

Funding the Future

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The tax justice movement is, unsurprisingly, [keen on the Biden tax plan](#). What Biden is proposing is fairly straightforward. First, he is suggesting that a company should pay a minimum rate of corporation tax in the USA. He will achieve this by disallowing expenses until that rate is achieved.

Second, and much more importantly, he is proposing that every corporation should pay a minimum corporation tax rate on its worldwide profits. Significantly, he's not suggesting this be calculated on a worldwide basis, but on a country-by-country basis instead. In other words, a minimum corporation tax rate will be required in Singapore, Ireland, Jersey, Cayman and so on. That this is very obviously an assault on the use of tax havens by multinational corporations is obvious.

Importantly, what the framing of the Biden tax announcement makes clear is that tax justice is at the heart of this proposal. This is unsurprising. Biden has recruited some key tax justice supporters to his Treasury team. In other words, so far so good.

However, I want to draw out several issues of significance.

First, the bias in the scheme as proposed is towards the country in which the parent company of the multinational corporation is located. Not all countries are considered equal within the scheme as a result, and the inevitable consequence is that developing countries may not benefit as much as they should. This will need to be corrected: The OECD has long said that there should be a global tax system where the right amount of tax is paid at the right rate, in the right place at the right time, including whether that right place happens to be a developing country, or not, and so it must ensure that this happens.

Second, I have a really big issue with the proposed rate of 21%. Remember that it was only in 2017 that the headline rate of US corporation tax was 35%, and it was only just over a decade ago that it was 30% in the UK. On average the rate is in excess of 25% around the world at present, when weighting country tax rates by population. 21% is in that case a very modest ambition. I would suggest that it is much too modest, and that it is the job of tax justice campaigns to ask for a much higher right now. That is partly because justice requires it, but also because unless somebody is making that demand

then the already low suggested rate will be negotiated lower, and we will end up with something in the teens, which will be utterly unacceptable. I see no reason why a rate of 30% should not be demanded now. As I've just noted, this is entirely historically appropriate. What is not is the current low rates, which are an aberration. There is no reason to lock them in.

Third, I come to my most important point. It's all well and good campaigning for a percentage of something, but you have to know what that something that you're claiming a percentage of might be if you are going to do that. The Biden tax plan might say this is a percentage of the declared profits of a corporation in the jurisdiction, but the reality is that what this figure might be is not only very often unknown, but it is also inconsistent in itself, and potentially subject to significant abuse unless steps are taken to stop this happening.

This needs explanation. Although we do now have country-by-country reporting for tax purposes amongst multinational corporations, the approach that a company is required to adapt on this is not consistent. So, for example, companies are allowed to work on both a top-down and bottom-up basis of estimation of their profits by jurisdiction.

When working on a top-down basis the transaction recorded in the group consolidated accounts are apportioned to the country where they might arise. There is an obvious advantage to this. If we are trying to tax the global profits of a multinational corporation once, and once only, then there is merit to using the group accounts, because they are prepared on one consistent account basis, and there is only one figure for profit. The likelihood is, then, that it is just those profits that will be apportioned.

On the other hand, if a bottom-up method of preparing country-by-country report is adopted by a multinational corporation then what happens is that the accounts of each of its local subsidiaries are used as the basis for reporting. It can, of course, be argued that this is appropriate because as a matter of fact this is where everything starts, and where tax is due.

However, in accounting terms there are many problems. First, this requires that a proper consolidation by jurisdiction takes place, which means that all the intragroup transactions between the companies within the jurisdiction are eliminated from view to get a proper perspective on the profit actually made in that place. It is an unfortunate fact that the OECD got this accounting wrong when introducing their version of country-by-country reporting: what they asked groups to do when working on a bottom-up basis was to aggregate the accounts of the companies in the jurisdiction. Aggregation simply means that the accounts are added up, but this does not eliminate intragroup transactions, and the resulting profits and losses that arise from them as a consequence, and as a result the view that the OECD version of country-by-country reporting presents of activity by jurisdiction can be seriously misstated, either by accident, or as a result of manipulation.

That, though, is not the only problem with this approach. What is more problematic is that many multinational corporations do not use the same system of accounting throughout the group, but do instead use local generally accepted accounting principles in each country, which may be by no means compatible with each other. So, the basis for profit estimation in one country may be quite different from the basis for profit estimation in another. Both approaches are legal, but the result is that this does not create something that is anything like appropriate as the basis for group taxation, which is what the Biden tax plan envisages.

There is, then a third problem. This is that when all these local subsidiaries are consolidated into the group accounts adjustments have to be made to take out of consideration all the transactions that take place between them. We know that these transactions are commonplace, and that many take place without any tax motivation at all. However, the process of their elimination does give rise to a significant issue, which is just where is it considered that the adjustments to the consolidated profit take place?

Is that adjustment to be split between the jurisdictions which the transaction involves, if there is a multijurisdictional aspect to this? Or, is the adjustment to simply be allocated to the head office location? Since, in my experience of observing these adjustments many eliminate profit rather than add to it (which many might find surprising) is it fair to allocate the adjustment to the head office, which will then underdeclare tax? Or should they be declared in the subsidiary's jurisdictions, which may reduce tax owing? Or is some better method required?

Alternatively, is a top-down method always to be mandated on the basis that this is most likely to eliminate these problems, albeit that it then takes any consideration of local taxation rules almost entirely out of consideration in determining likely receipts in a jurisdiction that hosts subsidiary entities, and leaves the method of group consolidated accounting as the determining factor of what may, or may not, be considered a fair profit to apportion to the country in question, which may give rise to substantial sources of dispute in the future?

Finally, let me raise one further issue. This is to ask what is tax paid? There is no consistency in the measurement of this sum. It would seem very unlikely that the figures included in the accounts of the company should be considered an appropriate estimate of tax paid, precisely because it is far too estimated in its nature. At best most such figures are fairly broad brush, and rushed, calculations put into the accounts at the last moment after almost everything else has been concluded within the financial statements, and evidence that I have collected over the years suggest that these figures are inherently unreliable. In that case another figure has to be used.

That, however, cannot be the cash paid in a year, because again this will be estimated, based upon the company's own declaration of what it thinks owing, at least in the first instance, rather than the actual liability that will finally be agreed, which could be subject to negotiation for a number of years. And how is this audit process to be treated

within the calculation of the minimum tax rate?

I pose all these questions for good reason. Rather remarkably there is, right across the tax profession, very little interaction between those who specialise in tax and those who have any understanding of accounting. Although the tax experts frequently come from the big four firms of accountants, few who engage in tax appear to have much recall of what the accounting aspects of their work might have been. Tax professionals from other career paths e.g. from within a tax authority, have even less understanding of accounting. This is also true of most tax justice campaigners. I am not criticising anyone when saying this, but am merely pointing out a fact.

That uncomfortable fact is that accounting data is rarely, when it comes to taxation, consistent, reliable, or free from abuse. Instead, the data is usually open to dispute, and for good reason. Even cash paid lacks objectivity when it comes to tax.

What that means is that when discussion on the global minimum tax rate takes place, it is just as important that discussion on what the global tax base to which this percentage will be applied to takes place in parallel, with those involved being open-minded as to the issues within accounting that must be resolved if this basis of tax payment is to be fair and appropriate for all parties, including the companies and the countries involved.

Saying so, so let me stress one thing, and that is that no one has ever attempted to achieve this as yet, and so finding that appropriate basis will require us to fly blind: innovation to ensure a successful outcome will be a necessary part of this process.

I am simply recording there must be an openness to this reality as a necessary part of preparation for the negotiations to come on the plan Biden has offered to the world, and which we should all welcome. There is a great deal of work to be done if this plan is to succeed. It is my hope that civil society will have a significant part in that process because it has had that engagement in almost every other stage of progress towards it, but recognition of the problem is the first stage in achieving that.