SHIFTING SANDS: TAX, TRANSPARENCY AND MULTINATIONAL COMPANIES

POVERTY

Christian Aid wants to see an end to poverty, everywhere. One of the ways that we believe this can be achieved is through equipping developing countries to collect a fair amount of tax from the companies operating within their borders, enabling governments to pay for essential services for poor communities.

Why tax?

In January 2009, Christian Aid launched a public campaign to highlight the role of taxation in development and expose the impact of tax evasion and avoidance on developing countries. The campaign was based on the premise that, in the long term, developing countries need to raise revenue to enable them to provide essential services to poor people. However, it is not only the amount but also the source of revenue that is important. Over-dependence on aid or natural resource rents has, in the past, led to governments being more accountable to aid donors than to citizens – or indeed not accountable at all. By generating revenue from tax, governments are likely to be more accountable to their citizens and in turn citizens are more likely to engage in the political process – demanding services and representation in turn for the taxes they pay.[1]

While governments in countries that are members of the Organisation for Economic Co-operation and Development (OECD) tend to raise around 35 per cent of their GDP in taxes, the track record is much lower in developing countries, with an average of 16 per cent in Latin America[2] and Africa[3].

The Monterrey Consensus on Financing for Development in 2002 showed that the governments of the world recognised the importance of generating income from domestic sources (of which tax is a key element),[4] but yet tax has received relatively little attention in development-finance debates both in policy and academia. However, two years on from the launch of Christian Aid's campaign, the political appetite for a different perspective on development is growing.

While they acknowledge the importance of tax for the reasons stated above, many developing countries across the globe are affected by a set of common challenges.

Revenue authorities are often weak and fail to collect the taxes they should; the size of the informal sector makes monitoring of economic activities and the collection of taxes a huge challenge; countries are ill-equipped to monitor and effectively tax international financial flows; and there is a lack of accountability regarding agreements with and the operations of multinational companies (MNCs) and the taxes they pay. The latter problems are exacerbated by limited international cooperation in tax matters and the lack of participation of developing countries in (or indeed their direct exclusion from) international tax matters.

Why corporate transparency?

Christian Aid argues that tax is crucial for development and that transparency is a necessary step towards holding MNCs to account for the taxes they pay.

But why focus on the role of MNCs? Surely there are more pressing problems that would deliver greater progress more easily at the national level? While it is vital that developing countries receive support to enable them to mobilise revenue for their own citizens, there are three reasons why the accountability of MNCs for the taxes that they pay is also crucial.

The first and most obvious reason relates to the scale of multinational operations and their importance for the global economy.

By generating revenue from tax, governments are likely to be more accountable to their citizens

christian aid

There is a growing recognition that tax evasion and avoidance is a significant problem for developing countries and may cost them more than they receive in aid each year

The OECD has estimated that as much as 60 per cent of world trade occurs within MNCs.[5] While the scale of operations in developing countries may be small fry for the companies themselves, the significance for the host countries' economies can be huge.

These massive volumes of trade occurring within companies but across borders create huge complexities for taxation. Such complexities can create power asymmetries: MNCs with expertise and resources can exploit this system to their own advantage, and while developed countries have the resources to monitor and stand up to companies, most developing countries do not. Even where countries do have the capacity to challenge companies, there is often pressure not to do so because of the threat that the MNC will relocate. There is a growing recognition that tax evasion and avoidance is a significant problem for developing countries and may cost them more than they receive in aid each year.[6] Christian Aid estimates that trade-related tax evasion by some unscrupulous companies operating internationally may cost developing countries as much as US$160bn each year.[7]

The second problem relates to the perception of equity (or inequity) within the tax system. Academic researchers have demonstrated that tax morale (the willingness of citizens to pay tax) is strongly affected by the perception of equity in the system.[8] As such, if a culture of non-payment of tax is to change, a perception that the big players are paying their fair share becomes crucially important.

Finally, the issue of accountability for the payment of tax is crucial. Companies are provided with the privilege of incorporation within a country by the legislative system within that country. In return for this, corporations provide many benefits including the creation of jobs, development of infrastructure, and revenue payment.[9]

Christian Aid's proposal for country-by-country reporting

Christian Aid is campaigning for a country-by-country reporting standard that requires the disclosure of the following information by each MNC in its annual financial statements.

- The name of each country in which it operates.
- The names of all its companies trading in each country in which it operates.
- Its financial performance in every country in which it operates including:
  - sales, both third party and with other group companies;
  - purchases, split between third parties and intra-group transactions;
  - labour costs and employee numbers;
  - financing costs split between those paid to third parties and those paid to other group members;
  - pre-tax profit.
- Details of the cost and net book value of its physical fixed assets located in each country.
- Details of its gross and net assets in total for each country in which it operates.
- The tax charge included in its accounts for the country in question split according to:
  - tax charge for the year split between current and deferred tax;
  - tax payments made to the government of the country in the period;
  - liabilities (and assets, if relevant) owing for tax and equivalent charges at the beginning and end of each accounting period;
  - deferred taxation liabilities for the country at the start and close of each accounting period.

For companies operating within the extractive industry, the standard would require additional information on benefits paid to the government of each country in which the MNC operates, broken down between the categories of reporting required in the Extractive Industries Transparency Initiative (EITI).[10]

At present in international accounting standards, MNCs are not required to provide a country-by-country picture of their financial activities showing where profits are made and taxes paid. Because of this, a range of stakeholders lose out:

- revenue authorities and civil society cannot monitor the allocation of profit between companies operating internationally and, if necessary, challenge the company's local tax arrangements;
- investors have incomplete information when assessing risk (including tax risk);
- tax-compliant and responsible companies miss the opportunity to demonstrate powerful public evidence of their corporate social responsibility (CSR) in regards to tax payment.

Two game-changing moments

The financial crisis of 2008 created an impetus for change in OECD countries. Tax havens were apportioned part of the responsibility for facilitating off-balance-sheet operations through their provision of financial secrecy, while the lack of accountability and transparency of banks and other financial institutions became an important political issue. At the same time, a combination of huge bank bailouts and the ensuing economic downturn renewed the impetus for OECD countries to recover revenue they were losing to tax dodging. While this was a pragmatic rather than a structural response to the crisis, it created an opportunity for non-governmental organisations and others to introduce the development aspects of the debate, calling on world leaders to address the problem. The G20 committed to developing proposals to ensure that developing countries would benefit from the new cooperative tax environment.[11]

In 2010, the human and ecological disaster resulting from the BP 'Deepwater Horizon' accident created significant political pressure in the United States on the oil and gas industry to be more transparent. In the wake of this disaster, and following years of campaigning by the Publish What You Pay coalition, US Congress passed the Wall Street Reform and Consumer Protection Act requiring companies listed on the Securities Exchange Commission (SEC) operating in the oil and gas and extractives industry to disclose payments to governments on a country-by-country and project-by-project basis.[12]

The political appetite and momentum for greater corporate transparency has increased dramatically as a result of these events.

The political appetite and momentum for greater corporate transparency has increased dramatically

A private-sector perspective

If we are to discuss business regulation, it makes sense to talk to business about it. Over the course of 2010, Christian Aid has been discussing tax and development with tax directors from some of the largest companies in the world. We launched a survey to solicit the perspectives of FTSE100 companies on the role of business in tax and development. Of the 100 companies surveyed, 20 responded by completing the survey and a further 16 responded by letter.

Of those companies that completed the survey, 19 firms agreed that 'tax is a vital source of income for developing countries' and 'multinational companies should fully comply with tax laws in the countries in which they operate'. Twelve agreed that 'payment of tax in developing countries should form a key part of an organisation's corporate social responsibility commitment'.

In relation to transparency, seven firms agreed that 'reporting of tax payments by multinational companies may be beneficial to the development agenda' and 12 respondents agreed that their firm is 'persuaded of the need for greater transparency for developing countries'.

Nineteen firms agreed that 'tax is a vital source of income for developing countries'

This is a controversial and sensitive area. While Christian Aid is clear that business plays a crucial role in development, and tax is part of the contribution that companies can make, some feel that this is an anti-business campaign and are unwilling to discuss these issues. Others feel that the country-by-country proposal is not the right way to go about helping developing countries and that the focus should be on strengthening poor countries' tax authorities. Some however, recognising the long-term trend is towards transparency, want to be ahead of the game. They want to discuss the kinds of information that would meet the objectives of ensuring greater accountability for taxes paid and helping developing countries raise more revenue without causing negative impacts on business.

It is clear that country-by-country reporting is possible. Eleven firms agreed that 'this information is already recorded within our company' and 19 firms agreed, or did not deny, that it would be possible for the company to collate this information. Seven firms agreed that 'it would be reasonable for this information to be audited' and seven firms were neutral on this point. In response to the statement 'publishing this information would further the development agenda', four replied positively, 11 gave a neutral response, and four responded negatively.

Only three firms supported the introduction of country-by-country reporting as an international standard

On the willingness to support country-by-country reporting, six firms agreed that they would 'be willing to explore piloting a country-by-country accounting standard' and nine firms would be willing to 'support the introduction of country-by-country reporting as part of its CSR reports'. However, only three supported the introduction of country-by-country reporting as an international accounting standard.

The tax directors of many major companies are now agreed that the compliance cost should not be a constraint. In fact, there may be a case for companies requesting an international accounting standard to limit compliance costs. Some companies are concerned that following the US legislation, other countries will follow suit in unilaterally implementing disclosure standards. This would lead to a patchwork of different accounting standards requiring companies to comply with each separately, thereby substantially increasing their compliance costs.

The technical compliance burden is one thing, but some companies suggest that having information in the open will cause problems. First, they may have to disclose commercially sensitive information, which puts them at a competitive disadvantage. However, if a country-by-country reporting standard were applied globally, then no major listed company would be able hold an advantage by having undisclosed information. Second, some agreements with governments are based on information being kept secret. In politically sensitive environments, this is a real concern that the various stakeholders need to address. One respondent suggested that 'the desire for tax transparency needs to respect the sovereignty of countries and commercial and competitive sensitivities'.

Country-by-country reporting could be positively beneficial if it shines a light on

Developments in corporate tax transparency since 2009

In the past two years, a number of relevant policy changes have occurred on the international stage.

- April 2009: at its London summit, the G20 commits to develop proposals for developing countries to benefit from the new cooperative tax environment.
- June 2009: in the UK, the *Guardian* newspaper reports the Treasury Minister Stephen Timms' support for country-by-country reporting and his role in persuading the OECD to conduct a feasibility study into a new standard.
- July 2009: in the UK, the Labour government supports country-by-country reporting in its Department for International Development (DFID) white paper on international development.[13]
- September 2009: in the UK, Vince Cable, the Treasury spokesman for the UK Liberal Democrat Party, writing in the *Guardian* newspaper argues that 'new accounting standards are also needed to force multinational companies to declare publicly the profits they make, and the taxes they pay, in every country in which they operate. That way anomalies would be quickly spotted.'[14]
- January 2010: the OECD publishes a report on country-by-country reporting and agrees to include a form of the transparency standard in its Guidelines for Multinational Enterprises.
- January 2010: the OECD global development forum focuses on tax and development, and the OECD sets up a multi-stakeholder taskforce on tax and development including governments, NGOs, businesses and multilateral institutions.
- March 2010: the International Accounting Standards Board opens a consultation on a country-by-country reporting standard for the extractives and energy sectors.
- April 2010: the European Commission publishes a paper addressing *Good Governance in Tax Matters*, which calls for further investigation into country-by-country reporting. The principles in

the communication were subsequently affirmed by the EU heads of state.

- April 2010: African civil society groups publish the Nairobi Declaration on Tax and Development, calling for country-by-country reporting.[15]
- May 2010: it is reported that PricewaterhouseCoopers is advising clients to be more transparent in relation to tax payment in developing countries.[16]
- May 2010: the coalition agreement of the new UK government commits to tackling tax avoidance. In the *Telegraph* newspaper, Vince Cable, Secretary of State for Business, Innovation and Skills, writes: 'Tackling tax avoidance by businesses is essential and this is an area that I will be looking at closely in my new role.'[17]
- June 2010: the Hong Kong stock exchange implements rules requiring mineral companies applying for a listing to disclose important information about their exploration and extraction activities, including payments made to host governments.[18]
- July 2010: the US passes the Wall Street Reform and Consumer Protection Act, which includes a landmark provision requiring energy and mining companies registered with the US Securities Exchange Commission to disclose how much they pay to foreign countries and the US government for oil, gas, and minerals. The US government commits to working with other countries to ensure the implementation of similar disclosure requirements in other financial markets.[19]

corrupt practices of governments that may not otherwise bow to international pressure to be transparent – through the Extractive Industries Transparency Initiative, for example.

However, if such an international standard was perceived by some developing countries as an imposition from the North, it may serve to undermine trust, and points to a need for the genuine engagement of these countries in developing a standard.

Of course, the need for reconciliation with local accounting rules may result in questions being asked of companies about any discrepancies – and we cannot pretend that these questions would not be significant. One respondent suggested that 'country-by-country reporting will be sensible, but only if all financial information is prepared on the comparable basis'.

But if companies are tax compliant in every jurisdiction in which they operate, there will always be a legitimate explanation for any discrepancy. Arguably the transparency that the standard would bring would be a significant deterrent for those companies that might otherwise be involved in tax abuse.

The transparency that the standard would bring would be a significant deterrent for those companies that might otherwise be involved in tax abuse

Finally, there are questions about whether such a standard would result in businesses relocating away from developing countries. If the standard were applied globally, the compliance burden would be no greater for companies operating in the global South than in the North. The transparency afforded by the standard may change the behaviour of companies and therefore influence investment-location decisions. It is impossible to determine the impact of this on investment in developing countries. However, it is not unreasonable to suggest that those companies genuinely interested in investment and job creation will consider other factors before tax. A recent study on the location decisions of investors showed that infrastructure, political stability, labour productivity, low corruption, minerals for extractives companies and other economic fundamentals were more important to an investment decision than the tax regime.[20] Christian Aid argues that, in the long term, the transparency and accountability afforded by country-by-country reporting would benefit the citizens of countries rich and poor.

The future of corporate transparency

It is clear that there is a growing interest in corporate transparency for tax purposes. With major governments now supportive and businesses recognising the reality of the world in which they now operate, it is likely that interest in tax transparency will continue to grow. Indeed, some business people have referred to tax and development as the next corporate responsibility issue.

However, controversy is likely to arise over whether to take a mandatory approach through an international accounting standard or to create competitive pressure for firms to adopt this as a corporate social responsibility issue and for the adoption of the standard in voluntary guidelines such as the OECD Guidelines for Multinational Enterprises. There is clearly a role for both approaches, but Christian Aid argues that a CSR approach will only attract those who want to be a leader in this area, while a mandatory accounting standard will create a level playing field for all large firms operating internationally.

Endnotes

1 Deborah Brautigam, 'Introduction: taxation and state-building in developing countries', in *Taxation and State-Building in Developing Countries: Capacity and Consent,* edited by Deborah Brautigam, Odd-Helge Fjeldstad and Mick Moore, Cambridge University Press, 2008.

2 OECD, *Latin American Economic Outlook*, 2009, www.oecd.org/dataoecd/14/60/41577384.pdf

3 John Marshall, *One Size Fits All: IMF Tax Policy in sub-Saharan Africa*, Christian Aid occasional paper no. 2, April 2009.

4 www.un.org/esa/ffd/monterrey/MonterreyConsensus.pdf

5 John Neighbour, 'Transfer pricing: Keeping it at arm's length', OECD *Observer*, January 2002, www.oecdobserver.org/news/fullstory.php/aid/670/Transfer_p (accessed 18 May 2009).

6 Jeffrey Owens and Richard Parry, 'Why tax matters for development', OECD *Observer*, June 2009, www.oecdobserver.org/news/fullstory.php/aid/2943/Why_tax_matters_for_development.html (accessed 14 September 2010).

7 David McNair and Andrew Hogg, *False Profits: Robbing the Poor to Keep the Rich Tax Free*, Christian Aid, 2009, and Andrew Hogg, Judith Melby, Anjali Kwatra et al, *Death and Taxes: the True Toll of Tax Dodging*, Christian Aid, 2008.

8 Luigi Bosco and Luigi Mittone note that tax compliance is most likely in conditions where perceived levels of redistribution are high, and individual expectations of others' compliance are high. L Bosco and L Mittone 'Tax evasion and moral constraints: some experimental evidence', *Kyklos* (50), pp297-324, 1997.

9 Richard Murphy, *Country-by-Country Reporting: Holding Multinational Corporations to Account Wherever They Are*, Taskforce of Financial Integrity and Economic Development, June 2009.

10 Ibid.

11 The G20, in an annex to its communiqué from the London summit, committed to 'developing proposals, by end 2009, to make it easier for developing countries to secure the benefits of a new cooperative tax environment' www.g20.org/Documents/Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf (accessed 14 September 2010).

12 www.whitehouse.gov/the-press-office/statement-press-secretary-transparency-energy-sector

13 *Eliminating World Poverty: Building our Common Future*, DFID, July 2009.

14 Vincent Cable, 'The Offensive Secrecy of Tax Havens', the *Guardian*, September 2009, www.guardian.co.uk/commentisfree/2009/sep/23/tax-havens-g20 (accessed 2 September 2010).

15 www.afrodad.org/index.php?option=com_docman&task=doc_download&gid=86&Itemid=16

16 John Preston, a senior tax partner at PWC, said in the *Telegraph* that 'The issue of tax and the developing world is on the agenda and any well-planned company would be thinking about that. Transparency in accounts would be a good thing. We then need a debate about what transparency is helpful.' www.telegraph.co.uk/finance/yourbusiness/7731201/Vince-Cable-to-target-tax-avoidance-by-businesses.html

17 http://programmeforgovernment.hmg.gov.uk/files/2010/05/coalition-programme.pdf

18 www.hkex.com.hk/eng/newsconsul/mktconsul/documents/cp200909m_e.pdf (accessed 15 September 2010).

19 www.whitehouse.gov/the-press-office/statement-press-secretary-transparency-energy-sector

20 Nils Bhinda and Matthew Martin, *Private Capital Flows to Low Income Countries*, Development Finance International, 2010.

Poverty is an outrage against humanity. It robs people of dignity, freedom and hope, of power over their own lives.

Christian Aid has a vision – an end to poverty – and we believe that vision can become a reality. We urge you to join us.

Christian Aid, 35 Lower Marsh, London SE1 7RL
t. 020 7620 4444 www.christianaid.org.uk