Funding the Future

New briefing – the benefits of country-by-country...

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When in Norway earlier this week I was asked what the benefits of country-by-country reporting are.

It was a good question. It deserved a full answer.

As a result a new briefing sheet on his issue has been published today. It’s [available here](). Comments are welcome.

The benefits are summarised in this table:

Data to be disclosed under country-by-country reporting

Information need met

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1. The name of each country or jurisdiction in which a multinational corporation operates;

¬? Discloses geographic spread of the multinational corporation

¬? Advises host communities of the presence of the multinational corporation in their jurisdiction

¬? Indicates presence in locations likely to be subject to geo-political risk

¬? Indicates exposure to local regulatory and tax regimes.

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2. The names of all its companies trading in each country or jurisdiction in which it operates;

¬? Identifies completely and accurately the full groups structure of a multinational corporation, a feat rarely possible at present

¬? Lets a multinational corporation be properly identified in the host communities that facilitate its activities

¬? Allows those engaging with a multinational corporation locally to identify ultimate responsibility for the entity with which they are trading

¬? Ends the corporate culture of secrecy about activities in many jurisdictions, whether they are secrecy jurisdictions or not

¬? Means a multinational corporation is accountable for all its actions — a pre-condition of corporate social responsibility.

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3. Sales, both third party and with other group companies. Sales information will also require additional analysis. If sales to any state are more than 10% different from the figure from any state then data should be declared on both bases so that there is clear understanding of both the source and destination of the sales a multinational group makes

¬? The extent and direction of sales flows by multinational corporations will be documented

¬? The full extent of intra-group sales will be understood for the first time

¬? The use of tax havens / secrecy jurisdictions as locations for the routing of intra-group transactions will be properly understood

¬? The splitting of sales from the location in which a service is received from the jurisdictions from which they are billed will be capable of identification, an issue of particular significance in services where limited data on sales flows is currently available

¬? The relocation of sales for tax purposes will be identifiable

¬? The risk inherent in internal supply chains will become apparent

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4. Purchases, split between third parties and intra-group transactions

¬? This data is requested to complement that on sales: when the sales of a multinational corporation from a jurisdiction are largely matched by intra-group purchases it is likely the jurisdiction is being used for re-invoicing purposes and transfer mispricing may be taking place: a cause of concern to almost all tax authorities

¬? The extent of outsourcing in source jurisdictions likely to be at the start of supply chains can be identified, especially when compared to labour data (see below)

¬? The vulnerability of supply chains can be identified

¬? By comparing intra-group purchases and intra-group sales likely intra-group supply chains can be established

¬? Sourcing from locations with high geo-political risk should be identifiable

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5. Labour costs and employee numbers

¬? The organisation of labour by jurisdiction within multinational corporations can be identified

¬? Unusual incidence of value added in proportion to labour cost can be identified

¬? The likelihood of outsourcing can be identified

¬? Average reward per employee by jurisdiction can be calculated

¬? Trends in labour relationships over time can be monitored

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6. Financing costs split between those paid to third parties and to other group members

¬? Financial flows indicate where financial assets and liabilities are located within and beyond multinational corporations: disclosure of income and payments, especially on an intra-group basis will indicate the extent to which profits are relocated through the use of debt that creates internal and external financial risk within the multinational corporation

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7. Pre-tax profit;

¬? Pre-tax profit is, without exception, the principle starting point for determining:

o The location of retained reserves

o The ability to finance activity without recourse to third parties

o The likelihood of ongoing financial stability of the entity

o The potential for making payment of taxation liability on income arising

¬? Pre-tax profits located in many countries where there is considerable corporate secrecy are currently wholly unascertainable

¬? The presence of significant profit in locations where most purchases and / or sales are intra-group might indicate artificial relocation of profits

¬? The absence of profits in locations where it would be expected there should be considerable value added e.g. in source locations for extractive industry supply chains, might indicate transfer pricing issues

¬? Persistent losses in a jurisdiction might indicate the misallocation of resources by a multinational corporation, as might strongly differing profit rates between jurisdictions

¬? Significant profits arising in politically sensitive jurisdictions might indicate vulnerable future earnings

¬? Significant earnings in tax havens / secrecy jurisdictions might indicate high tax risk or unsustainably low tax charges indicating a likely change in future after tax earnings ratios

¬? Significant profits arising outside a parent company location where corporate taxation is assessed on a remittance basis might indicate limited access to funds for dividend distribution purposes

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8. The tax charge for the year split between current and deferred tax;

¬? The extent to which a tax charge is expected to arise when compared to headline tax rates indicates the effectiveness of a tax regime in capturing income for tax assessment purposes

¬? The degree to which corporate tax liabilities can be deferred indicates the existence of incentive allowances out of alignment with economic costs incurred, and indicates future potential reversal and erratic cash flows

¬? The ratio of tax paid to profitability across jurisdictions is at present unknown: country-by-country reporting would provide it and indicate the extent and nature of cross border tax planning and international tax arbitrage

¬? If a declared tax rate appears aberrant it may indicate unsustainability

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9. The actual tax payments made to the government of the country or jurisdiction in the period;

¬? It is not accruals made for tax that allow governments to meet their obligations — it is cash in its bank accounts that allows it to do that: cash paid is the ultimate proof of tax settled. This data is currently entirely unavailable and as such the contribution of multinational corporations to individual national economies is very hard to assess

¬? It is cash that is the subject to corruption: it is cash for which governments have to be held to account. This data is vital for that purpose

¬? Cash settlements of less than liabilities declared in earlier years suggest the presence of undetected tax planning or corruption. In either case the effectiveness of the tax regime of the jurisdiction is in question.

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10. The liabilities (and assets, if relevant) owing for tax and equivalent charges at the beginning and end of each accounting period

¬? This data is required to undertake an overall tax reconciliation for a jurisdiction: tax due at the beginning of the period plus the current tax charge for the period less tax paid should equal the closing liability. If it does not there is indication of irregularity in accounting or in the statement of taxes due, in either case worthy of investigation

¬? The failure of a jurisdiction to collect tax owing to it is indicated by this data: if tax outstanding relates to more than one year prime facie there is a tax collection problem within the jurisdiction or the entity is declaring liabilities in its accounts that are inconsistent with those declared to tax. In either case problems are indicated

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11. Deferred taxation liabilities for the country or jurisdiction at the start and close of each accounting period.

¬? Deferred taxation indicates any of these things:

o Excessive allowances offered by he jurisdiction

o The existence of significant tax avoidance

o A non-alignment of taxation with underlying economic reality

¬? In each case there is cause for concern

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12. Details of the cost and net book value of its physical fixed assets located in each country or jurisdiction and

13. Details of its gross and net assets in total for each country or jurisdiction in which operates.

¬? Without indication of the capital dedicated by a multinational corporation to a jurisdiction it is not possible to calculate:

o Rate of return on capital employed in the jurisdiction and to compare these

o To determine whether capital invested justifies the level of profit reported

o To determine whether capital assets are being appropriately allocated to support labour productivity, or not

o To determine where assets and liabilities are likely to be within a group and whether they are as a consequence available a) to shareholders and b) to creditors

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14. A full breakdown of all those benefits paid to the government of each country in which a multinational corporation operates broken down between the categories of reporting required in the Extractive Industries Transparency Initiative if the multinational corporation is engaged in extractive industry activities

¬? Required for all the reasons noted by the Extractive Industries Transparency Initiative

As noted: these benefits from the data noted are indicative and should not be considered complete.

In combination it is suggested that this data would contribute to the benefits users of the financial statements of multinational corporations would secure from the transparency created by country-by-country reporting.

In summary, country-by-country reporting would:

* Provide a stakeholder view of accounting;

* Create reporting of results by country, without exception, which has previously been unknown;

* Provide a new view of corporate structures;

* Impart a new understanding of what the business of a corporation is, and where it is;

* Opens up a new perspective on world trade because intra-group transactions would be reported for the first time in multinational company accounts;

* Give a new view of world labour markets;

* Create an entirely new tool for geo-political risk profiling of companies;

* Permit better appraisal of corporate contributions to the governments that host their activities and in the process contribute to constraining corruption on the part of some recipient governments;

* Provide better awareness of the true extent of tax haven activity;

* Allow measurement of tax lost through tax planning by corporations through the relocation of profit;

* Provide a better understanding of the physical resource allocation of the corporate world.

It is for these reasons that the data it can supply is requested by those campaigning for its introduction.