



## **Christian Aid Ireland submission on European Commission proposals on public tax transparency rules for multinationals**

20.05.2016

Christian Aid welcomes the opportunity to make a submission on the issue of public country by country reporting in response to the European Commission's recently published proposals. Christian Aid has called for public country by country reporting (CBCR) since 2008.

We believe that CBCR serves a vital function in improving the transparency and accountability of the taxation of Multinational Companies (MNC). It is clear that public trust has been lost in this area and needs to be rebuilt. As taxation is recognised to be an area of significant flexibility and judgement, and having a significant impact on developing countries, we believe that an equitable solution will involve a high level of public transparency in addition to non-public transparency towards revenue authorities. By providing the information publicly to help policy makers, parliamentarians, journalists, investors, NGOs and citizens understand the role that MNCs are playing in and the contributions they are making to our societies, CBC reporting can be a part of rebuilding that trust by showing where companies are playing a positive role in the development of countries, and by helping us all understand how a globalised economy is working, and enabling better rules to govern these activities to emerge.

We believe the European Union has an important role in addressing these issues, and we particularly welcome the Commission and the Parliament's engagement on the issue. However, it is our view the Commission proposals of April 12th this year, fall far short of what is required to tackle corporate tax dodging in Europe. It is also difficult to see how the proposals will do anything to allow developing countries prevent MNCs shifting vast profits out of their countries, avoiding tax that could and should be spent on the provision of essential services and fulfilling citizens' fundamental rights. Developing countries suffer most as a consequence of corporate tax dodging with the IMF, putting the figure lost to developing countries as high as \$200 annually<sup>1</sup>

This submission is in two parts. The first part looks at the specifics of the Commission proposals, while the second part addresses some of the principle concerns MNCs have expressed in response to the prospect of full public country by country reporting. It draws on the findings of a Christian Aid survey<sup>2</sup> conducted with FTSE100 companies, as well as on MNC submissions to the OECD's Base Erosion Profit Shifting (BEPS) public consultation, including on public country by country reporting. It is hoped that addressing these concerns will be a useful contribution to the Irish government's deliberations on this important issue.

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<sup>1</sup> <https://www.imf.org/external/pubs/ft/wp/2015/wp15118.pdf>

<sup>2</sup> <http://www.christianaid.org.uk/images/country-by-country-survey-sept-15.pdf>

## PART 1

*The Commission proposals would require large multinational companies to disclose publicly the income tax they pay within the European Union, on a country by country basis. In addition, they would be asked to disclose how much tax they pay on the business they conduct outside the European Union. For those tax jurisdictions that do not abide by tax good governance standards (so-called tax havens), this information will need to be disclosed on a disaggregated basis. Any multinational company — European or not — that is currently active in the EU's single market with a permanent presence in the Union and that has a turnover in excess of EUR 750 million would have to comply with these additional transparency requirements.<sup>3</sup>*

These proposals are problematic for a number of reasons.

- Firstly, these proposals cannot be called country by country reporting for the simple reason that they do not cover every country in which a company might operate. Companies with subsidiaries outside of the European Union, and not on the yet-to-be-defined non cooperative tax jurisdictions, will only be required to report on these subsidiaries on an aggregate basis. Rolling together the jurisdictions where profit is likely to be shifted to, with those where profit stripping may be most egregious, and in particular developing countries of the global south, is of course to negate the entire point of CBCR — which is to understand the disaggregated distributional picture. Those who wish to use CBC reports to help devise policy and understand MNC behaviour will be thwarted, or potentially come to wrong interpretations due to the aggregated nature of CBC reports. An essential benefit of CBCR should be to improve our understanding of how investment decisions are made and how policy affects investment, particularly in developing countries, but aggregated data will impede that understanding—potentially making it worse.

In addition, these proposals may actually incentivise companies inclined to engage in aggressive profit shifting to simply shift their presence to one of the jurisdictions where aggregate reporting is the only requirement, inadvertently promoting a 'race to the bottom' between countries competing for this business.

The proposals are particularly problematic for developing countries which will be unable to see the entire spectrum of company activities essential to help them identify possible instances of illegal profit shifting by companies. This is despite the OECD's own acknowledgement<sup>4</sup> that developing country measures to challenge BEPS is often hindered by lack of information. The CBC reports required under the OECD's BEPS initiative are only to be exchanged on the basis of existing tax treaties between states, and as many developing countries do not have extensive treaty networks, they will be unable to access the information. Public country by country reporting therefore is the only way in which developing countries can be guaranteed access to this vital information.

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<sup>3</sup> <https://www.djei.ie/en/Consultations/Consultations-files/European-Commission-FAQs-Tax-Transparency.pdf>

<sup>4</sup> <http://www.oecd.org/tax/part-1-of-report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf>

- Secondly, there is no shared definition of what constitutes a non-cooperative jurisdiction. Previous attempts by the European Union to draw up such a list have failed as a result of major power imbalances and the intrinsically political nature of such a process. It is highly unlikely that any future list will include, for example, the United States or Switzerland, despite both jurisdictions being acknowledged as being attractive to some companies on the basis of the high levels of corporate opacity that they offer<sup>5</sup>. Proposals that have at their core a black list of jurisdictions that holds little international credibility will leave the process fundamentally flawed.

In addition, as the black list is unlikely to be static, countries being added to, or removed from the list will generate additional compliance costs for businesses and a confusing picture for those looking to use the reports, particularly for research purposes. For example, if one year the report features Bermuda as a separate reporting jurisdiction, the following year may see it being aggregated with others. That will dramatically reduce the utility of the reports, given that those countries that have just graduated from the list are ones that probably merit most attention as to the impact of either being on or off the EU list.

- Thirdly, the threshold of \$750 million under which companies are not obliged to provide country by country reports is too high to be useful. Setting a threshold of \$750 million will rule out between almost 90% of all multinationals, according to OECD figures<sup>6</sup>. The rationale behind setting the threshold this high seems to be to ensure that smaller companies are not subjected to onerous additional reporting requirements and echoes the OECD argument that 10% of companies are responsible for 90% of all MNC revenues. However this is not necessarily true at local level, and in particular in developing countries, where companies that fall below that threshold may still be significant local actors and taxpayers. (The issue of compliance costs is dealt with in part 2). While we are sympathetic to the European Parliament's suggested threshold which is based on the Commission's own definition of 'large undertakings' as detailed in the Accounting Directive<sup>7</sup>, we also acknowledge that trying to introduce new requirements on all large companies in one go, may be difficult as there is a limited number of SAP programmers to amend and adapt the relevant systems. An alternative proposal would be to initially introduce the threshold at \$750 million and over the following five years reduce that amount until all large companies were compliant.

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<sup>5</sup> <http://www.financialsecrecyindex.com/>

<sup>6</sup> <http://www.oecd.org/ctp/beps-action-13-guidance-implementation-tp-documentation-cbc-reporting.pdf>

<sup>7</sup> The Parliament has (eg. in the Shareholders' Rights Directive) supported a threshold based on the definition of "large undertakings", which, according to the **Accounting Directive** (art. 3 section 4), means multinationals that exceed at least two of the three following criteria: a) balance sheet of 20 mn euros, b) turnover of 40 mn euro, c) 250 employees.

## PART 2:

Over the past eight years, support for public CBCR has grown, with the supportive voices stretching far beyond civil society to the European Parliament,<sup>8</sup> investors,<sup>9</sup> businesses<sup>10</sup> and the High Level Panel on Illicit Financial Flows from Africa.<sup>11</sup> Support for greater publicly accessible reporting from companies is also strong among the Irish public.<sup>12</sup>

In addition to this backing, there have been some significant policy developments.

Some companies have voluntarily committed to providing CBCR<sup>13</sup> (often as part of third party accreditation, such as the Fair Tax Mark<sup>14</sup>). Laws requiring extractive companies to reveal their payments to government on a country- by-country basis have been passed and are being implemented in many countries.<sup>15</sup> In the EU, major financial institutions are required by law to provide public CBCR on their turnover, profits, number of employees, state subsidies received and taxes paid,<sup>16</sup> the first reports of which have already been published. (It is notable that following this requirement to publish this information, the banking sector has stated its support for all sectors to become more transparent). And as referenced above, the OECD BEPS Action plan includes a form of country by country reporting, although crucially this will not be publicly available.

So while the overall trend does seem to be towards greater transparency from MNCs, there are still some concerns around making this information publicly available. Some of these concerns are available to read as part of submissions made by MNCs to the OECD as part of the BEPS public consultation process<sup>17</sup>.

For the purposes of this submission, we have addressed each of the concerns in turn, with a view to arguing that there is little justification for access to country by country reports to be anything other than fully public, and truly country by country.

### 1. The first main concern is around the fear that the information would be misinterpreted

*'For large and complex multinational groups ... who report publically by division, publishing a prescribed set of numbers by country will inevitably need detailed clarification and will clearly have the potential for conclusions to be drawn by the reader that are simply wrong.'* – Response to Christian Aid survey.<sup>18</sup>

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<sup>8</sup> See Transparency International, 'European Parliament committee sets the tone for Europe's debate on multinational transparency', [www.transparency.org/news/pressrelease/european\\_parliament\\_committee\\_sets\\_the\\_tone\\_for\\_europes\\_debate\\_on\\_multinati](http://www.transparency.org/news/pressrelease/european_parliament_committee_sets_the_tone_for_europes_debate_on_multinati)

<sup>9</sup> For example, see Eurosif's position on CBCR, [www.eurosif.org/eurosif-position-on-country-by-country-reporting/](http://www.eurosif.org/eurosif-position-on-country-by-country-reporting/)

<sup>10</sup> <http://www.theguardian.com/politics/2015/dec/15/meps-should-support-a-fair-tax-payer-label>

<sup>11</sup> United Nations Economic Commission for Africa, Illicit Financial Flows, [www.uneca.org/publications/illicit-financial-flows](http://www.uneca.org/publications/illicit-financial-flows)

<sup>12</sup> [http://www.christianaid.ie/pressoffice/pressreleases/september\\_2015/Vast-majority-believe-tax-avoidance-by-multinationals-to-be-morally-wrong.aspx](http://www.christianaid.ie/pressoffice/pressreleases/september_2015/Vast-majority-believe-tax-avoidance-by-multinationals-to-be-morally-wrong.aspx)

<sup>13</sup> For example, SSE.

<sup>14</sup> Fair Tax, [www.fairtaxmark.net](http://www.fairtaxmark.net)

<sup>15</sup> Including EU, US and Canada.

<sup>16</sup> Article 89 of Directive 2013/36/EU, <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32013L0036&from=EN>

<sup>17</sup> <http://www.oecd.org/ctp/transfer-pricing/volume1.pdf>

The main objection appears to be that the information provided might be misinterpreted, with negative results – reputational damage seems to be the main concern. It is, however, unclear why the result of CBCR should be misinterpretation. Also companies where they feel their numerical results may open several lines of interpretation can complement public CBCR with narrative explanation of major transactions and operations in secretive jurisdictions as has already been done by some multinationals.<sup>19</sup>

When PwC looked at the potential impact of a form of public CBCR for financial services companies, it found that ‘the balance of opinion suggests that these provisions (public reporting of CRDIV country by country reports) are likely to have some impact, as intended, in improving the trust of citizens of the European Union in the financial services sector. Specifically, the impact assessment conducted by PwC suggests that the respondents expect Article 89 to have some positive impact on the transparency and accountability of, and on the public confidence in, the financial services sector in the EU.’<sup>20</sup>

This does not suggest that information will be misinterpreted; indeed a further finding by PwC suggests that some companies may deliberately misrepresent their affairs in their existing financial reports: ‘Our results suggest that improved disclosure quality, which is a key objective of CBCR, could improve firms’ competitive outcomes. The analysis suggests that an improvement in disclosure quality is associated with a reduction of earnings management, which could have positive impacts on firms’ competitiveness.’<sup>21</sup>

This finding helps explain why an increasing number of investors support CBCR, which will provide better information, in a standard, comparable format, on which they can base their investment decisions, and will reduce the likelihood of companies artificially massaging their figures. Tax represents a reputational, cash-flow and financial risk<sup>22</sup>; investors therefore need the information to assess that risk. Increased guidance to investors<sup>23</sup> together with sharing of good practices<sup>24</sup> from leading responsible investment bodies is leading to greater engagement by investors on tax matters.

Many who argue that CBCRs will be misinterpreted base their argument on recent media stories – most commonly the tendency of such stories to look at taxes paid in relation to turnover rather than profits. While this may be a valid criticism of recent media reporting, it is less clear why it should serve as a criticism of CBCR. Currently, it can be very difficult to obtain the range of information that would ideally be used to inform a comment on a multinational company’s operations. Given that CBC reports will clearly report turnover and profits, taxes paid and other information, all on a single line for each country, it will be much more likely that resulting media reports will contain more accurate information and analysis. For instance the reporting on

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<sup>18</sup> Response to Christian Aid survey.

<sup>19</sup> [http://www.vodafone.com/content/annualreport/annual\\_report14/downloads/financials.pdf](http://www.vodafone.com/content/annualreport/annual_report14/downloads/financials.pdf)  
<https://www.vodafone.com/content/sustainabilityreport/2015/index/operating-responsibly/tax/our-contribution-country-by-country.html#ctable>

<sup>20</sup> European Commission, General assessment of potential economic consequences of country-by-country reporting under CRD IV, Study prepared by PwC for EC, 2014, p9, [http://ec.europa.eu/internal\\_market/company/docs/modern/141030-cbcr-report\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/modern/141030-cbcr-report_en.pdf)

<sup>21</sup> Ibid. Earnings management is defined as: ‘where a firm’s management use accounting discretion in presenting financial results in order to present the entity to investors in an artificially positive light’.

<sup>22</sup> See Christian Aid, Tax and Sustainability: A framework for business and socially responsible investors.  
<http://www.christianaid.org.uk/images/tax-and-sustainability-2011.pdf>

<sup>23</sup> [https://www.unpri.org/download\\_report/8531](https://www.unpri.org/download_report/8531)

<sup>24</sup> <https://www.unpri.org/about/pri-teams/esg-engagements/tax-resources>

French banking led to increased scrutiny of the banks in public as 11% of banking revenue of the top five banks were in Luxembourg<sup>25</sup>, which then led to a response refuting Luxembourg's tax haven status<sup>26</sup>.

Indeed, armed with better, standardised, and comparable data about companies, it is likely that trusted third parties will use the data, making it much more difficult for poor quality analysis or misinformation to gain credibility. The alternative, given that media interest in corporate tax affairs does not appear to be slowing, would appear to be a continued challenge to enabling informed analysis.

It may, of course, be the case that even with the CBC report, questions are raised as to why turnover, profits and so on are allocated in the way they are to particular countries, as in the French case concerning the top five banks<sup>27</sup> but it would be wrong to describe such questioning as undesirable misinterpretation. It is entirely legitimate for the media and other observers to question the efficacy of the tax system, its results, and where responsibility for undesirable outcomes lies.

Indeed, to ensure we have tax systems that are trusted and respected, it is necessary to engage in such debates. While these may have been regrettably absent until recently, that only seeks to enhance their desirability now. Furthermore, as we enter a period of change in the international tax system with the BEPS actions, it is vital that it is possible to track the impact of these changes. In the discussion draft on monitoring BEPS, the OECD highlighted the potential role for CBCR in assessing the effectiveness of the BEPS Action Plan<sup>28</sup>. Instead of creating misunderstanding, CBCR therefore represents a huge opportunity to increase our understanding of tax systems.

Some companies agree. One company willing to make its CBC report public told Christian Aid: 'It is important that there is clarity of information available in the public arena.' It is planning public reporting combined with additional disclosure to explain the tax regime in which it operates. That this company, which has a very low tax charge, is willing to make such disclosures public should give confidence to other companies that good compliance can be explained and understood.

## **2. The second concern is around possibly revealing sector and business model specifics:**

*'The reason for our hesitation may perhaps be illustrated by a brief further explanation of our business and the way taxing rights over our profits are allocated between relevant jurisdictions.'* – Response to Christian Aid survey<sup>29</sup>

These concerns appear to be a subset of the misunderstanding concerns: that the way in which a certain sector or business is run will look anomalous in comparison to other companies and put it at risk of misunderstanding. Examples include companies that are set up as Real Estate Investment Trusts (REIT) and

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<sup>25</sup>[http://www.stopparadisfiscaux.fr/IMG/pdf/Rapport\\_Final\\_Sur\\_la\\_piste\\_des\\_banques\\_francaises.pdf](http://www.stopparadisfiscaux.fr/IMG/pdf/Rapport_Final_Sur_la_piste_des_banques_francaises.pdf)

<sup>26</sup> Castel, Boris and Pelloli, Matthieu (2016) Les Banques Croient Au Paradis, Le Parisien, 16 March

<sup>27</sup> <http://www.stopparadisfiscaux.fr/que-font-les-etats/la-france/article/nouveau-rapport-en-quete-de>

<sup>28</sup> See <http://uncounted.org/2015/05/13/measuring-tax-avoidance-what-data-for-beps-11/>

<sup>29</sup> Response to Christian Aid survey.

those with a franchise model, where the majority of the firm's activity is leasing intellectual property to franchise operators.

While it is certainly true that CBC reports may look different for such companies, the case has not been made that this renders CBCR generally undesirable. It is possible for companies to explain their structures and/or the tax regimes in which they operate to enable readers to understand their situation (third parties can also play a role here, eg Fair Tax Mark). Furthermore, as highlighted in the previous section, the fact that one FTSE100 company with a low tax charge is willing to make information publicly available shows that this view is shared by at least some companies.

While not a reason to reject public CBCR entirely, this concern does suggest that a requirement for public CBCR should make provision for companies to provide explanatory comments over and above any included in the template. Indeed, as already highlighted, one company made this point explicitly: *'We trust that, in developing any such legislation, consideration will be given to producing a disclosure that is useful to readers of the information. That will hopefully allow businesses the flexibility to provide the information that is most relevant to their organisation.'*

**3. The third concern relates to where a company's operations are so specialised that the CBC report would potentially divulge information specific enough to compromise a company's negotiating position**

*For an MNE operating in a high-tech niche market with a few very large customers, the negotiating position for product prices would be impaired if the value chain profits were transparent. – AMV response to OECD consultation<sup>30</sup>*

This concern only appeared in companies' responses to the OECD, but it does appear to be related to CBC reports. Essentially, the concern is that a company's operations in a given country could be limited to one very specific function, so the CBC report could be effectively equivalent to providing trade secrets.

While it is unfortunate that the small number of companies that mentioned this concern did not provide examples, there does appear to be, in principle, some merit to this concern because some operations may indeed be very specific. However, it remains unclear just how much this would differ from very specialised companies operating wholly within one country; presumably their annual accounts would also provide a similar level of detail, yet such companies would not be given a derogation from reporting.

While this concern may need looking into carefully, it should be noted that it was raised by very few companies (and none of the FTSE), and in relation to very specific circumstances (e.g. high-tech niche market with a few very large customers), and so is not a widespread concern. There should be a very high threshold for considering making allowances for this concern. They should not be granted just to protect pricing information, because the Arm's Length Principle (ALP – the principle for allocating profits on MNCs' internal

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<sup>30</sup> AWW response to OECD consultation on BEPS Action 13, <http://www.oecd.org/ctp/transfer-pricing/volume1.pdf>

transactions<sup>31</sup>) relies upon the idea that prices are publicly available both to support companies' pricing structures and to be used by revenue authorities to check compliance. Given that most companies support the continuation of the ALP, public CBCR should not be prevented or limited to allow MNCs to avoid providing public information that enables the ALP to function.

Indeed, this is at the heart of the argument around commercially sensitive information. While there may be some information that companies would prefer was not made public, it seems that generally this information would be useful to the market because it would improve competition - markets work on information. We therefore need to be very careful when companies claim commercial sensitivity, to ensure that they are not merely seeking to preserve a monopoly or oligopoly position.

#### **4. The fourth concern is around costs:**

*'We are prepared to engage with the UK government and others to consider any requirements to publish CBC data provided such requests were consistent and proportionate to the administrative burden of collection and dissemination.'* – Response to Christian Aid survey.<sup>32</sup>

Interestingly, while the cost of CBCR has been often raised as a concern previously,<sup>33</sup> only two companies raised the issue of costs in their responses to our survey. In both cases this was, as indicated above, a plea to ensure the compliance burden is proportionate, rather than claiming costs as a definitive reason to object to CBCR. Given that many countries, including Ireland, have committed to requiring MNCs to provide a CBC report to tax authorities, it is clear that there would be minimal extra costs involved in making such reports public. Indeed there would arguably be less cost involved in having full CBC reports for all countries than the EU proposal, as the EU proposal will require companies to adjust their reports to include/exclude whichever countries are on the blacklist or not, and to aggregate up the others. All of which will provide some extra compliance burden.

#### **5. There was also concern expressed around disclosing information unilaterally, without statutory requirement, would put companies at a competitive disadvantage:**

*We feel that until there is a statutory requirement for all multinationals to publish such information, unilateral publication could put the Group at a commercial disadvantage.'* – Response to Christian Aid survey.<sup>34</sup>

Several companies raised concerns about voluntary disclosure, suggesting that it could lead them to suffer competitive disadvantages (though without explaining exactly what these disadvantages would be).

What is notable is an acknowledgement by another FTSE100 firm: 'The possible competitive disadvantages that may arise from the voluntary public disclosure of CBC template information may, in our view, be substantially reduced were all relevant MNCs required to similarly disclose this trade sensitive information.'<sup>35</sup>

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<sup>31</sup> The Arm's Length Principle is simple, in that MNCs internal transactions should be priced at the same price as if the transaction were taking place between unrelated companies. While simple in theory, it is almost impossible to apply in practice, not least as many transactions that take place within companies would never take place in the open market.

<sup>32</sup> Response to Christian Aid survey.

<sup>33</sup> For example, see paragraph 5.3 in the Chartered Institute of Taxation response to the International Development Committee Report on Tax and Development, [www.publications.parliament.uk/pa/cm201213/cmselect/cmintdev/130/130vw05.htm](http://www.publications.parliament.uk/pa/cm201213/cmselect/cmintdev/130/130vw05.htm)

<sup>34</sup> Response to Christian Aid survey.



For Christian Aid, the responses to our survey suggest that governments should not sit back and hope that MNCs will voluntarily take action. While some will, our survey suggests that many would accept regulations but are less likely to go forward by themselves.

As one FTSE100 member company told us: 'Given that public disclosure of such reporting is not currently required under international standards (or UK) regulation, I think you would agree that to publish such data before it is required of all companies would place [us] at a commercial disadvantage... If publicly available country by country reporting becomes a statutory obligation for companies, [we] would be happy to comply in full.'<sup>36</sup>

Given that the EU is currently debating the question of regulations requiring public CBCR,<sup>37</sup> the fact that companies appear less wary of regulatory disclosure than they are of voluntary disclosure is an important finding. Not only would regulations create a more level playing field for companies, they would also help to ensure companies' reports are more comparable with one another. Common standards can be set, rather than companies developing a multiplicity of standards.

- In conclusion, it is important to note that under the Lisbon treaty<sup>38</sup> EU member states are obliged to ensure policy coherence in support of international development objectives. In other words, the policies of one government department should not inadvertently undermine the development of other countries. This is echoed in the government policy document 'One World One Future'<sup>39</sup>, in which there is a commitment to ensuring that government policies in one area do not undermine the objectives of Irish Aid. EU efforts to introduce greater transparency into corporate reporting, and to tackle corporate tax dodging should be guided by this objective. Introducing a country by country reporting standard, that places developing countries in particular at a disadvantage (as detailed above) clearly runs contrary to this objective. The Irish government should support only full public country by country reporting and use their influence at European level to ensure other member states do likewise.

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<sup>35</sup> Response to Christian Aid survey.

<sup>36</sup> Response to Christian Aid survey.

<sup>37</sup> The European Parliament has included proposals for CBCR in its negotiating mandate for the Shareholder Rights Directive.

<sup>38</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:C:2007:306:FULL&from=EN>

<sup>39</sup> <https://www.irishaid.ie/media/irishaid/allwebsitesmedia/20newsandpublications/publicationpdfsenglish/one-world-one-future-irelands-new-policy.pdf>