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Why mandatory public country by country reporting is good for business

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1. Introduction

Large-scale corporate tax avoidance – and the secrecy that enables it – have continued to hit the headlines throughout the Covid-19 pandemic.[1] It's not difficult to understand why since corporate tax avoidance costs countries around the world an estimated US$ 500 billion every year.[2] In the European Union (EU), the annual loss to profit shifting by multinational corporations is conservatively estimated to be €50-70 billion each year.[3] While many governments have been struggling to finance public health systems and recovery from the Covid-19 crisis, some large multinationals have made record profits during the pandemic.[4] Meanwhile, many small- and medium-sized businesses are struggling to cope with the effects of the pandemic.[5]

One of the key problems with today's corporate tax system is the secrecy surrounding information about where corporations do business and what they pay in tax in those countries – a problem that could be easily addressed through the introduction of public country by country reporting (CBCR). This would allow everyone – including citizens, policy-makers, investors, trade unions, journalists and researchers – to see information about where corporations do business and what they pay in tax in each country where they operate through "country by country reports".

Transparency through public CBCR is one of the most effective ways that business can demonstrate responsible tax behaviour. Corporate transparency on tax matters is also important so that all stakeholders have an informed view of whether businesses pay their share and how the tax system is working. However, one element that is often ignored in dialogues around transparency and taxes is the value transparency can have for the private sector itself. Public CBCR data is hugely valuable to investors in making informed and sustainable investments. Businesses themselves can benefit from greater tax certainty and a level playing field. In addition, transparency can build public trust, demonstrate commitment to sustainable business practices and enable evidence-based dialogue with all stakeholders.

Transparency can help to support a level playing field, to inspire investor confidence and to help sustain public trust – all of which will in turn support business. This is why there is a strong business case for mandatory public country by country reporting.

2. The investor case for public CBCR

There is a strong investor case to be made for public CBCR because this data offers valuable economic, risk and social impact insights. CBCR data allows investors to ascertain how a company approaches its tax obligations so they can understand the reputational, legal and compliance risks[6] and the extent to which this is aligned with the investor's own values and priorities. Mandatory public CBCR is a key tool to strengthen investor confidence, to ensure that the EU and other regions can effectively attract investment and to safeguard companies' access to capital. Investor advocates of public CBCR span traditional commercial investors, institutional investors and environmental, social and governance (ESG) investors because this data offers an insight into whether a company's performance is based on sustainable economic activity, the operational and governance approach of a corporation, as well as the level and tolerance of risk. One reason that investors are actively advocating for new mandatory public CBCR standards, is because existing rules have failed to provide them with the necessary data. The Organisation for Economic Co-operation and Development (OECD) introduced a secret CBCR standard through BEPS Action 13.[7] but this data is not publicly available and cannot be accessed by investors. The European Union (EU) has recently reached political agreement upon new transparency rules that will oblige companies to report additional information on activities in EU countries and a small number of countries that the EU has included in its list of jurisdictions that it considers non-cooperative on tax matters.[8] But this transparency will fail to provide investors with meaningful data due to its incomplete nature.[9] In addition, both standards only apply to the largest multinational corporations (MNCs) and exclude the majority of MNCs from reporting obligations.[10] The world's largest ESG reporting standard, the Global Reporting Initiative (GRI), has introduced public CBCR as part of its standards. This development has been welcomed by investors, but the voluntary nature of the standard means that not all companies are obliged to publish CBCR. Voluntary reporting provides considerable discretion to reporting corporations which may result in data providing investors with an incomplete understanding. Mandatory public CBCR has the significant benefit of providing consistent and comparable data for all large multinational corporations.

2.1 Rapidly growing focus on responsible investment and tax-based divestment

ESG finance is rapidly growing in Europe and outperforming other funds.[11] This offers a key opportunity for businesses seeking capital. Responsible business practices – including on tax matters and on public disclosure – are important attributes for ESG investors and businesses seeking capital can benefit from public CBCR.

Principles for Responsible Investment (PRI) – the global initiative on responsible investment with an international network of 3,800 investor signatories representing more than US$ 100 trillion in assets under management – supports mandatory public CBCR.[12] Most recently, PRI has called on the EU to introduce real public CBCR[13] and called on the OECD to transform their secret CBCR standard to public reporting.[14] PRI is not alone. Numerous investors of all sizes and profiles are actively advocating for mandatory public CBCR from decision makers in the EU,[15] the OECD[16] and the US.[17]

Not only are investors advocating for public CBCR, there has been a recent example of divestment based on poor transparency around corporate tax practices – a trend that looks set to continue as stakeholders place greater weight on responsible tax behaviour and transparency by companies. In October 2020, Norway's sovereign wealth fund – one of the largest of its kind in the world – divested from seven companies citing poor transparency on tax matters as the reason.[18] The fund lists tax and transparency among the key societal impacts they monitor and has endorsed the GRI tax standard and the importance of country by country reporting.[19] In the past year, it assessed reporting on tax for 200 companies and entered into dialogue with a number of them, contributing to companies adopting new policies on the issue.[20] The Norwegian wealth fund and Dutch pension fund ABP have also established an investor network dedicated to discussing investors' expectations of companies' corporate tax and disclosure practices.[21]

Public CBCR provides a win-win situation for investors and businesses seeking investment. CBC data provides investors with important information on the economic value and sustainability of a company, as well as the risk profile and alignment with mainstreamed responsible business practice expectations. Likewise, businesses gain assurance that investment is based on an accurate understanding of a company's operations and approach, leading to greater long-term sustainability.

3. A sustainable economy and level playing field

3.1 SME's competitive disadvantage

Secrecy within the corporate tax system is an important enabling factor for large-scale corporate tax avoidance. Transparency will play a critical role in addressing this problem, and thereby promoting equal opportunity for all businesses. A level playing field ensures that factors like economic value, demand and innovation drive business success, rather than the most aggressive tax avoidance strategies.

MNCs operate across borders, thus providing greater opportunities for tax planning, while small- and medium-sized enterprises (SMEs) are less likely to operate across borders. As a result, the secrecy and tax avoidance strategies used by some MNCs are significantly less likely to be available to SMEs.[22] In contrast, domestic companies are often subject to transparency requirements at a national level, such as filing publicly accessible accounts[23] and publishing tax payments.[24] While MNCs might be subject to the same requirements at the national level, their international structures can mean that a real overview of the corporation is not possible unless the transparency requirement covers all their operations on a country by country basis.

In addition, research has found that SMEs often have higher effective tax rates (ETRs) than MNCs, although the lack of public data on corporate taxes does present a challenge in determining accurate ETRs for MNCs and for comparing tax incidence.[25] In Europe, research suggest that, in countries with high corporate income tax rates, a company with cross-border operations in the EU is estimated to pay on average 30 per cent less tax than a similar firm that is active in only one country.[26] Therefore, it is no surprise that several SMEs and their representative bodies have called for legislation to introduce mandatory public CBCR in the EU[27] and the US,[28] as well as calling for the OECD to transform their secret CBCR to a public standard.[29] In addition, several groups have endorsed the GRI template as a standard for convergence.[30]

3.2 Positive experience from public CBCR for the banking sector in the EU

The EU introduced public CBCR for the banking sector in 2013 after the financial crisis.[31] Research suggests that the measure has already dis-incentivised tax avoidance,[32] but has not negatively impacted on the sector's competitiveness.[33] In addition, research has found that this disclosure has provided stakeholders with valuable information that is not otherwise available,[34] providing policy-makers and experts with a clearer understanding of tax practices. The positive experience with mandatory public CBCR for the banking sector in the EU has allayed concerns that reporting discloses commercially sensitive information and creates challenges for businesses in collecting and publishing this data. Just as importantly, it has also demonstrated the value this data offers to both private sector stakeholders and experts, policy-makers and citizens.

3.3 Improved certainty, reduced costs

One of the challenges for businesses that report CBCR information secretly is that the inadequate system of automatic information exchange undermines the value of disclosure for business certainty and therefore does not deliver the efficiency it should. The European Court of Auditors has found that EU Member States do not sufficiently check data quality or completeness before sharing this with other tax authorities,[35] which creates opportunities for misunderstandings and introduces risk for companies. In addition, the OECD system of CBCR exchange relies on activated exchange relationships between countries, which results in many countries having no access to secret CBCR data and most countries having incomplete data.[36] For example, only four African countries can currently receive CBCR information through this system.[37] A number of countries have introduced local CBCR filing requirements in order to overcome the shortcomings of the secret CBCR exchange system.[38] Public CBCR would ensure all relevant stakeholders – including tax authorities in the countries where an MNC operates – have access to CBCR, which would remove the need for duplicate filing. Public CBCR would also allow companies to include narrative explanation in addition to data in order to ensure information is complete and can be interpreted correctly.

Legislative action on public CBCR has delivered disappointing results to date. The EU has recently agreed upon transparency rules that will oblige companies to report additional information in some jurisdictions.[39] It is misleading to refer to these rules as public CBCR, since companies will not be obliged to report on activities on a country by country basis for all their countries of operation.[40]

This was a major missed opportunity for EU leaders to introduce real transparency and establish a mandatory public CBCR standard on which other regions and bodies could converge. The incomplete nature of the transparency rules that will be introduced in the EU increases the likelihood that other regions, such as the Unites States, will introduce different standards in order to generate meaningful data. This means that companies might have to comply with different standards in different regions.

Investors, SMEs and civil society organisations have called for convergence on a single public CBCR template that MNCs would be obliged to publish, based on the GRI tax standard. This approach would ensure that companies can produce a single public country by country report to meet any disclosure obligation. It would also ensure that the data contained in the report is adequate, uniform, comparable and provides meaningful transparency for all stakeholders. Public CBCR has the significant advantage of ensuring that all relevant stakeholders have access to accurate information, reducing opportunities for misunderstandings and compliance costs associated with multiple reporting systems.

4. Public trust, stakeholder dialogue and ESG contribution

Businesses benefit from the tax-funded infrastructure and public services that enable their operations –including roads, electricity, telecommunication networks and strong security and legal systems – as well as capable workers who have been supported by the state's education and healthcare systems. Companies' tax contribution – including corporate income taxes – are one important way in which a company contributes to the infrastructure it benefits from, and is also vital for ensuring a public sense of tax justice. Cases of corporate tax avoidance have severely damaged public perception of large businesses' tax practices and have created a strong demand for change. Transparency through public CBCR is one of the most effective ways companies can address public mistrust and concerns that companies are not paying their share.

4.1 Scandals and growing mistrust can be addressed with transparency

Corporate tax avoidance has been a major concern for people across the EU for many years, with tax scandals like LuxLeaks,[41] the Paradise Papers[42] and OpenLux[43] giving the public a brief glimpse into the veiled world of tax avoidance by large multinational corporations. The 2021 Global Corruption Barometer found that half of all people in the EU believe companies often avoid paying their taxes,[44] and the Eurobarometer of public opinion has shown that three quarters of citizens want the EU to intervene more in the fight against tax fraud.[45]

Corporate lobbying to prevent and weaken public CBCR has further damaged public trust and presented an unfavourable view of the role of business in decision-making on tax matters. For example, researchers have identified extensive efforts by large accountancy firms[46] and corporate lobby groups[47] to weaken EU legislation on public CBCR. Some Members of the European Parliament (MEPs) have also raised concerns about specific corporate actors and their role in the debate.[48] Most recently, a media exposé alleged that the French business representative group MEDEF had been part of drafting France's official state position on the EU legislative proposal for public CBCR, which sought to drastically limit transparency and include a major loophole in the legislation that would allow multinational corporations to delay reporting for several years.[49] These efforts by corporate lobbyists contribute to a view that business has something to hide.

In contrast, public disclosure enables a company to demonstrate its commitment to transparency and responsible tax practices, while mandatory public CBCR would ensure all companies share equivalent and comparable information. This would also allow the public focus to expand from individual companies to understanding how the tax system as a whole is functioning.

4.2 Voluntary disclosure and ESG standards

Some companies have already responded to stakeholders' demands for transparency by publishing CBCR on a voluntary basis. The world's largest ESG reporting standard, the Global Reporting Initiative (GRI), has introduced a tax standard to its voluntary reporting templates, which includes public CBCR that contains more information than the existing public and non-public measures.[50] This standard was developed by an expert committee made up of representatives of investors, multinational corporations, financial services, academic experts, civil society and trade unions. Following this development, it is expected that many large multinationals will voluntarily publish CBCR data in 2021 on the basis of the new template. In fact, a number of companies have already published CBC reports aligned with the GRI standard including Vodafone,[51] BP,[52] Orsted,[53] NN Group,[54] Anglo American,[55] Allianz[56] and Newmont.[57]

4.3 Customers, workers and the public

Responsible tax practices have also become a mainstream indicator of ethical business conduct for many citizens and consumers. A June 2021 poll in the UK determined that more than 77 per cent of people believe companies should publicly disclose their tax payments.[58] The results also highlighted that the respondents strongly indicated that they would prefer to shop with and work for companies that disclose that they pay their share of tax.

Another example of well-established consumer and worker interest in transparency on tax matters is the Fair Tax Mark. The Fair Tax Mark certification scheme awards the mark to companies with responsible tax practices in a similar way as the Fair Trade mark is awarded to fairly produced and fairly traded products. Companies publish public CBCR as part of the requirements and the scheme recently expanded from the UK to become a global initiative in response to a demand for fair tax accreditation around the world.[59] The diverse group of accredited organisations includes large energy providers like SSE Airtricity, well-known high street retailers like Lush, financial service providers, as well as many SMEs.[60]

5. Conclusion

Public country by country reporting offers a valuable disclosure tool for businesses to demonstrate responsible tax behaviour, to address the demand for greater transparency around corporate tax practices and to improve trust and confidence in one's brand. However, the value of public CBCR extends beyond these commonly addressed benefits. Public CBCR will also play an increasingly important role in access to finance in future, while mandatory reporting can help to create a level playing field and evidence-based tax laws. Compared to a situation where different non-public standards will develop in parallel, public CBCR could help to reduce compliance costs and create greater and more sustainable business certainty when coupled with responsible practice.

Endnotes

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