when engaging with tax authorities around the world.

But although frequently cited in relation to addressing tax avoidance by multinational corporations, this is not what the OECD Transfer Pricing Guidelines themselves claim to do. They frame their purpose as a technical one, a tool for companies and tax authorities to assess how best to account for the tax payments of MNCs working across a variety of jurisdictions, and specifically how to avoid double taxation. The guidelines state:

*"The consideration of transfer pricing should not be confused with the consideration of problems of tax fraud or tax avoidance, even though transfer pricing policies may be used for such purposes."*¹⁵¹

The fact that the Transfer Pricing Guidelines are not set up to address tax avoidance, despite transfer pricing being a cornerstone of this problem, largely explains why they have been so lacking in positive impact in this regard.¹⁵² It is hard to be effective if you are not even trying. But the OECD Guidelines have a more insidious effect – they have acted as a smokescreen, undermining potentially more impactful action, because so many companies, governments, and even civil society groups refer to them as part of the solution to tax avoidance. It is easy to see why.

Helping to ensure that companies pay the right amount of tax in each country in which they operate is more or less the same as preventing tax avoidance, right? Not so, for several reasons. The main one being that the OECD Transfer Pricing Guidelines ignore the role of subsidiaries as tax avoidance *structures*. The guide-

lines start from an unwritten assumption that anywhere a company has a subsidiary is legitimate and they proceed to provide guidance on how transactions should be priced between related subsidiaries of an MNC.

The case of Shell Western Trading and Supply (SWST) is a clear illustration of this lacuna. The Bahamas has no relationship to oil trading and had a zero per cent corporate income tax rate during the period under review, 2018–23. Nothing in the OECD Transfer Pricing Guidelines considers the basic question of why Shell has an oil trading subsidiary in The Bahamas at all. It is not a red flag. On the contrary, the guidelines offer Shell a range of very useful justifications with which to explain the enormous profits made, as our first case study discusses.

Another problem with the OECD Guidelines is that they offer companies a menu of options combined with a level of technicality that appears open to manipulation. As such, they confer legitimacy on practices and outcomes that would otherwise be considered highly questionable from a tax fairness perspective. Companies can twist and turn the system to their advantage.

The following sections of this chapter look at specific issues arising in the OECD Guidelines that relate to one or more of the cases presented in this report.

The arm's length principle: a useful myth

The OECD Transfer Pricing Guidelines focus on the application of the arm's length principle (ALP) to evaluate the allocation of economic costs and profits between associated companies. This is central to how transfer pricing – and consequently the allocation of taxable profits – is ostensibly assessed and addressed. Yet the way the guidelines explain the ALP raises questions. For example, the guidelines state:

“there are some significant cases in which the arm's length principle is difficult and complicated to apply, for example, in MNE groups dealing in the integrated production of highly specialized goods, in unique intangibles, and/or in the provision of specialised services.”¹⁵³

This appears to be quite a comprehensive list that arguably covers an MNC that extracts, refines, and trades in oil, and also manages the licensing of intellectual property (IP) for an integrated oil company that sells unique products (such as Shell V-Power).

The OECD Guidelines also acknowledge that evidence to support the ALP can be difficult to find and assess:

“Both tax administrations and taxpayers often have difficulty in obtaining adequate information to apply the arm's length principle ... it can demand a substantial amount of data. The information that is accessible may be incomplete and difficult to interpret; other information, if it exists, may be difficult to obtain for reasons of its geographical location or that of the parties from whom it may have to be acquired. In addition, it may not be possible to obtain information from independent enterprises because of confidentiality concerns” (emphasis added).¹⁵⁴

In summary, the guidelines acknowledge a significant range of difficulties in applying the ALP via finding comparable transactions, particularly when it comes to obtaining data. However, the guidelines go on to say:

*“The arm’s length principle is **sound in theory** since it provides the closest approximation of the workings of the open market in cases where property (such as goods, other types of tangible assets, or intangible assets) is transferred or services are rendered between associated enterprises” (emphasis added).*¹⁵⁵

So, having set out a range of problems with the ALP, to which it offers no solution, the OECD sweeps them all under the rug, and the ALP is given an imprimatur of having a sound theoretical basis.

Self-evidently, the ALP is an untenable fiction. It asks MNC groups with a clear self-interest and imperative to maximise ‘shareholder value’ to operate in a manner directly opposite to their natural inclination, and what many would see as their basic *raison d’être*.

Comparability and benchmarking

According to the OECD, “a ‘comparability analysis’ is at the heart of the application of the arm’s length principle”.¹⁵⁶ This entails identifying and analysing comparable independent transactions. Companies can use benchmarking studies to underpin comparability analysis.

As noted above, the OECD itself acknowledges the significant challenges in identifying comparable transactions, not least because independent companies do not publish full (or even much) information about their transactions. Chapter III of the OECD Guidelines provides a detailed and lengthy description of how the analysis can be done. Notably, many of the steps involve choices the company can make, including on methods used.

In response to SOMO’s concerns about the level of flexibility companies have in this exercise and the risks of manipulation, the OECD stated:

*“[the view] that multinationals can freely choose comparables or manipulate benchmarking outcomes is not correct. The transfer pricing guidelines require a factual determination of comparability and do not allow companies to select comparables arbitrarily. Furthermore, the assertion that companies can choose whether comparables exist is inaccurate; the availability of comparables is determined by market realities, not by taxpayer choice.”*¹⁵⁷

However, the lengthy and complex considerations that Chapter III of the guidelines offers do not support this contention. While companies cannot compare oil trading with selling oranges, they still have choices as to which transactions they choose as comparators (and perhaps more importantly, which they do not choose). The ‘factual determination’ can be more accurately described as the provision of a justification. Once a set of facts, a range of assumptions, and a method or methods are chosen, then the company must provide supporting evidence. It is the company, a self-interested actor, that frames (and provides to tax authorities) the specific circumstances of any trade and comparator.

The problem is exposed in different ways in each of our case studies. For example, SOMO considered how relatively profitable SWST was compared with other Shell oil trading subsidiaries and found a substantial difference.

In the case of comparators for IP licences, Shell uses non-Shell entities to which it also offers licences. But, as the case study noted, the nature of the package sold to non-Shell entities has been significantly different in the past. It is not clear, and Shell has not explained, how these differences are addressed.

The OECD guidance on comparability analysis also raises other questions. For example, the guidelines state:

*“because transfer pricing is **not an exact science**, there will also be **many occasions** when the application of the most appropriate method or methods produces a range of figures all of which are **relatively equally reliable**”* (emphasis added).¹⁵⁸

Again, the guidelines text appears to acknowledge a fundamental issue (in the case of the quote above, the range of methods and the variability of results). Yet, by some undisclosed fallacious reasoning, we are told the variable possible results are all equally reliable. As the case study on Switzerland noted, an independent investigation into benchmarking studies found up to 200 per cent difference between the lowest and highest figures produced. Yet all would be equally legitimate according to the guidelines.

The option for companies to use different methods is part of the OECD process:

*“Each method may produce an outcome or a range of outcomes that differs from the other because of **differences in the nature of the methods and the data**, relevant to the application of a particular method, used. Nevertheless, each separate range potentially could be used to define an acceptable range of arm’s length figures”* (emphasis added).¹⁵⁹

A plain reading of this statement is that different methods, which can involve the company using different data and assumptions, can easily produce different results, yet any one of these outcomes is acceptable. The entity choosing the method with its associated parameters is the company whose tax outcomes will ultimately be defended based on the method and its fruits. The guidelines exhibit no recognition of any potential conflict of interest. It appears up to national tax authorities to identify any issues. They do so based on information provided by the company itself, and this, based on our review of the Shell Files, means wading through vast documentation riddled with OECD-based formulas and defences.

The Transfer Pricing Guidelines offer an open invitation to choose the method that provides the best results. The ‘factual determination’ that the OECD refers to means what is included should be factually correct, but the guidelines do not prevent the company making choices at almost every step.

Defining risk and reward

When a comparable transaction is identified, the company then has to determine how this price should be applied to and adjusted for its own intra-group transaction and the subsidiaries or affiliates involved. This requires an assessment of,

among other things, the functions each company performs, the assets it possesses, and the risks it assumes. The MNC can adjust them, thereby assigning value creation – and hence profit capture – in different proportions to each of its subsidiaries involved in the transaction. The process is based on an acknowledgement that the comparable transaction is not, in fact, really comparable. Adjustments must be made to reflect the specific context of the MNC’s subsidiaries involved in the transaction, to determine where profits are allocated.

Our first case study, on SWST in The Bahamas, illustrates this. It explains how Shell’s relatively tiny operation is vastly more profitable than most other Shell subsidiaries, including subsidiaries carrying out similar work (trading oil), and the Shell companies that extract the oil. Shell’s explanation of SWST’s financial success is that the company takes risks and is rewarded accordingly.

The OECD Guidelines include risk as a key element when determining which entity in an intra-group transaction contributes most to value creation. However, based on the guidelines, the assumption of risk is not purely an independent factual matter. In many cases, the corporate group can decide, to a significant degree, which subsidiary in a transaction should bear the risks. There is ample scope to decide that a subsidiary in a low-tax jurisdiction is the main bearer of risk. While a factual justification should be provided, MNCs can relatively easily craft apparently adequate justification for a decision on which entity bears the most risk.

In the SWST case, any argument that SWST bears the substantial risks and is entitled to be “remunerated accordingly” cannot be considered without reference to SWST being based in a tax haven. Yet this is precisely what the OECD Guidelines allow for and support. They ignore the huge red flag and accept that a company locating its oil trading in such a jurisdiction will be applying the guidelines in good faith.

It is not credible that a company would set up a subsidiary in a tax haven offering a zero per cent corporate income tax rate, and then apply the guidelines in a way that negates the tax advantage.

The OECD did not respond to our request for comment on the issue of “risk taking entrepreneurs”.

The valuation of intellectual property licensing

In the case of SBI in Switzerland, the Shell Files allowed us to explore how Shell deals with its intellectual property (IP). A section of the Transfer Pricing Guidelines is devoted to intangibles, which is the broad category into which IP falls. The OECD Guidelines recognise that one or more subsidiaries may have the legal ownership rights to IP but that other subsidiaries in the corporate group may have contributed to the development of the IP. As mentioned in the Swiss case, there is no evidence that SBI developed the IP it owns, or even that the IP was developed in Switzerland. Shell’s IP, including trademarks such as V-Power and the brand licensing used by petrol stations, was created by other members of the group. New products are likely created in Shell’s 19 R&D centres, for example.¹⁶⁰ Therefore, while SBI owns the rights, it is not the creator of the economic value.

Speaking to this issue, the OECD Guidelines state:

*“Although the legal owner of an intangible may receive the proceeds from exploitation of the intangible, other members of the legal owner’s MNE group may have performed functions, used assets, or assumed risks that are expected to contribute to the value of the intangible. Members of the MNE group performing such functions, using such assets, and assuming such risks must be compensated for their contributions under the arm’s length principle.”*¹⁶¹

The guidelines go on to say:

*“The return ultimately retained by or attributed to the legal owner depends upon the functions it performs, the assets it uses, and the risks it assumes, and upon the contributions made by other MNE group members through their functions performed, assets used, and risks assumed.”*¹⁶²

Shell has stated that SBI’s tax position is in line with the OECD Guidelines. The initial OECD guidance, quoted above, on IP (intangibles) is clear: legal ownership of IP is different from having created the value of the IP. However, the subsequent reference to functions, assets, and risks again introduces the problems referred to earlier. Who defines which functions are relevant, and which risks are borne by which entity?

At-cost service provision

The issue of at-cost provision of services was central to our UK and Netherlands case study. The starting premise of the Transfer Pricing Guidelines is that services should not be provided at cost:

*“In an arm’s length transaction, an independent enterprise normally would seek to charge for services in such a way as to generate profit, rather than providing the services merely at cost.”*¹⁶³

However, the guidelines also accept that there are circumstances where providing services that do not in themselves make a profit can exist. Such circumstances were set out in the UK and Dutch case study; and, as noted there, the few examples suggested by the OECD do not appear to match Shell’s provision, via UK and Dutch subsidiaries, of a range of services to its global group.

Shell has claimed that its Tax Contribution Reports explain its service cost allocation system, and how it is set up and operated in accordance with the OECD Guidelines.¹⁶⁴ SOMO reviewed six such reports (2019–24). They do not refer to the various defences and explanations found in the Shell Files. They simply say services are provided based on actual costs. A reference to proportionate sharing of costs appears to link to the OECD concept of cost contribution agreements (CCAs), but there is no evidence that the UK and Dutch companies are involved in CCAs or that they derive the proportionate benefits as well as costs. Shell has also told SOMO it “applies a (deemed) profit mark-up in, amongst others, the United Kingdom and the Netherlands for the services provided by its service companies in those countries”.¹⁶⁵ There is no mention of this in the Tax Contribution Reports. Nor, as the case study demonstrated, is there any clarity on how the profit margins were arrived at.

All the options Shell refers to in the Shell Files (it is not clear if Shell has actually used all of them), when read alongside its response to SOMO (which focuses on deemed profit mark-up) and the Tax Contribution Reports (which refer to charging based on cost and then refer to a tool for CCA), underline the ‘pick-and-mix’ problem with transfer pricing guidance. It is almost impossible, despite repeated communication with Shell, to unravel how its pricing of services has evolved over the past decade, which justifications have been used, and how any of what is represented in these various documents is consistent with the OECD Guidelines. Shell should answer some of this, but the guidelines themselves have provided the framework for this confusion and obfuscation.

Summing up: Taking back power over the system

In terms of addressing tax avoidance by MNCs, the OECD Transfer Pricing Guidelines are unsound. To begin with, this is not what they claim to do, despite being widely referenced as a solution to transfer pricing abuse. They fail to consider power, motivation, and the logical basis for location of subsidiaries in low- and no-tax jurisdictions. The ALP is, by the OECD’s own admission, riddled with challenges, but nonetheless the core of the guidelines. Comparability analysis, central to the ALP, depends on a level of information on specific circumstances being provided to tax authorities by the company, a self-interested party. Assessment of functions and risks similarly relies on a host of corporate choices. All three of our case studies show up these weaknesses.

In its response to SOMO, the OECD acknowledged:

“While this exercise [ALP] gives rise to practical challenges and opportunities for taxpayers to take aggressive positions many of the issues highlighted in your paper have now been addressed through BEPS and the GMT initiatives.”¹⁶⁶

This response is noteworthy. First, it acknowledges, albeit only partially, what the Transfer Pricing Guidelines do not: that companies may seek to aggressively avoid tax. This at least acknowledges some kind of motive or intent. Second, it refers to the problems being addressed via two initiatives. The Base Erosion and Profit Shifting (BEPS) initiative has been ongoing since 2013.¹⁶⁷ Much of what SOMO found in the Shell Files happened after this. The Global Minimum Tax (GMT) process is also ongoing, but significantly weakened by both the USA pulling out and, subsequently, recent agreement to effectively exempt US companies.¹⁶⁸

The BEPS and GMT initiatives have not solved anything – they are part of the problem. Endless technical processes have resulted in ever more complex formulas that play into the hands of corporate tax avoidance. This is one of the main criticisms of BEPS. Every time journalists or tax justice advocates expose tax avoidance and the weakness of the system, the system extends and expands its multi-year processes to ‘address’ the problem; meanwhile, the problem of MNCs’ tax avoidance persists. What is achieved is perpetual stalling and the delay of real action. Each legitimate criticism is answered with yet more technical evolution of the guidance.

This is aided by the fact that companies participate, directly and indirectly via intensive lobbying of their governments, in the OECD's tax processes. It is a classic and effective corporate tactic: a problem that benefits them does not have to be truly solved as long as it is always being 'addressed'.

The OECD Transfer Pricing Guidelines apply a technical solution to a problem created by excessive economic and political power. Solving a political economy problem with a technical set of guidelines influenced by powerful actors with an interest in maintaining the status quo is likely to end up where the OECD's tax process has ended up: co-opted, discredited, and ultimately ineffective.

Conclusions – and where next?

The corporate behaviour described in this report runs contrary to years of effort on the part of global tax justice advocates. SOMO and many others have long sought **to prevent companies from abusing complex corporate structures to unjustly enrich themselves and their shareholders** – at the expense of tax revenues due to countries in which they operate and from which they derive their profits.



The data on Shell's operations in The Bahamas and Switzerland, and on its provision of services from the UK and the Netherlands, raises serious questions about Shell's use of transfer pricing to avoid paying its fair share of tax. The OECD's Transfer Pricing Guidelines, supposedly a tool for correctly attributing profit to subsidiaries, provide a veneer of legitimacy to profit shifting and tax avoidance. In Shell's lengthy explanations in its Transfer Pricing Reports of why its profits end up in tax havens, the company repeatedly references the OECD Guidelines as the basis for its arrangements. The convoluted and vague design of the guidelines leaves much open to interpretation, providing MNCs like Shell the opportunity to interpret the rules in the way that best serves their financial interests.

Shell's response

We gave Shell the opportunity to comment on our research findings in advance of publication. Shell stated that it is committed to comply with the letter and spirit of the law wherever it operates, and that, in each of the three cases described in this report, its tax position is in line with the OECD Transfer Pricing Guidelines. Shell's response also mentioned that it uses tax incentives and exemptions when available and appropriate.

Shell said that its average tax rate across all jurisdictions is 39.9 per cent, which is higher than the statutory corporate income tax rate levied across most OECD member states. SOMO notes that this relatively high rate is to be expected in the oil industry and does not reflect corporate income tax, but rather additional taxes levied on the exploitation of oil reserves, to compensate host states for the loss of their resources.

We have integrated case-specific comments from Shell into the respective case studies, and published the company's full response on SOMO's website, accompanying this report.

The solution: unitary taxation

As SOMO's findings in this report show, the transfer pricing system is in urgent need of replacement. Thankfully, a solution already exists: unitary taxation with formulary apportionment.

Unitary taxation with formulary apportionment aims to align MNCs' reported profits with their genuine economic activity and to reduce opportunities for tax avoidance by taxing them as single entities. To achieve this, it takes an MNC's total worldwide profit and distributes this profit between the jurisdictions where the company does business. To determine the distribution, unitary taxation uses a formula to establish where real economic activity has taken place, typically considering factors such as payroll, assets, and sales. Each jurisdiction then taxes its apportioned share of the profit according to its own domestic tax legislation.¹⁶⁹

For many years, civil society actors such as the Tax Justice Network,¹⁷⁰ and academics including Sol Picciotto and Reuven S. Avi-Yonah,^{171, 172} have advocated

for unitary taxation and formulary apportionment as a fairer way to tax MNCs. The approach would be particularly beneficial for countries in the Global South, which are overwhelmingly the losers of the current system, suffering the most from profit shifting and tax avoidance.

While the concept may sound radical, some of the world's largest economies, such as Canada, China, and the USA, already use unitary taxation and formulary apportionment to distribute taxes internally between their states and other subnational jurisdictions.¹⁷³ At the supranational level, the European Union explored the idea through its proposed Common Consolidated Corporate Tax Base (CCCTB), first introduced in 2011 and relaunched in 2016.¹⁷⁴

Even the OECD has moved towards using aspects of unitary taxation. Its Pillar One proposal for taxing digital services established a formulary methodology to allocate part of an MNC's total global profits to countries based on the company's sales made there.¹⁷⁵ This move has provided broader legitimacy for the consideration of formulary apportionment in international tax discussions,¹⁷⁶ even if the OECD itself appears unwilling to consider replacing the arm's length standard.

Unfortunately, the design of Pillar One means it would have limited effect in curbing tax avoidance, while its global adoption is also unlikely due to strong opposition from the USA. On the first day of Donald Trump's second term as US President, he issued an executive order taking the USA out of the OECD's "Global Tax Deal", which includes Pillar One. Shortly after, President Trump also signed a memorandum proposing retaliatory action against any foreign state taxing US MNCs through digital services taxes, which are unilateral alternatives to Pillar One.¹⁷⁷

The issues these proposals for unitary taxation have run into indicate the practical and political difficulties of implementing this approach globally.¹⁷⁸ Practically, applying unitary taxation with formulary apportionment worldwide would involve detailed and standardised financial reporting across all the world's jurisdictions, and the universal sharing of such reporting internationally.¹⁷⁹ This would require strong international cooperation, infrastructure, and capacity. Countries would need to agree politically on a formula, which would require negotiations.¹⁸⁰ Further, some 'winners' in the current system – wealthier countries, tax havens, and MNCs themselves – would oppose the reform altogether.

Yet, despite these difficulties, there is now a chance to reach a solution to corporate tax avoidance for the first time in many decades. Through the current United Nations process of developing a Framework Convention on International Tax Cooperation, the countries of the world are negotiating what global tax governance should look like.¹⁸¹ This process provides a unique opportunity to dispense with the transfer pricing system and its arm's length principle and move towards a unitary taxation system.

So far in the UN framework tax convention process, many OECD member states have tried to maintain the status quo,¹⁸² while the USA recently withdrew altogether.¹⁸³ Nevertheless, on 24 December 2024, the UN General Assembly adopted

the terms of reference for the negotiation of a framework tax convention, and in the coming years UN member states will negotiate the convention's text.

As this report clearly demonstrates, the current OECD transfer pricing system for allocating profits between jurisdictions is not functioning justly or effectively. Unitary taxation with formulary apportionment represents a solution, and the UN Framework Convention on International Tax Cooperation process provides a key opportunity to achieve a truly inclusive and equitable system for taxing multinational corporations.

Photo by Duncan Sanchez via Unsplash.



Endnotes

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13. Some studies use the metric alongside others to come to an overall calculation. For example, in its 2020 paper on “the axis of tax avoidance”, the Tax Justice Network compares the profits booked in countries with the share of employees, tangible assets, and sales of multinationals as a way to measure the level of profit shifting to those countries. The Tax Justice Network also uses the number of employees as part of its methodology to estimate global corporate tax avoidance by multinationals in its State of Tax Justice report. It combines share of employees with share of wages to establish real economic activity and show profit shifting by multinationals: Tax Justice Network, *The Axis of Tax Avoidance*, April 2020, https://www.taxjustice.net/wp-content/uploads/2020/04/The-axis-of-tax-avoidance-Tax-Justice-Network_April-2020-1.pdf; Tax Justice Network, *The State of Tax Justice 2024 Methodology: Corporate Tax Abuse*. Alongside this work, several publications analysing profit shifting to European banks, including by Oxfam France, Oxfam International, and the EU Tax Observatory, have similarly used the profit per employee metric alone as the core measure of profit shifting: Tax Justice Network, “Following the Money: French Banks’ Activities in Tax Havens,” 16 March 2016, <https://taxjustice.net/2016/03/16/following-the-money-french-banks-activities-in-tax-havens>; EU Tax Observatory, *Have European Banks Left Tax Havens? Evidence from Country-by-Country Data*, September 2021, <https://taxobservatory.world/publication/have-european-banks-left-tax-havens-evidence-from-country-by-country-data/>, p. 9. In academic work, A. C. Clausing used a calculation dividing the total profits of US multinationals by both the number of employees and the value of assets as a metric to establish profit shifting. Clausing differentiates tax havens into two separate categories: low-activity havens (e.g. Bermuda, Cayman Islands) and higher-activity havens (e.g. Ireland, Singapore, Switzerland). In the research, Clausing finds US multinationals were reporting profitability per employee at 100 times higher in low-activity havens and between 2.8 and 12 times higher in high-activity havens compared to in other foreign countries: A. C. Clausing, “Five Lessons on Profit Shifting from the U.S. Country by Country Data,” *Tax Notes Federal* 169(9), 2020, pp. 925–40, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3736287, at pp. 930, 939.
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Colophon

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July 2026

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Editor Miles Litvinoff

Design karenpaalman.com

Cover Photo Max-o-matic

Acknowledgements The authors would like to thank Alex Cobham (Tax Justice Network), Tove Ryding and Markus Trilling (EURODAD), Reuven Avi-Yonah (University of Michigan), Veronica Grondona (ICRICT), Sol Picciotto (Lancaster University), Jan van de Streek (University of Leiden), Eli Moskowitz (OCCRP), Sidonie East (formerly with SOMO) and Arnold Merkies (formerly with Tax Justice Netherlands) for their input and reviews of earlier versions of the report. The final content of the study is the sole responsibility of the Centre for Research on Multinational Corporations (SOMO).

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