The value of public country-by-country for the UK

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Tax avoidance in the UK

Academic research from the University of Oxford, based on unique access to UK corporate tax returns, shows the scale of profit shifting by multinational companies. The UK subsidiaries of foreign multinationals are shown to declare taxable profits at the rate that is just half that of equivalent UK companies of similar scale and in the same industries. If that difference could be eliminated, those multinationals would pay an additional £25 billion pounds a year in UK tax (Habu, 2017).

This estimate relates to the period before changes to the international tax system made after the financial crisis, in the OECD Base Erosion and Profit Shifting initiative (BEPS). But BEPS involved piecemeal changes only, rather than confronting the need for a comprehensive alternative. Unsurprisingly perhaps, there is as yet no evidence that BEPS has reduced the scale of the problem.

Country-by-country reporting

The idea for multinational companies to publish information about their activities in individual countries dates back to at least the 1960s. The growing complexity of their business structures, coupled with the weakness of international accounting standards, led to the suspicion that the biggest economic actors in the world might also have become the least transparent.

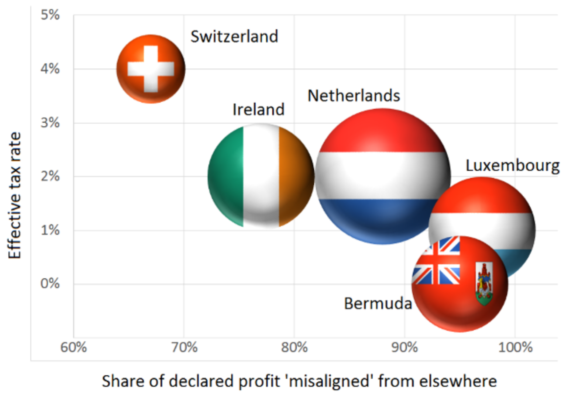
In 2003, the newly formed Tax Justice Network published a draft international accounting standard for country-by-country reporting (Murphy, 2003; Cobham, Gray & Murphy, 2017). This is a measure designed to bring multinationals to a similar level of transparency to that of simple domestic companies operating in a single country.

Under country-by-country reporting, multinationals would be required to publish, for each jurisdiction in which they operate, the following:

- **Identity**: for each entity within the multinational group, the name, type of entity, place of incorporation and principal activity;
- **Locations** in which reporting entity and related parties operate;
- **Economic activity** in each jurisdiction of operation, including the **value of sales** (distinguishing genuine external sales to third parties from intra-group transactions), the level of **employment** and of **tangible assets**;
- **Profits** declared in each jurisdiction; and
- **Taxes** on corporate profit paid by the reporting entity and its related parties in each jurisdiction

This data would ensure that companies can be held to account for their efforts to dodge taxes by shifting profits away from the locations of the real, underlying economic activity. At the same time, it would also lay bare the extent to which jurisdictions like the Netherlands and Luxembourg have made a living at the expense of others, by poaching profit from their neighbours.

Profit misalignment of US multinationals



Source: Cobham & Jansky (2017).

The value of public information

In 2013, the G20 and G8 groups of major countries gave the OECD a mandate to follow the Tax Justice Network's lead and develop a country-by-country reporting standard. That standard is now in operation, but only requires multinationals to report to their home country tax authorities (with a complex information exchange process for other countries' tax authorities to seek access).

While this is a valuable step forward, it stops short of making the data public – which would allow everyone to see the extent to which multinationals in their own countries were declaring profit in alignment with their real economic activity, or alternatively if they are shifting their profit to low-tax or no-tax jurisdictions instead.

The European Union did however introduce a weaker form of country-by-country reporting for financial institutions, under the fourth Capital Requirements Directive – and this information *is* required to be made public. And now a study by German academics (Overesch & Wolff, 2018) has shown the impact that this transparency has had on the tax behaviour of those banks.

Specifically, the authors find that "multinational banks paid substantially more taxes than their domestic peers after the reform… [T]he overall tax expenditure of an affected banking group increased by approximately one tenth in total" through the introduction of even a weak form of public country-by-country reporting. Banks with tax haven networks saw an even bigger rise in tax payments after the reform.

Taking the estimate of Habu (2017) as baseline, if we assume that multinationals in the UK would increase their tax payments by a tenth, **the resulting UK revenue gain from public country-by-country reporting would be £2.5 billion each year**.

This is conservative for a number of reasons, including that many of the multinationals operating in the UK do indeed have major tax haven networks, and so a larger response would be expected on the basis of Overesch & Wolff's

(2018) findings; and that Habu's (2017) estimate of potential revenue relates to 2011 (later data being unavailable). Assuming a static proportion of avoidance in relation to total profits, or even simply adjusting for inflation, would imply the baseline figure of £25bn would be substantially higher in nominal terms now.

In addition to these potential immediate gains, the revealed level and nature of profit misalignment from public country-by-country reporting is likely to offer much greater opportunity for reforming the UK's tax rules to prevent abuse in the future.

At the same time, the costs would be near zero. Multinationals are already required to prepare this information, so the compliance cost is only that of publishing online. The UK government has already legislated to be able to require publication, so no further parliamentary time is needed.

All that is required is for the Chancellor Philip Hammond to simply announce that this legislation will now come into force – which he could do at any time, including the upcoming Budget.

Why wouldn't he?

References

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About the Tax Justice Network

The Tax Justice Network is an independent international network, launched in 2003. It is dedicated to high-level research, analysis and advocacy in the area of international tax and financial regulation, including the role of tax havens.

The Tax Justice Network maps, analyses and explains the harmful impacts of tax evasion, tax avoidance and tax competition; and supports the engagement of citizens, civil society organisations and policymakers with the aim of a more just tax system.

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About Tax Justice UK

Tax Justice UK is a campaigning and advocacy organisation. We want to ensure that everyone in the UK benefits from a fair and effective tax system.

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