Adviesraad inzake beleidscoherentie
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Conseil consultatif sur la cohérence
des politiques en faveur du développement

# Opinion of the Advisory Council on Policy Coherence for Development

# "Public country-by-country reporting by large companies"

## 1. Introduction

01. This opinion relates to Public reporting by large companies, country-by-country. It was electronically approved on 10th May 2016.

Original language of this document: Dutch

## 2. Presentation of the issues

02. It is estimated that two-thirds of worldwide cross-border trade is conducted between the various entities of multinational companies. This trade is particularly sensitive to abuses where by multinational companies make use of the inconsistencies in the tax regulations of various countries and the lack of any international framework for coordinating these regulations to move profits to jurisdictions where they are subject to little or no tax with the aim of avoiding corporation tax in the jurisdictions where the economic profits are generated.[1]

03. The financial impact of this practice is significantly greater for developing countries than it is for OECD countries[2], given the relatively large proportion of corporation tax as part of total government revenue in developing countries and in view of how important multinational companies are for the tax base. The most recent World Investment Report (October 2015) published by the United Nations' Conference for Trade and Development estimates the tax losses for developing countries at more than $US 100 billion per year as a result of tax shifting by multinationals to jurisdictions with low or non-existent taxes.[3]A recent study by the IMF estimates the loss of revenue due to relocation activities related to 'tax havens' for developing countries at approximately 1.3% of GDP

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[1]Recent studies show that the rise in profits of multinational companies is systematically linked to a rise in the proportion of pre-tax profits of subsidiaries in countries with low taxes compared with the proportion of pre-tax profits reported by subsidiaries in countries with high taxes (Dharmapala D. and Riedel N. (2013). Earnings shocks and tax-motivated income-shifting: Evidence from European multinationals, *Journal of Public Economics*, Vol. 97, pp. 95-107). These studies also show that entities in countries with low taxes lend money to entities in countries with higher taxes in order to increase the interest rate burden in these latter countries (C. Fuest, S. Hebous, N. Riedel. (2011). *International Profit Shifting and Multinational Firms in Developing Economies*, WP).

[2]Fiscal competition between countries is not only harmful for the home countries of the multinationals or subsidiaries, but also for the countries where they set up and for their community equilibrium (Killian S. 2006. Where's the harm in tax competition?: Lessons from US multinationals in Ireland, 2006, *Critical Perspectives on Accounting*, Vol. 17, Issue 8, pp. 1067-1087).

[3] UNCTAD, (2015) "*World Investment Report 2015*", p. 200 and ff. Available at http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf

(approximately $US 200 billion).[4]By way of comparison: the total development cooperation (ODA) of OECD countrieswas $US 137 billion in 2014.[5]

04. One of the elements of this tax shifting and avoidance that explains the hollowing out of the government finances of developing countries is the lack of transparency in the financial flows between internationally linked companies.[6]Today multinational companies publish their financial details on a consolidated basis, whereas they are not considered by the tax authorities in this way. Each separate entity within the group is subject to tax separately. This makes it difficult to gain an overview of the business as a whole and the authenticity of the location of this business within the group. An obligation for such companies to publish their financial data by the country where the company operates (known as Country-by-Country Reporting, or CBCR), is a cost-effective way of getting a better grip on these practices.

05. At an international level, there is growing consensus about the effectiveness and desirability of CBCR. The Addis Ababa Action Agenda, approved by the member states of the United Nations at the third international conference on the financing of development in July 2015, encourages countries 'to strengthen transparency and adopt appropriate policies, including multinational enterprises reporting country-by-country to tax authorities where they operate'.[7]

06. In Addis Ababa, Belgium undertook, via its Minister of Development Cooperation, 'to ensure relevant domestic tax policies reflect the joint objective of supporting improvements in domestic resource mobilisation in partner countries and applying principles of transparency, efficiency, effectiveness and fairness' in the context of the so-called 'Addis Tax Initiative'.[8]

07. In order to reinforce policy coherence for development and to bring about the commitment made in the context of the 'Addis Tax Initiative', it is crucial for the Belgian federal government to adopt a clear position on public country-by-country reporting on a European and international level which supports additional national initiatives. The 'Plan to fight tax fraud' states that transparency is an essential objective and condition of the government's approach.[9]

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[4]Crivelli, E., De Mooij, R. & Keen, M., '*Base Erosion, Profit Shifting and Developing Countries*', IMF working paper, May 2015, p.21, available at http://www.imf.org/external/pubs/ft/wp/2015/wp15118.pdf

[5]OECD. (2014) Detailed final 2014 aid figures released by OECD/DAC. Available at http://www.oecd.org/dac/stats/final2014oda.htm

[6]In the area of transparency, the relocating of intangible fixed assets is a highly esteemed instrument for shifting profits given the high level of geographical mobility and low level of transparency of the prices for the transfer of these assets (Dischinger M. and Riedel N. (2011)."Corporate taxes and the location of intangible assets within multinational firms", *Journal of Public Economics*, Vol. 95, pp. 691-707). That is the reason why the OECD, in the context of the BEPS plan, is paying particular attention to it (OECD. (2013, 30thJuly). *Revised Discussion Draft on Transfer Pricing Aspects of Intangibles*, § 89).

[7]United Nations. (2015). *The Addis Ababa Action of the Third International Conference on Financing for Development*. Available athttp://www.un.org/esa/ffd/ffd3/wp-content/uploads/sites/2/2015/07/Addis-Ababa-Action-Agenda-Draft-Outcome-Document-7-July-2015.pdf

[8] United Nations. (2015). *The Addis Tax Action Initiative* - Declaration. Available athttp://www.taxcompact.net/documents/Addis-Tax-Initiative_Declaration.pdf

[9]Ministryof Finance (2015). Plan to fight tax fraud. Available at http://vanovertveldt.belgium.be/sites/default/files/articles/Plan%20ter%20bestrijding%20van%20de%20fiscale%20fraude_2015.pdf

08. Public country-by-country reporting (CBCR) has the following beneficial effects: i) it gives tax authorities global and not just national data that makes it possible to compare multinational companies in their jurisdiction, ii) the public nature of the reinforced information provides citizens and unions, as well as shareholders and investors, with the necessary data to better assess the financial and social risks of investments, iii) this openness of data also enables regulators and independent investigators the opportunity to analyse the financial traffic between the various subsidiaries of international companies, including banks,[10] which contribute to financial stability and confidence in the economy, iv) public CBCR provides for honest competitive conditions (level playing field) between international companies and SMEs and also strengthens the competitiveness of companies at a low cost, v) public CBCR enables the market to function better by increasing transparency between operators on the market.

## 3. CBCR at an international level

09. In the United States, the Dodd-Frank Act[11], passed in July 2010, requires the mandatory publication of data about payments to governments by companies in the extractive sector for each country where the company operates. Through this proposal, the concept of country-by-country reporting appears for the first time as both necessary and reasonable.

10. In the context of the European Union, two major reforms were approved in June 2013. Directive 2013/34/EU introduces a requirement equivalent to the Dodd-Frank Act.[12] A fourth review of the directive on capital requirements was also approved. This directive obliges major European banks, for each country where the bank operates, to publish information about the name(s) of the companies, the nature of their business, their turnover, the number of full-time equivalent employees, their pre-tax results, the tax paid and subsidies received.[13] According to the impact study conducted on behalf of the European Commission, this review should have no negative economic effects on the competitiveness of the companies in question.[14]

11. Action point 13 of the action plan against aggressive fiscal planning by multinationals (the BEPS plan, an abbreviation of Base Erosion and Profit Shifting), drawn up by the OECD on behalf of the G20, provides for a detailed system of country-by-country

[10] Practices in the area of profit-shifting in the banking sector vary based on the different segments of banks and are particularly difficult to identify (Merz J. and Overesch M. (2016). Profit Shifting and Tax Response of Multinational Banks, *Journal of Banking & Finance*, to be published), but in addition to the fiscal implications also cause actual obstacles in monitoring the stability of the banking sector because it is impossible to locate certain transactions, or because it results in incorrect locating.
[11] The Dodd Frank Wall Street reform and consumer protection Act of 2010. Pub.L. 111-203, H.R. 4173 (Dodd Frank)
[12] Directive 2013/34/EU from the European Parliament and Council issued on 26th June 2013 regarding annual financial statements, consolidated financial statements and related reports from certain company forms, amending Directive2006/43/ECfrom the European Parliament and Council and withdrawing Directives 78/660/EECand 83/349/EECfrom the Council.
[13] Article 89, Directive 2013/36/EU from the European Parliament and Council issued on 26th June 2013 regarding access to the company of credit institutions and the prudential supervision of credit institutions and investment companies, amending Directive 2002/87/ECand withdrawing Directives 2006/48/EC and 2006/49/EC.
[14] European Commission. (2014, September). *General assessment of potential economic consequences of country-by-country reporting under CRD IV*. Available at http://ec.europa.eu/internal_market/company/docs/modern/141030-cbcr-report_en.pdf

reporting.[15] Although the nature and extent of the data subject to reporting is very extensive and is based on sound principles[16], the terms of audit are still to be developed. Also, the reporting obligations only apply to multinational companies with an annual turnover in excess of 750 million EUR (which, according to OECD estimates, means that 80-95% of the multinationals in Europe would be exempt) and the data will only be available for tax authorities. OECD recommendations in the context of BEPS are not binding, although the European Commission tabled a draft directive in January 2016 making this system mandatory on an EU level.[17]

12. In the context of the review of the directive on the rights of shareholders, the European Parliament on 8th July 2015 passed the first reading of an amendment - by a large majority - that extends for country-by-country reporting for banks to all economic sectors[18]. These negotiations have been suspended as the result of the initiatives taken in this area by the OECD.

## 4. The European Commission's draft directive

13. On 12th April 2016, the European Commission officially tabled the draft of a European directive on public CBCR for all multinational companies with an annual turnover in excess of 750 million EUR, regardless of whether their head office is located inside or outside the EU. This draft is designed to be complementary to the draft Directive of 28th January 2016 (see paragraph 11). However, this reporting for each country where the company is operational is restricted to the 28 member states of the EU and a number of 'tax havens' yet to be determined. A combined publication of the draft directive is planned for the other countries.

14. The reporting requirement encompasses 7 elements: i) a short description of the nature of the business, ii) the number of employees, iii) the amount of the net turnover, including turnover generated with associated parties, iv) the amount of the profit or loss before tax on profits, v) the amount of tax on profits owed (current financial year) – this is the tax for the current year included in the taxable profits or losses for the financial year lodged by companies and subsidiaries that are resident for tax purposes in the tax jurisdiction in question, vi) the amount of tax paid on profit – this is the amount of the tax on profit that companies and subsidiaries that are resident for tax purposes in the tax jurisdiction in question have paid during the financial year in question, and vii) the amount of combined profit. This report must be publicly available and must contain an explanation describing why the applicable tax on profits

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[15] OECD, Transfer Pricing Documentation and Country-by-Country Reporting. BEPS action13, 2015 final report, 2015, available at http://www.oecd.org/tax/transfer-pricing-documentation-and-country-by-country-reporting-action-13- 2015-final-report-9789264241480-en.htm

[16] Multinationals are required to provide information for each country in a 'local file' about settlement prices in line with the transactional aspects of the activities reported, stating the relevant transactions between the parties, the amounts involved and the analysis of settlement prices established by the company for these transactions.

[17] European Commission, Proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, 28th January 2016. Available at http://eur-lex.europa.eu/resource.html?uri=cellar:89937d6d-c5a8-11e5-a4b5-01aa75ed71a1.0014.02/DOC_1&format=PDF

[18] Draft for a Directive from the European Parliament and Council to amend Directive 2007/36/EC promoting the long-term involvement of shareholders, and Directive 2013/34/EU relating to certain sections of the declaration on corporate governance /* COM/2014/0213 final - 2014/0121 (COM).

and the actual tax on profits paid do not correspond.[19]

15. The draft directive of the European Commission proposes the modification of the existing directive on annual financial statements, consolidated financial statements and associated reports from certain forms of company (2013/34/EU). The Council of the European Union is yet to make a statement about this in the context of the normal legislative procedure, with a qualified majority.

16. The draft directive of the European Commission falls short in a number of areas: i) the scope is limited to EU member states and to a yet-to-be-defined list of 'tax havens', which means that developing countries are not included, ii) the threshold value at a turnover of 750 million EUR (which excludes 85 to 90% of the companies with residence in the European Union), and iii) the effectiveness of the yet-to-be-drafted list of 'tax havens' is by no means guaranteed.

## 5. Recommendations

17. In the context of the negotiations in the European Council, the federal government must adopt a position for stronger and more effective country-by-country reporting for multinational companies. In practical terms, this means:

a) An extension of the obligation to all companies with a turnover figure in excess of 40 million EUR, in line with the definition of a large group in the existing Accounting Directive.

b) An extension of the obligation to provide broken down details per country to all countries where the company operates.

c) An extension of theinformation that must be reported to include all elements of the framework developed in OECD-BEPS[20]

d) Homogeneous reporting that is available via open data

18. If there is not a sufficiently effective and ambitious European initiative, Belgium could modify the existing legislation on financial reporting by companies on a national level so that the publication of data for each country becomes obligatory for all companies that meet the criteria developed in the context of OECD-BEPS, with the exception of small companies not listed on the stock exchange.

19. Parallel to this, the Belgian government must make available the necessary resources and capacity to ensure the proper monitoring and audit of the data provided.

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[19] European Commission. (2016, 12th April). European Commission proposes public tax transparency rules for multinationals. Available at http://europa.eu/rapid/press-release_IP-16-1349_en.htm?locale=en

[20] OECD. (2015). Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 – 2015. Available at http://www.oecd-ilibrary.org/docserver/download/2315381e.pdf?expires=1454086923&id=id&accname=guest&checksum=BBDF9B6F7356370C1C16A9FCFFACADF9