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EU Country by country reporting

Overview of the political process and existing country by country reporting

Introduction

Every year, corporate tax avoidance costs countries around the world an estimated US$500 billion.[1] In the European Union (EU), the annual loss to profit shifting by multinational corporations is conservatively estimated to be €50-70 billion each year.[2] This money is sorely needed to fund public services such as healthcare and education, as well as climate action and sustainable development. 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 can be addressed through the introduction of public country by country reporting.

Public country by country reporting (CBCR) would allow everyone – including citizens, policy-makers, 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". This was introduced for the banking sector in the EU during the first half of 2013[3] and the measure has already been shown to disincentivise profit-shifting.[4]

In the intervening period, a number of high-profile tax scandals such as LuxLeaks,[5] the Paradise Papers[6] and Mauritius Leaks[7] have continued to expose systemic and wide-scale tax avoidance by multinational corporations and the enabling role that secrecy plays. Meanwhile, tax justice has remained a priority issue for citizens. In Europe, the Eurobarometer of public opinion continues to show that three quarters of citizens want the EU to intervene more than they currently do in the fight against tax fraud.[8]

EU negotiations about public country by country reporting

In the wake of the Panama Papers tax scandal in 2016,[9] the European Commission published a legislative proposal on public country by country reporting for multinational corporations in all sectors.[10] In 2017, the European Parliament adopted in Plenary its report, substantially amending the Commission's proposal.[11] However, until now, a lack of consensus between EU Member States has delayed the adoption of a final position from the Council of the European Union that would allow trialogue negotiations and agreement on what the final rules will look like.

In the first quarter of 2019, the European Parliament proceeded to close its first reading of the file.[12] In October 2019, shortly after the EU elections, the newly elected Parliament adopted a resolution calling on EU Member States to "*break the deadlock within the Council and to conclude their first reading on the public CBCR proposal and to enter interinstitutional negotiations with Parliament in order to finalise the legislative process as soon as possible and to respect the principle of sincere cooperation…*'[13] Following these developments, the Council finally held the first ministerial-level discussion of the proposal, but failed to reach agreement.[14]

Timeline

April 2016
European Commission publishes legislative proposal[15]

July 2017
European Parliament amendments adopted[16]

December 2017
Presidency of the Council of EU Member States introduces a compromise text[17]

January 2019
Presidency of the Council of EU Member States introduces a second compromise text[18]

March 2019
European Parliament closes its first reading, with no changes to its position[19]

October 2019
European Parliament adopts a resolution urgently calling on the Member States to progress[20]

November 2019
Presidency of the Council of EU Member States introduces a third compromise text[21]

First minister level discussion of proposal takes place in Council, without reaching a compromise[22]

Overview of institution positions

The Commission proposal

The Commission proposal for public county by country reporting[23] follows the positive experience of public CBCR for the banking sector[24] as well as transparency requirements for the extractive and forestry sectors,[25] which were already introduced through EU legislation. However, the Commission's proposal contains several serious loopholes that are highly problematic for a number of reasons.

First, the Commission proposal does not require corporations to report on their activities in all countries where they operate. Instead, the proposal only requires them to report on their activities in the EU and a small number of jurisdictions blacklisted by the EU. This is a fatal weakness that prevents the public from getting a complete picture of corporations' activities. Second, it also creates the potential for companies to restructure to avoid transparency and engage in profit shifting to low-tax jurisdictions that are not blacklisted by the EU. Third, developing countries could be especially disadvantaged by this proposal, as it would leave them in the dark about the activities of large multinationals operating in their jurisdictions.

Another problematic point is that the Commission's proposal would only apply to corporations with a turnover of at least €750 million per year. According to the Organisation for Economic Co-operation and Development (OECD), 85-90 per cent of the world's multinational corporations would not meet this threshold.[26] This is in contrast to the existing EU definition of a 'large undertaking', which captures a much greater portion of the largest multinational corporations.[27]

In November 2019, the new college of commissioners was confirmed by the European Parliament after a long period of hearings with the candidates.[28] Public CBCR featured prominently in these hearings. For example, Margrethe Vestager – who was Executive Vice-President-Designate of the European Commission at the time – stated in her hearing with the European Parliament: "*The second thing we are still missing is public country-by-country reporting. It works in the financial sector. The last time I looked, we still had a financial sector, so it doesn't seem to be too damaging. I think any CEO could be proud to tell the number of employees, activities, turnover, profits and taxes paid. And that will also allow us to have a completely different perspective on taxation, also as individuals.*"[29]

At the time, another Executive Vice-President-Designate, Valdis Dombrovskis, added in his hearing with the Parliament: "*I will keep the fight against tax avoidance high on my agenda, as I did in the last mandate, for example, with my proposals on country-by-country reporting. Multinationals must be taxed effectively, so that our citizens and [small and medium enterprises] don't have to bear an unfair tax burden.*"[30]

The European Parliament position

In July 2017, the European Parliament adopted its amendments to the European Commission's proposed Directive.[31] If included in the final directive text, the Parliament amendments would improve it by requiring companies to report their activities in all countries worldwide, not just EU countries and blacklisted jurisdictions. In addition, the Parliament extended the information disclosed and introduced a requirement that country by country reports are published using a common template in an open data format – two changes that are critical to ensuring the necessary data is reported and can be easily accessed and understood by the public.

However, the European Parliament also introduced a serious loophole into the draft Directive – a "corporate get-out clause". The loophole would allow corporations to avoid reporting what they consider "commercially sensitive information". This is highly problematic, since it leaves it to the discretion of multinational corporations to decide whether they should omit information. It is therefore essential that the new Parliament removes the loophole from their position and pushes for an ambitious outcome, in order to deliver meaningful public country by country reporting.

The Council of EU Member States position

More than three years after the proposal was first introduced by the Commission, the Council of EU Member States has failed to reach a position on the proposal – effectively blocking trialogue negotiations to commence between the EU institutions. These trialogue negotiations are needed to allow the European Parliament, Commission and Council to agree the final wording of the new directive.

Over the years, several compromise texts have been presented by Council presidencies. The latest draft compromise text[32] includes provisions that water down the Commission's proposal significantly. For instance:

- According to the proposal, reporting requirements should only cover corporations that are 'operating' in the EU. This significant change would allow letterbox companies, which often play a central role in the tax avoidance activities of large multinationals, to be excluded from the reporting obligation.
- The loophole introduced by the Parliament has been supported by the compromise text of the Council, but the text does at least introduce a time limit, which would require companies to publish the omitted CBCR information after a six-year delay.
- The Council draft position introduces another loophole, the comply-or-explain clause, which would allow the subsidiaries or branches of non-EU parent companies to explain why they are not able to disclose information related to their non-EU activities.
- In addition, Member States have increased the threshold to require multinational corporations to have €750 million in turnover for two consecutive years, further reducing the number of companies that would be obliged to report.

However, the reason for the delay in agreeing a compromise position is that some EU Member States have proposed a change to the legal basis for the proposal (see Box 1). The suggested change would in effect exclude the European Parliament from the decision-making, and would give each EU Member State the opportunity to veto the legislation[33] – a move that would in all likelihood lead to a less ambitious outcome, or even no outcome at all.

Discussions about the legal basis of the proposal have caused one delay after the other.[34] This is despite huge public support for greater action to tackle tax avoidance by large multinational companies.[35]

Box 1: Discussions about the legal basis

One issue that has caused a lot of delay in the Council of EU Member States is a discussion about the legal basis. Some Member States have proposed a change to the legal basis of the file from Article 50 to Article 115 of the Treaty on the Functioning of the European Union.[36] Such a move would change the procedure for adopting the legislation from ordinary to special legislative procedure, removing the European Parliament as co-legislator and requiring unanimity among Member States to pass into law.[37]

The argument that the legal basis should be changed relates to a concern that the issue is a matter of taxation, rather than accounting and reporting. This is relevant because EU decisions on taxation are normally made on the basis of Article 115.[38] However, when addressing this issue during a discussion in the Council in November 2019, Finland's Minister of Employment, Timo Harakka, underlined that: "*This is not a tax file. This proposal does not at all concern the taxation of individual companies, nor tax rate, nor tax base, nor tax jurisdiction. Thereby this does not touch upon the sovereignty of taxation matters at all. I wish to stress that the legal obligations cover exclusively matters of corporate reporting as is. The file is at its core about corporate transparency, which is in the public interest at large, rather than the aim of deterring tax avoidance specifically for the benefit of tax authorities.*"[39]

The Council Legal Service examined the proposal and supported the legal basis being changed to Article 115.[40] This is despite the fact that the EU has already introduced similar requirements for banks and the extractive sector through ordinary legislative procedure in 2013.[41] The primary difference between the current proposal and those already in force is simply that it applies to all large multinational corporations, rather than a specific sector. The Legal Affairs Committee of the European Parliament has also rejected the proposal to change the legal basis, and instead argued that the legal basis should remain Article 50 of the Treaty on the Functioning of the European Union,[42] in line with what the European Commission argued when it originally put forward the proposal on public CBCR.

Overview of existing CBCR

Public CBCR for banks

Public country by country reporting was introduced for the banking sector in 2013 through the fourth Capital Requirements Directive (CRD IV),[43] which obliged European banks to publish country by country reports annually. This transparency measure for banks was widely supported by the public.[44] Since companies began reporting, it has enabled stakeholders, journalists, parliamentarians and the general public to see where banks are operating and how much tax they are paying in each jurisdiction.

One important aspect of the reporting is the obligation to disaggregate data for each country of operation. This has ensured that the data provides a complete picture of banks' activities. Data from the public CBCR for the banking sector has already enabled researchers to undertake detailed analysis of banking activity in tax havens.[45] Furthermore, civil society researchers have also been able to translate the data into accessible formats in order to enable policy-makers and the general public to interact with it easily and meaningfully.[46]

Evidence has shown that public CBCR has not negatively impacted on the sector's competitiveness,[47] but has already disincentivised profit-shifting to low tax jurisdictions.[48]

Extractive sector transparency requirements

In 2013, the EU introduced new transparency requirements for the extractives and forestry sectors. The Accounting Directive requires reporting of EU registered companies' payments to governments on a country by country and a project-by-project basis.[49] There is also a similar provision in the EU Transparency Directive targeting publicly listed companies.[50] The transparency that the EU has introduced also applies companies domiciled outside the EU.[51] Another very important aspect of the transparency has been the leadership role the EU has played. Since the adoption of the EU rules, similar laws have been adopted in third countries, including Norway and Canada.[52] This demonstrates the EU's ability to oblige companies headquartered and operating outside the EU to comply with reporting obligations and the union's ability to initiate trends towards transparency as a first mover.

Although the extractive sector transparency obliges reporting on a country by country basis, it does not cover the same data as the public country by country reporting introduced for the banking sector.[53] Therefore, while it provides important transparency, it does not replace the need for the type of CBCR which currently applies to banks to be expanded to include all sectors, including the extractive industries.

OECD BEPS Action 13 – non-public CBCR

After the introduction of public CBCR for the banking sector and increased transparency requirements for the extractive sector, momentum was building in the EU for expanding the system to all-sector reporting that would allow everyone, including the general public, to see information about where corporations do business and what they pay in tax.[54] However, the political picture changed in 2015 when the negotiations on 'Base Erosion and Profit Shifting' (BEPS) at the OECD resulted in a decision to introduce secret country by country reporting.[55]

Through the OECD BEPS system, corporations now report this information to the tax administration in the country where they are headquartered, and it is then shared with tax administrations in other countries where the corporation is present through exchange agreements.[56] To state the obvious, this means that the general public does not get access to even basic information about where individual multinational corporations do business and what they pay in taxes. Additionally, under the OECD system, national parliaments cannot access country by country reports, depriving them of important data that is essential for informing evidence-driven law making to tackle corporate tax avoidance. It also means that some developing countries can have difficulties accessing the data, since it normally requires both an exchange agreement with the headquarter country of a given multinational corporation, and a system to ensure that data can be kept and handled confidentially. If country by country reports were public, these problems would no longer exist.

The European Commission's proposal on public CBCR was launched in 2016, after the adoption of BEPS.[57] In response, some members of the OECD secretariat argued that public country by country reporting would be a violation of BEPS.[58] Although this is legally incorrect (the Commission's proposal was designed to be compatible with BEPS while still introducing public CBCR), it did not help to move the EU proposal forward.

Voluntary country by country reporting initiatives

While binding rules for public country by country reporting have been held up at the EU level, momentum for transparency about multinational activities has resulted in some businesses going beyond their legal obligations by voluntarily publishing country by country reports.[59] In addition, new voluntary initiatives have established templates and procedures for voluntary reporting.

The Fair Tax Mark provides certification for businesses that commit to and implement responsible tax practices, including public country by country reporting.[60] The diverse group of accredited organisations includes large companies like energy giant SSE Airtricity, global cosmetics retailer Lush, as well as many small and medium-sized enterprises (SMEs).[61]

In December 2019, the Global Reporting Initiative (GRI) launched a new tax standard, known as GRI 207: Tax, which has been integrated into their sustainability reporting templates and includes public country by country reporting.[62] The new tax transparency standard was developed by a multi-stakeholder expert group and was subject to significant consultation with business and investor groups.[63]

In addition, many companies like Vodafone, BHP Billiton and Unilever have independently moved towards voluntarily publishing CBCR information.[64]

At the same time, some investors have been suggesting that companies should voluntarily publish public country by country reports. Investor support arises from both the risk that aggressive tax planning can pose to the reputation of a business and the importance of country by country reporting data for assessing if a company's performance is based on real and sustainable economic activity or tax planning. As Morris Pearl, a former Executive Director of BlackRock, puts it: *"The competitiveness of a firm relies on the health, strength, and growth of the firm – not on tax disclosures. Though disclosing material may influence investors to make decisions one way or another, if every company releases the appropriate disclosures, then every company is equally tasked with an additional consideration when addressing investor decisions*."[65]

In April 2017, Norway's sovereign wealth fund, one of the largest of its kind in the world, announced new guidance, which underlined that, "*Public country-by-country reporting is a core element of transparent corporate tax disclosure. Our expectations fall into two main categories: boards should adopt appropriate and prudent tax policies, and companies should be transparent about where they generate economic value*."[66]

Voluntary reporting cannot provide a meaningful alternative for legally binding obligations, since the lack of control of enforcement and quality undermine the availability of reliable and comparable data, and many multinational corporations will continue to keep their practices under wraps. However, the enormous activity in this area clearly demonstrates that some businesses are embracing public CBCR. And not only has this transparency had a notable lack of impact on the competitiveness and profitability of businesses doing country by country reporting, the fact that citizens and investors are demanding more action could also translate into benefits and opportunities for those reporting.

Conclusion

A central problem in 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 can be addressed through the introduction of public country by country reporting.

Governments and EU Institutions must allow the public to access the key corporate information necessary to ensure accountability and tax justice. For this purpose, they should adopt full country by country reporting for all large multinational corporations, and ensure that this information is publicly available in an open data format that is machine readable and centralised in a public registry.

This should be treated as an urgent issue. In particular, the EU Council of Member States must urgently move forward and adopt its position, so that the trialogue negotiations between the European Parliament, the Commission and the Council can be initiated as soon as possible. Second, it is vital that the final outcome of the trialogue negotiations is ambitious and fit for purpose. In particular, it is important that corporations are required to report on a country by country basis for all jurisdictions where they are present. It is also important to ensure that all loopholes that might allow corporations to keep their activities in the dark are closed.

Endnotes

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