Funding the Future

BEPS Policy Failure - The Case of EU Country-By-Country...

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I argued for years that we needed country-by-country reporting. We did. We still do. And so far we have not got it. The only public country-by-country reporting data we have to date is from banks. And so that's what we have to look at.

I have done so in a new peer-reviewed academic paper, [published by the Nordic Tax Journal](#) just before Christmas. The paper was co-authored with Atul Shah of City, University of Lond0on and Petr Jansky of Charles University, Prague. The data is interesting. I will get to it, in other posts. What really got to me when working on this data was just how poor it was, and how the absence of any meaningful accounting standards for the preparation of the inf0rmation had undermined the attempts by legislators to deliver useful info0rmation on profit shifting by banks.

This fact did become the primary focus of the paper as a result. The abstract and introduction are noted here: the whole paper is open access and so free to read:

Abstract

The tax gap between taxes that are "actually" paid and taxes that "ought" to have been paid by multinational corporate entities has become an area of huge public policy concern in recent decades. This study reviews the impact of new legislation to reveal the tax gap created by the EU banks and financial institutions passed in 2013 and in particular of the quality of the resulting country-by-country reporting (CBCR) requirement for banks. Although resulting tax gap estimates are noted, they suffer due to significant problems in the published data; much of it is due to the quality of the regulation requiring its publication and implementation. The findings reveal a lack of understanding of the technical and structural weaknesses of accounting in a transnational context in the design of this regulation. CBCR is destined to fail in achieving its regulatory objectives in this context unless necessary reform of the regulation is undertaken.

Introduction

In 2013, the European Union included a requirement that the EU-based banks publish a *limited form of country-by-country reporting (CBCR) in the revised Capital Requirements Directive IV (CRD IV) [15]. As noted in this article, the objective was to "allow stakeholders to gain a better understanding of the structures of financial groups, their activities, and geographical presence and help to understand whether taxes are being paid where the actual business activity takes place" [18]. The initial objective of the research that underpins this article was to test whether this objective could be fulfilled by checking whether reliable estimates of profit misallocation by the reporting banks could be prepared based on the data they published. The objective appeared reasonable, given the stated objective of CRD IV in this regard. In practice, this research objective could not be fulfilled as planned: the data published as a result of the CRD IV requirements could not support that objective. This article explores how and why this happened, and what can be done about it.*

Global corporations, and their growth in power and dominance, have raised increasing concerns among academic researchers [2, 25] and a whole field of corporate governance research has emerged in the past two decades [32, see, e.g.]. This research suggests that in their efforts to externalize costs, firms have been determined to reduce taxes, seeing taxation as a major burden and cost to the business, rather than an opportunity to repay states for vital infrastructure services and legal protections [2, 6, 56]. In a similar vein, their power has increasingly led to corporate boards seeing regulations of any kind as a cost or a burden to their profit-making purpose [30], and firms have actively shopped globally for minimal regulations and constraints [51]. This has eroded the tax base of countries and led to a race to the bottom.

Given the significant rates of corporation taxes charged on company profits, ranging from 0% to more than 40% of profits [31], these taxes have been a key target for minimization. Organizations such as Tax Justice Network [56] and movements such as Occupy Wall Street have had a significant impact in exposing the significant levels of corporate tax avoidance through media outlets and by direct campaigns and public rallies. They have suggested that income from high-tax jurisdictions is being shifted to low-tax jurisdictions, making it very difficult for nation states to collect fair taxes–leading to a major "tax gap" [47]. As a result, transnational regulatory organizations have been pressurized to respond. Under instruction from the G20 and G8, the Organization for Economic Cooperation and Development (OECD) took charge of the initiative to tackle global tax avoidance, through the base erosion and profit-shifting (BEPS) initiative [9, 39, 40]. The primary purpose of this exercise was to identify the levels of such tax avoidance and the locations used to pursue it and to use the resulting transparency to encourage local tax authorities to effectively police and recover taxes that should legitimately fall due within their jurisdictions.

Among the measures adopted as a part of the BEPS process was a form of CBCR [40]. This was explicitly derived from recommendations made by civil society groups [33, 37]. In this context, it is important to note that CBCR is based on accounting and not tax *data [37]. The purpose of CBCR is to indicate whether the risk of BEPS exists and not to, in itself, be the basis for taxation assessment. That said, there is now a growing awareness that accounting data based on most existing accounting standards, including those issued by the International Financial Reporting Standard Foundation that are used by most multinational corporations, are not suitable for the appraisal of many taxation issues [53]. This is partly by design: the International Financial Reporting Standard foundation states that they are not intended for this purpose [26, para 1.10]. This might explain why every country adjusts accounting numbers when determining tax charges [53]. The issue is compounded by the fact that accounting rules and practices also vary internationally and that even where there are international standards, their interpretation is often variable, making the implementation and enforcement of tax rules, technically very complex and difficult to enforce [48, 53]. The consequence is that there are very serious and frequently intractable technical problems in determining what a fair taxation liability for a multinational corporation might be, and how this can be apportioned among states in an equitable manner. As a result Sikka and Murphy [53] proposed a whole new conceptual framework for tax accounting, something that has never been attempted before. In the current and likely continuing absence of the adoption of such a standard, there are serious problems for the enforcement of tax rules, given the power and resources of these giant corporations and the lack of any global tax monitoring authority. The chance of CBCR succeeding has, then, to be appraised within this context. CBCR combines financial reporting with a tax methodology in an attempt to identify the consequences of BEPS. What it cannot do is overcome the inherent deficits in the accounting of a multinational corporation if that accounting data are in itself not fit for tax reporting purposes. Although similar point has been made elsewhere [e.g. 19], our additional contribution is in using specific data from reports published by banks for the period 2013—2017. This research shows how these deficits were ignored in the policy design stage, leading to a significantly detrimental outcome from a regulatory and enforcement perspective.*

In the light of these various concerns, this article addresses two issues and then outlines the research method adopted. The first is the development of CBCR and the motivations for it, including the appraisal of tax gaps. Next, it considers the motivation for the adoption of CBCR by regulatory authorities, concentrating in particular on the use made of it by the European Union to appraise the tax affairs of banks. The research method and objectives for the third and final part are then outlined. The findings from the research reveal significant problems with the new disclosures and their accuracy and reliability. The quality of the data published as a result of the EU regulation and the failings within it are considered before; lastly, conclusions are drawn on the apparent failure of this process to date.