Taxing multinational companies - the right way

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A regular commentator on this blog asked yesterday:

Given the blatant abuse by some multinational companies of their capacity to move their taxable gains for their own convenience, it has been clear for many years now that a solution is needed that would involve full international agreement. With the country that is the base for the biggest of those companies actually proposing an idea, it is disappointing that our own government hasn't followed the lead of others in signing up to negotiations on this.

And it will need major negotiations, which I look forward to your thoughts on from your accountancy expertise. What should be the universal way of determining profit subject to corporation tax?

This was the reply I gave on this issue when submitting evidence to the Treasury Select Committee last autumn:

The first reform that the UK could adopt to address the issues noted is to require that all multinational corporations trading in the UK publish their annual accounts for filing with Companies House on a country-by-country reporting basis, whether or not they have their head office in this country. The right to demand such accounts on public record in the UK so that the UK public have the right to know whether or not the tax paid by the multinational corporations that they trade with make fair and appropriate payment of tax in the UK as a result of the activity that they undertake here will be entirely within the power of the UK to demand post-Brexit.

The current best example of the potential country-by-country reporting disclosures that might be required of multinational corporations in this way is provided by the 2019 standard on this issue published by GRI (the Global Reporting Initiative)[1] [2]. There can be no doubt that public pressure will provide the best mechanism to create demand for companies to reform their taxation practices, and country-by-country reporting data published on a consistent and reliable basis will provide the public with the information that they need as consumers to bring that pressure to bear.

There would be no significant additional cost on companies to comply with this requirement since the standard is based on, and is a development from, the information that almost all multinational corporations in all major economies must now supply to their tax authorities on a country-by-country reporting basis for tax risk appraisal purposes. As such all multinational corporations should already have the information to deliver this information in their possession already.

The second basis on which reform could be made would be for the UK to adopt a unitary apportionment formula basis for the taxation of multinational corporations. This would remove from debate all the disputes that arise as a result of the existing international tax system which assumes that:

* All the subsidiaries of a multinational corporations are wholly independent of each other for tax purposes, when that is clearly not true; and

* Market based prices can be found to determine the prices that these interdependent subsidiaries should use when trading with each other, when in the vast majority of cases that is not now true.

A unitary apportionment basis for the taxation of a multinational corporation assumes it is a single entity and is managed as such. Its single profit is then apportioned to the countries where it trades based on a formula. The most common formula weights profit before tax (P) on the basis of where third party sales (S), employees (E) and tangible assets (A) are located on the basis of the following formula to determine the profit attributable to a location (L) as opposed to the corporation as a whole (C):

$$PL = PC \times (SL/SC + EL/EC + AL/AC)/3$$

Other options are available, for example to allow for environmental extraction, but this is the usual default option that is discussed.

It is, of course, possible to claim that the result is arbitrary, but so too is the existing system.

In addition, it can be claimed that a formula could not be agreed, but nor is it required that transfer prices be agreed between countries now.

What is apparent is that this basis of tax provides a viable and continuing system for corporate taxation on an international basis when the existing system is unsustainable because it is based on assumptions that have no relationship to the real world, whereas those underpinning unitary taxation reflect the economic reality of there being a single entity under common control, which is what a multinational corporation is. It is for this reason that the UK should adopt this basis of tax, even if it would be a pioneer in this field. Doing so would provide multinational corporations based in this country with the certainty that they need on the taxation liabilities that they might owe in this country.

[1] See https://www.globalreporting.org/standards/work-program-and-standards-review/development-of-gri-207-tax-2019

[2] Richard Murphy was a member of the advisory panel that assisted drafting of this standard. He also created the concept of country-by-country reporting in 2003.

I should add that this is not the Biden plan, as yet. That has no asset formula. And there are other accounting issues in it. But, the Biden plan is a step in this direction. It is not perfect, but I am a pragmatist. That is why I support it. I am also biased of course: this plan is based on country-by-country reporting, which I created.