Funding the Future

Multinationals face gathering tax storm

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FT.com / UK - Multinationals face gathering tax storm.

The FT has an extensive commentary on the campaign for country-by-country reporting today. Written by Vanessa Houlder I quote this at length using the public interest defence for doing so:

The once-radical idea that natural resources - and possibly foreign aid - might be more of an economic curse than a blessing has become accepted wisdom. Countries that raise their own taxes are more likely to be accountable to their citizens and promote broad economic growth, the theory goes.

So far, so uncontroversial. But the resulting drive to improve the tax-gathering capacity of developing countries has blown up into a row engulfing multinationals and their accountants.

At issue is the arcane question of how multinationals price transactions between different arms of their businesses. A formidable array of charities and campaign groups accuse them of manipulating "transfer prices" to artificially shift profits out of developing countries.

The campaigners say that hundreds of billions of pounds - far more than the inflows of aid - are being siphoned out of developing countries. In 2008 Christian Aid published a report, Death and Taxes, in which it asserted that 1,000 children were dying every day due to poverty that could be blamed on transfer pricing abuses.

Multinationals - now bracketed with drug barons, racketeers and terrorist masterminds by campaigners - are bemused by these charges.

Yes, internationally mobile capital has become more difficult to tax. Yes, they often clash with governments over transfer pricing, as illustrated this week by AstraZeneca's £505m settlement of a long-running transfer pricing dispute with the British government.

In franker moments, they admit to shifting profits from high tax countries to low tax ones. But they see the idea that they shift profits out of developing countries to developed ones as fundamentally misconceived. Businesses have no incentive to do this because developing countries are themselves low tax jurisdictions.

Their governments offer tax holidays in return for building infrastructure and creating jobs. The campaigners' arguments - based on controversial calculations using trade data - are plain wrong, they say. But in the wake of the global economic crisis, businesses are being forced to take the campaigners seriously, particularly as their goal of greater transparency is shared by some developed countries, notably the UK and France. The issue of "trade mispricing" has shot up the agenda of policymakers in the Paris-based Organisation for Economic Co-operation and Development and the European Commission.

Draft guidelines on "country-by-country reporting," the remedy proposed by the campaigners, are set to be drawn up by the OECD by the end of the year. The International Accounting Standards Board is exploring a standard on country-by-country reporting in the extractive industries.

Businesses are focused on whittling down the demands of the campaigners. They say that some additional disclosures, such as cash tax payments would not be too onerous, but companies would face a huge compliance burden if they were forced to disaggregate data on a country-by-country basis.

Putting confidential information in the public domain would put them at a competitive disadvantage and expose them to unfair criticism. Extensive legal and economic analysis is required to assess whether transfer prices have been correctly calculated; reams of data could easily be misinterpreted.

The campaigners are unimpressed. They want chapter and verse, enforced by a full international financial reporting standard for all multinationals. It is not just a matter of putting pressure on multinationals. They also want to hold to account the developing country governments that do sweetheart deals with favoured companies.

Their campaign has come so far, so fast that it has developed its own momentum. But to go beyond voluntary guidelines will be a stretch.

Companies are already quietly pointing out to their governments that they will be put at a disadvantage if they are forced to implement such measures ahead of their competitors. As Chinese companies extend their influence in across Africa, there will be no shortage of dealmakers willing to take up any slack left by multinationals.

Two comments: no one is more surprised than me, as the person who thought up the whole thing, about the highlighted comment.

Second, as more and more Chinese companies are listed and as China moves towards International Accounting Standards Board convergence the issue noted in the last paragraph holds no threat.

As I said to the tax director of a major multinational corporation recently, who said country-by-country reporting would only happen over his dead body, he might live (or not) to regret that statement. I think it will, and sooner than most predict.