



OXFORD UNIVERSITY
**CENTRE FOR
BUSINESS TAXATION**

Transparency in reporting financial data by multinational corporations

Report of a group chaired
by Michael Devereux



Saïd Business School
UNIVERSITY OF OXFORD

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PREFACE

In its first meeting in May 2010 the OECD Informal Task Force on Tax and Development identified the issue of transparency in financial reporting as being potentially important in helping development efforts in lower income economies, on the grounds that greater transparency could provide necessary information for holding both governments and multinational enterprises more accountable regarding tax revenues and payments.

This report was commissioned by the Task Force, with a view to examining in more detail the case for greater transparency. The report was submitted to the Task Force for its meeting in April 2011.

There are already in the public domain a number of initiatives to promote greater disclosure of tax information by multinational enterprises. The report reviews and discusses them, as well as the central issues involved in the debate about transparency in financial reporting. It tries to answer some of the fundamental questions about the objectives of greater transparency, how it can be better achieved at least cost, and to what extent it could achieve its objectives. The purpose of this report is to identify and clarify issues, and not to take any positions or to make recommendations.

The report is the product of a group, chaired by Michael Devereux, Director of the Oxford University Centre for Business Taxation. The group included representatives of the OECD, business, NGOs and academia. The group also received comments and advice from a broader group, the OECD Sub Group on Transparency in Reporting Financial Data by Multinational Corporations.

This report reflects a broad consensus amongst the group regarding the issues involving transparency of reporting by multinational companies. The report does not represent the views of the Oxford University Centre for Business Taxation, the OECD, or any other organisation.

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CONTENTS

1	Introduction	6
2	Objectives	7
	2.1. Holding governments to account	10
	2.2. Holding corporations to account	14
3	Alternative forms of disclosure	17
	3.1. Holding governments to account	17
	3.2. Holding corporations to account	23
	3.3. To whom should information be disclosed?	31
4	Costs	34
	4.1. Holding governments to account	36
	4.2. Holding corporations to account	37
5	Mechanism for requiring disclosure	39
	5.1. The use of accounting standards	39
	5.2. The use of mne guidelines plus guidance	42
6	Concluding remarks	43
	Appendix	44

1. INTRODUCTION

The suggestion that there should be more transparency in the reporting of financial data by multinational corporations, and more specifically, that their financial data should be reported country by country, has been debated now for a number of years. The European Commission has conducted a public consultation on financial reporting on a country-by-country basis by multinational companies. The OECD Informal Task Force on Tax and Development decided to take up the challenge of channelling this debate in the context of tax and development. The Oxford University Centre on Business Taxation was invited to lead a group of tax experts and practitioners to analyse the fundamental propositions which underlie the discussion.

This report is the result of a preliminary evaluation of the issues involved with transparency on financial reporting. The report addresses five distinct issues.

- What are the objectives of greater transparency in financial reporting by multinational companies? What is it that advocates of greater transparency hope to achieve?
- Are there forms of increased, or better, disclosure than are currently imposed or utilised which would reasonably be expected to meet these objectives?
- Does public disclosure of tax information by corporations have an effect on compliance above and beyond the enforcement effort of governments, even if they had reasonable capabilities? To whom should information be disclosed?
- What are the costs, both financial and otherwise, of such disclosure to governments and to business? What is the balance between the costs and benefits of different possible disclosures?
- How could greater transparency be achieved? For example, should greater disclosure be compulsory or voluntary? Should it apply to activities in all countries, or just developing countries? Could it be best achieved through changes to accounting standards, by amendment of the OECD Guidelines for Multinational Enterprises, or by some other route?

The organisation of this report follows these questions. The principal aim of this report is to identify and to clarify issues related to greater transparency in financial reporting, and to suggest areas for future work. It does not seek to provide recommendations.

¹ See http://ec.europa.eu/internal_market/consultations/2010/financial-reporting_en.htm.

2. OBJECTIVES

The public debate on whether MNEs should be more transparent in their financial reporting has identified a number of possible objectives. In this section we set out and discuss a comprehensive list of possible objectives. That does not necessarily imply agreement either with the objectives themselves, or that greater transparency would meet these objectives.

Below we consider six possible objectives. They differ from each other in two dimensions. First, four of the objectives relate to holding governments to account; the fifth and sixth relate to holding companies to account. Second, they may relate to holding either to account for applying existing tax laws in specific countries and internationally. But in principle they may also relate to providing information that can inform a better debate about the nature of existing tax laws, and whether there could be useful reforms. This is an important distinction: these objectives are very different from each other, and may lead in principle to the need for different forms of reporting, which we discuss at greater length in the next section.

The possible objectives discussed here are as follows:

- a) To hold governments to account with regard to:
 - i. Integrity of administration administration of tax collection;
 - ii. Efficient administration of tax collection;
 - iii. Appropriate domestic of tax policies; and
 - iv. Adoption of appropriate international taxation standards.
- b) To hold companies to account with regard to
 - v. Paying the amount of tax due in each country in which they operate; and
 - vi. The tax planning strategies of companies even where the amount of tax due has been paid.

The notion of the “amount of tax due” implies the amount due under the law. There may be difficulties in ascertaining this, due to problems of interpretation or application, in some cases. On one view, some types of artificial tax minimisation techniques, even if legal, may not be ethical. Those who hold this view claim that corporations should be guided by this higher standard and that public disclosure of information would encourage such higher standards. These commentators also argue that public disclosure would highlight aspects of the law that might need to be strengthened or changed.

The alternative view is that in the tax arena, corporate responsibility must be defined by the amount of tax legally due and companies cannot be expected to make voluntary payments over and above the amount required by the relevant legislation. According to those who hold this alternative view, in a democratic society it is for the legislature to determine the standards which should apply to taxpayers and companies must then abide by that law. These commentators argue that if one moves to other standards, it is hard to know who could lay these down and on what authority they are in a position to police them. As there was no consensus within the group on the appropriateness of objective vi, this report's discussion of holding companies to account considers only accountability with regard to the amount of tax due, objective v.

The remaining objectives clearly represent a range and this report does not discuss them all at equal length. It is important in particular to distinguish objectives iii and iv from the others. All of the other objectives concern holding governments and taxpayers to account for adequately complying with, and administering, existing laws. But objectives iii and iv concern the basis for those laws, and open the possibility that greater transparency can aid the process of formulating tax reform.

These are very different types of objectives. To consider this in more detail, consider two examples. First, consider a government which operates an efficient and honest tax system, but which believes that the economic interests of the country are best served by discretionary tax holidays awarded to inbound multinational companies. Such tax holidays will reduce the tax revenue collected from those multinational companies. In this case, that is the political choice made by the legitimate government involving a trade-off between revenue and inward investment. Organisations representing civil society either inside or outside the country may take a different view of this trade-off; especially those inside the country should have the right to express their view. It will be up to the government to decide whether or not to adapt its policies in response to this viewpoint.

For the purposes of this report the issue is not whether any particular national tax policies are appropriate or not. It is whether greater public disclosure of information about taxation would be useful to inform public debate about national tax policies.

As a second example, consider the case in which a multinational company adopts an aggressive approach to tax planning.² While the action taken might comply with national and international law, and might not be challenged by the tax authorities concerned, the company is able to pay little tax in specific countries, obtaining for itself a relatively low effective tax rate worldwide. In this example, the company may have complied with all relevant tax law, and so met the aim of condition v. But some would

² "Aggressive tax planning" is defined here as planning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences or taking a tax position that is favourable to the taxpayer without openly disclosing that there is uncertainty whether significant matters in the tax return accord with the law (Study into the Role of Tax Intermediaries (OECD, Paris, 2008), <http://www.oecd.org/dataoecd/28/34/39882938.pdf>).

argue that the outcome is unfair and inappropriate because of uncertain or poorly drafted law. Whether or not this is a reasonable position we leave to one side. The point here is to make a distinction in objectives. If the company has a tenable argument that it has complied with all relevant tax law, an alternative complaint would be that national law or international tax law itself is at fault.

This report does not discuss the merits of the existing system of international tax standards; that is beyond its scope.³ There nevertheless remains a question as to whether more transparent reporting of tax payments would provide information which would aid public debate about the appropriate structure of international tax principles.

Insofar as any information in the public domain may inform the electorate and decision-makers, greater transparency in financial reporting may be a benefit to the public debate about the best set of policies and international rules for protecting the tax base in less developed countries.

However, the material effect that greater disclosure of corporate financial information will have in the political dialogue in each country is very difficult to assess. Evidently, information can be used to support many differing arguments, and can be used more or less responsibly. Its net effect in the quality of the public debate is a matter that goes beyond the scope of this report. This report's principal purpose is to focus on the extent to which various forms of disclosure can improve the operation of existing systems.

Government and corporate accountability with respect to existing regulations is a very different issue from evaluating tax policy. In the remainder of this report, we confine our discussion to the former issues, and leave objectives iii and iv to one side.

The rest of the report hence focuses on the remaining objectives: whether increased disclosure of financial information by multinational companies could help to hold governments and companies to account within the context of existing tax policies, leaving aside the issue of whether greater transparency could aid public debate on appropriate tax policy. We discuss each of the other objectives in turn below.

Before doing so, it is worth noting one other objective which has been put forward but which we do not address in this report: to provide investors with better information about the activities of multinational companies. It is not the role of this document to analyse whether investors are already sufficiently protected by accounting standards as well as by stock exchange requirements. Investors have mechanisms to achieve the disclosures they require. To the extent that "ethical investors" have concerns about the effects on society of the behaviour of companies in which they invest, they are no different from

³ The current standards that define the international taxation system are the Model Tax Conventions of the OECD and the UN and the Transfer Pricing Guidelines of the OECD which are referred to by both Conventions. All OECD member countries abide by those guidelines, as well as many non-OECD member countries.

the rest of society, and therefore are subsumed under the more general point related to making multinational companies more accountable for their tax payments in developing countries.

2.1 HOLDING GOVERNMENTS TO ACCOUNT

2.1.1. Integrity in tax administration

For a number of years now there has been a growing international concern for combating corruption and increasing government accountability. In 1997 the OECD adopted the Anti Bribery Convention, to which all members and some non-member countries subscribe; in 2005 the UN Convention against Corruption entered into force as well. Some countries additionally have introduced in their domestic legislation specific provisions to prosecute those who pay foreign public servants in order to circumvent local rules and regulations, including tax obligations. This is the case, for example, of the US Foreign Corrupt Practices Act.⁴

Independent organisations too have worked to raise public awareness and to diminish tolerance of corruption. For instance, Transparency International, a global civil society organisation created in 1993, publishes yearly a Corruption Perception Index, which in 2010 included 178 countries.⁵

The Conference of the State Parties to the United Nations Convention against Corruption points out that transparency clearly plays a fundamental role in making the Convention operational and it recognises generally that disclosure of information to the public and community based organisations has an important role to play in this regard.⁶

Following this general line of argument, the first objective set out above is to hold governments to account for the honest enforcement of their tax policies and to combat corruption, particularly with respect to the collection of revenues from multinational companies. If the focus of attention here is only on multinational companies, then a key assumption is that in most cases a small number of such companies will represent a very large proportion of a developing country's total tax revenue, so that it would be relatively easy to perceive if such payments go unreported in government accounts.

This rationale has been central to recent developments in transparency in the extractive industries. For example, the organisation Publish What You Pay sets out its objectives as:

Publish What You Pay (PWYP) is a global civil society coalition that helps citizens of resource-rich developing countries hold their governments accountable for the management of revenues from the oil, gas and mining industries. Natural resource revenues are an important source of income for governments of over 50 developing countries. When properly managed these revenues should serve as a basis for poverty reduction, economic growth and development rather than exacerbating corruption, conflict and social divisiveness.⁷

Similar concerns led to the creation of the Extractive Industries Transparency Initiative in 2003, which has subsequently developed specific guidelines for disclosure both by corporations and by governments. The objectives of the EITI are set out as follows:

3.5 billion people live in countries rich in oil, gas and minerals. With good governance the exploitation of these resources can generate large revenues to foster growth and reduce poverty. However, when governance is weak, it may result in poverty, corruption, and conflict. The Extractive Industries Transparency Initiative (EITI) aims to strengthen governance by improving transparency and accountability in the extractives sector.⁸

While the aims of PWYP and EITI are clear, they apply only to extractive industries. Plainly, this is a very important sector for many developing countries. There are transparency initiatives underway in other sectors, but these are more focused on government spending, rather than payments to government. See, for example, the Construction Sector Transparency Initiative (CoST).⁹

These objectives may need to be adapted for multinational companies from other sectors. In doing so, it should be recognised that the impact of different business models on revenues paid to governments will not be the same. For example, extractive industry business models may generate significantly different revenue streams to a government than business models based on the importation and sale of products into that country's market.

Also, the extractive industry operates under specific circumstances which make it more sensitive in its relationship with governments as compared to companies in other industries. Typically firms in this sector obtain long term concessions or licenses from governments to extract raw materials which require very large and specific investments, concessions that are obtained following some type of bidding process. This has at least two crucial implications: one, large payments different from taxes, such as "signature bonuses" and periodical royalties, are fairly standard revenues collected by governments from this sector and, two, the operation itself will be regulated by a particular contract

⁴ The UK has new anti bribery legislation (the Bribery Act 2010),

⁵ www.transparency.org/policy_research/surveys_indices/cpi/2010.

⁶ See UN, *Report of the Conference of the States Parties to the United Nations Convention against Corruption on its third session, held in Doha from 9 to 13 November 2009 (CAC/COSP/2009/15)*, available at <http://www.unodc.org/documents/treaties/UNCAC/COSP/session3/V0988538e.pdf>.

⁷ <http://www.publishwhatyoupay.org/>.

⁸ <http://eiti.org/>.

⁹ www.constructiontransparency.org.

with the government, which may have confidentiality clauses, which may be interpreted as taking precedence over local legislation or even international regulation. Thus, the following key question needs to be asked: Is the misuse of revenues from multinational companies outside the extractive industries sector a significant problem in many developing countries? Are there particular activities outside the extractive industries which should be targeted by any new disclosure proposals?

The group has not had the time to consider evidence that would enable it to answer this question conclusively. For example, as indicated above, Transparency International (TI) produces information on perceptions of corruption on a country basis, as well as perceptions of which countries are more likely to have an environment in which bribes are paid.¹⁰ While perception-based indicators have been criticised on methodological grounds,¹¹ further work could be done to relate the latter measures to the importance of different sectors. The TI measures could also be compared to information about tax revenues declared by governments, in different sectors, and for different forms of tax. This may help to indicate whether there is any systematic relationship between low tax revenue relative to an appropriate indicator (e.g. GDP), economic dependency on extractive industries and poor transparency. To be useful, such an analysis would need to take into account different sources of tax revenue. Other, non-TI evidence would also need to be investigated.

2.1.2. Efficient administration of tax collection

Lower tax revenue than the legislation intends in a developing country may not stem from corrupt practices, but also from a lack of legal or administrative capacity. For example, a lack of auditing and tax collection resources may stem from inadequate training in tax administration and from inadequate funding.

In the case of corruption, greater transparency may help to reveal a punishable illegal act. In the case of inefficiency or lack of administrative capacity, greater transparency may reveal the need for greater spending, better training or a stronger revenue authority. It

may also raise questions around decisions taken by revenue officials in their interpretation of the law, but this latter issue would need careful handling. Information on these areas would need to be explained and understood in the context of tax incentives and reliefs given deliberately by governments, which also reduce the effective tax rate below the headline rate, so that simple publication of numbers might be insufficient.

Using information from greater disclosure of tax payments made by companies, and tax receipts by governments, it may be difficult to distinguish such lack of capacity or

¹⁰ See, for example, Transparency International (2010), Corruption Perceptions Index, and Transparency International (2008) Bribe Payers Index, both available at <http://www.transparency.org>.

¹¹ Christiane Arndt and Charles Oman (2006), *Uses and Abuses of Governance Indicators*, OECD Development Centre. The report argues that composite perceptions-based indicators lack transparency and comparability over time, suffer from selection bias and are not well suited to help developing countries identify how effectively to improve the quality of local governance.

other forms of inefficiency from corruption. In any case, typically corruption and low administrative capacity usually coexist and reinforce each other. Given that corruption tends to be hidden, distinguishing the two cases may be very difficult.

A second area in which it may be argued that governments need to be held to account reflects a very different motivation for both lower tax collections and non-disclosure. That is that governments may offer favourable tax treatment to multinational companies, and others, as a means of stimulating greater investment in an attempt to boost the domestic economy. This could be, for example, as a tax holiday or some other tax concession for a given period. This might be completely above board and transparent.

It is also important to note that tax policies in other countries will affect the business model chosen by the MNEs in the host country. The destinations of high income activities are determined by corporations, based, among other things, on comparative advantages in taxation. So, domestic tax policy may often be insufficient to explain MNEs' tax strategies, for their driver could well be determined by the advantage arising from tax benefits offered in other countries, including (sometimes prominently) in a number of developed economies.

Governments may seek to avoid disclosure of a tax concession to a multinational company. One possible reason for this could be to avoid the general perception that tax law is not generally equitably administered in the country, or to hide the fact that it is possible for some but not all to negotiate lower tax liabilities. Governments may not wish to disclose this information as it may affect their negotiation position with other companies seeking to agree a treatment in the future.

There may be an issue of transparency where discretion is used but not disclosed. Granting tax concessions without disclosure of such an incentive may also lead to a false presumption that the company involved has shifted profits out of the country when in fact it has received a tax incentive from the government.

A government may operate legitimately under a regulatory system that allows confidentiality and discretion on certain administrative decisions. There could be a variety of reasons for this, for example, public disclosure of some arrangements may be used by other countries to compete advantageously in attracting foreign investment. Also, agreements may involve the description and conditions of use of companies' commercial secrets, which they will want to protect from public disclosure. The case for undisclosed concessions made as matter of deliberate policy is a question whether the regulatory policy is appropriate, not whether the legal system is being properly administered, so is beyond the scope of this report. Some would claim, however, that even if legitimate, some type of public scrutiny would be desirable in such cases.

However, the lack of transparency in the administration of the discretionary rules involving special tax regimes could well favour inequities, corruption and costly inefficiencies in the tax system. Inevitably, public transparency on these issues will have a mixed effect; more research as to the best practices that are today in place which may best help (less developed countries) LDCs in this area could be considered.

2.2 HOLDING CORPORATIONS TO ACCOUNT

The second motivation for greater transparency in financial reporting of multinational companies is quite different: to hold the companies to account. This is the motivation, for example, of the Task Force on Financial Integrity and Economic Development. The preface of its recent report advocating country-by-country reporting states:

*Tax avoidance is a global problem. It involves the abusive exploitation of gaps and loopholes in domestic and international tax law that allow multinational companies (MNCs) to shift profits from country to country, often to or via tax havens, with the intention of reducing the tax they pay on some or all of their profits. Tax avoidance on such a large scale is facilitated by a lack of transparency in the way MNCs report and publish their accounts. Making MNC accounts more transparent would help tackle tax avoidance at very low cost.*¹²

The view here then is that governments in developing countries find it difficult – or even impossible – to collect the tax that is properly due from multinational companies, who are able to shift their profits to tax havens to reduce their tax liabilities.¹³ It is certainly plausible that profit is shifted from higher taxed countries to lower taxed countries; the incentive clearly exists. There is empirical evidence that such shifting takes place, although the scale of such activity is not clear.¹⁴

But in considering profit shifting, it is necessary to separate two types of activity. One is deliberate contravening of domestic or international law in order to pay less tax. This is illegal, and companies, like other taxpayers, should be held to account by tax authorities with the use of penalties to minimise such behaviour. Disclosure to the public may also have a role in creating a disincentive to such illegal behaviour.

¹² Richard Murphy (2009) “Country-by-country reporting: holding multinational corporations to account wherever they are”, Task Force on Financial Integrity and Economic Development, available at http://www.financialtaskforce.org/wp-content/uploads/2009/06/Final_CbyC_Report_Published.pdf.

¹³ The term profit shifting also requires a word of caution, so that it is not misinterpreted. Profits in any one country will be determined by the economic activities carried out by the resident firm, given the business environment in the country in which it operates and the prices at which it transacts in the market. Equivalently, the profits of a firm that transacts with related parties will be determined in the same way, where prices are those that independents would use in similar circumstances (i.e. the arm’s length principle of Article 9 of the OECD and UN Model Tax Conventions). In transfer pricing language, profits so determined will depend on functions performed, assets used and risks assumed in the relevant country. Profit shifting is generally conceived as the action of the management of the global enterprise to reallocate internationally such (market) profits via non arms’ length transfer pricing, so that the profits in each country no longer reflect those market considerations. This should not be confused with the choice that could be made by the enterprise to reallocate its economic activity (functions, assets and/or risks) among its various foreign affiliates. Of course, the transfer of economic activities raises the difficult question of whether there is a taxable event when such transfer occurs. See Chapter IX on business restructuring in OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 2010.

A second activity is the exploitation of gaps and loopholes in domestic and international tax law. By implication such activity, while it may represent aggressive tax planning, is legal, although some will object that it is not ethical or ‘acceptable’. In addition there may be a range of behaviour which is making use of uncertainty in tax law and where the effectiveness of the activity to reduce tax due is unclear, one way or another, until the matter is adjudicated by the courts or dealt with by arbitration. Establishing the boundaries and interpreting complex tax law is notoriously difficult. More aggressive tax planning typically seeks to push the boundaries of the law, where the precise tax status of particular, and usually complex, activities is unclear.

In any event, sometimes the intention of the law is not clear cut and different interpretations can legitimately be made. The choice of how aggressively to organise affairs to reduce taxes may be a function of the probability of being sanctioned for it.¹⁵ That probability clearly depends on government’s effectiveness and assertiveness on its tax administration and in the context of lower income countries these problems may be exacerbated by the weak capacity of tax administrations.

It is argued that the problem of profit shifting is particularly severe because of the scale of trade which takes place within multinational companies.¹⁶ It is estimated from US trade data for 2009 that around 40% of all international trade in goods takes place within multinational companies.¹⁷ While the majority of this is likely to be between developed economies, rather than with developing countries, the relative importance of multinational companies to a developing country economy means that the tax base that is being called to be the subject of greater transparency is important.

The difficulty of valuing the “transfer prices” at which the transactions between associated entities are undertaken depends on the circumstances. For example, valuing transfers of commodities or low value-added services does not typically present serious problems. Valuing more sophisticated services or assets, especially those involving unique intangibles, can be extremely difficult, sometimes for very good reasons because there is no public information on similar transactions with which to make comparisons and the adjustments or selection of method that may be needed to apply the arm’s length principle often are not trivial.¹⁸ This in turn implies that valuing profit arising in any country where such transfers take place can also be extremely difficult. Further, multinational companies

¹⁴ For a critical survey of the empirical literature which attempts to estimate the scale of profit shifting, see Clemens Fuest and Nadine Riedel (2009), “Tax evasion, tax avoidance and tax expenditures in developing countries: A review of the literature”, available at <http://www.sbs.ox.ac.uk/centres/tax/Documents/reports/TaxEvasionReportDFIDFINAL1906.pdf>

¹⁵ NGOs would argue that reputational sanctions are also a determinant of corporate behaviour in this respect.

¹⁶ See, for example, Christian Aid (2010) “Shifting sands: tax, transparency and multinational companies”, available at <http://www.christianaid.org.uk/images/accounting-for-change-shifting-sands.pdf>. See also Richard Teather, “Transfer mispricing & child mortality” (March 2010), available at <http://www.jerseyfinance.je/News/Free-Trade-Saves-5000-Children-Every-Day>.

¹⁷ See http://www.census.gov/foreign-trade/Press-Release/2009pr/aip/related_party/rp09.pdf.

¹⁸ Presently the OECD is working to produce more detailed guidance on the application of the arm’s length principle to intangible assets. See Transfer pricing and intangibles, scope of the OECD project. OECD, January 2011, http://www.oecd.org/document/44/0,3746,en_2649_33753_46988012_1_1_1_1,00.html.

have access to expertise in taxation and transfer pricing, which cannot be matched by the tax authorities of most, if any, developing countries.

It is not the purpose of this report to analyse in detail either the practical difficulties faced in particular by developing countries in implementing transfer pricing rules or the initiatives that could be undertaken to address those difficulties; the report by the Sub Group on Transfer Pricing to the informal Task Force on Tax and Development will address those questions. Nevertheless, this discussion raises the question of the problem of aggressive tax planning that pushes the boundaries of the law. If there are gaps or loopholes in tax law which governments do not intend, then the natural response of civil society is to hold governments to account to remove these gaps and loopholes. There are examples of civil society groups in lower income countries which support this work.¹⁹ In addition, civil society groups argue that companies should be accountable and responsible for how they use gaps and loopholes in tax law. Others question whether civil society should attempt to hold companies to account to a standard of behaviour that is not required by law.

3. ALTERNATIVE FORMS OF DISCLOSURE

Given the very different objectives set out above, the nature of the information that would need to be publicly disclosed on a country-by-country basis will clearly also differ. We therefore again discuss each objective in turn.

A number of examples are provided in this section of the form that relevant disclosure might take; these are meant as examples only and are neither endorsed nor recommended by the Group. Further work will need to be done in this area before any such recommendations could be made.

3.1 HOLDING GOVERNMENTS TO ACCOUNT

If there is a perception that payments made by multinational corporations may be misused, or not properly accounted for by governments, the central case for greater transparency concerns the value of those payments. The payments may take many forms – including, for example, payment of corporate income tax, payroll tax, other taxes, and royalties and charges for the rights to exploit natural resources. But the central aim appears to be to make public the total of those payments by each company.

This is exactly the aim of the EITI. Indeed, the EITI is a global standard to ensure more transparent management of natural resources. It is a voluntary standard for governments to adopt and supported by companies, civil society, investors and international organizations, defined by a methodology for an independent monitoring and reconciling of company payments and government revenues from the extractive sector. While the standard is clearly voluntary for governments, it is not for companies in countries which have chosen to participate in EITI; a country cannot be EITI compliant without all companies in its jurisdiction reporting.

The output of the EITI process is an EITI Report for the individual participating country, available to the public, where company payments to the government and government revenue figures are reconciled. To become an EITI candidate, a country must meet an initial set of indicators and provide a work plan documenting how it intends to achieve EITI compliance. To achieve EITI complaint status the country must comply with a larger set of criteria and go through the validation process, which is carried out by an independent

¹⁹ The Nairobi Declaration on Tax and Development is one example of a group of civil society organisations coming together to advocate on national and international tax issues. See http://www.afrodad.org/index.php?option=com_docman&task=doc_download&gid=86&Itemid=16.

validator selected by a multi-stakeholder board. If no progress is made the EITI Board can revoke candidate status.

The EITI does not require individual company information to be made public, but it encourages disaggregated company by company reporting as a good practice. The specific way in which the information is disclosed under EITI is agreed within each EITI country, considering whichever limitation might be placed on disclosure by local legislation. Thus, in some cases the companies' report to the EITI-authorized body (validator) are not made public individually in the final EITI Report, which may publish only aggregate data for the whole extractive sector, not company-specific information.

To be more specific, the EITI has set out criteria which must be met for EITI approval. It is worth stating these in some detail, as an example of one possible form disclosure could take. They are as follows:

- a) Regular publication of all material oil, gas and mining payments by companies to governments ("payments") and all material revenues received by governments from oil, gas and mining companies ("revenues") to a wide audience in a publicly accessible, comprehensive and comprehensible manner.
- b) Where such audits do not already exist, payments and revenues are the subject of a credible, independent audit, applying international auditing standards.
- c) Payments and revenues are reconciled by a credible, independent administrator, applying international auditing standards and with publication of the administrator's opinion regarding that reconciliation including discrepancies, should any be identified.
- d) This approach is extended to all [extractive industry] companies [operating in the country] including state-owned enterprises.
- e) Civil society is actively engaged as a participant in the design, monitoring and evaluation of this process and contributes towards public debate.
- f) A public, financially sustainable work plan for all the above is developed by the host government, with assistance from the international financial institutions where required, including measurable targets, a timetable for implementation, and an assessment of potential capacity constraints.²⁰

The key in this process is that both the company and the government make independent statements to the EITI country programme, and that the two are audited and reconciled by an independent administrator, and that the information is made public, on either an aggregate or a company by company basis: the idea of greater transparency is that potential users of the information can hold the government to account. PWYP makes the argument that increased disclosure, by both corporations and governments, could help to achieve two specific objectives:

²⁰ <http://eiti.org/eiti/principles>.

If companies disclose what they pay, and governments disclose their receipts of such revenues, then members of civil society in resource-rich countries will be able to compare the two and thus hold their governments accountable for the management of this valuable source of income. Revenue transparency will also help civil society groups to work towards a democratic debate over the effective use and allocation of resource revenues and public finance in order to meet development objectives, improve public services, and redistribute income.²¹

An example of disclosure by a company is provided in the Appendix: this comes from Rio Tinto. For each country in which it earns material profit, Rio Tinto provides information on the total taxes borne and collected in that country to a low materiality of profit level. Rio Tinto also provides information on payments by type of tax, but only on a more aggregated basis across countries. This is an example of a company which supports the EITI and which goes beyond its requirements on a voluntary basis, by publishing information on its website on all the taxes that it pays to governments in all countries, in which it makes material profits.

The EITI recently announced that a total of 11 countries are now fully compliant with the EITI criteria:²² Azerbaijan, Ghana, Liberia, Mongolia, Timor-Leste, Central African Republic, Kyrgyzstan, Niger, Nigeria, Norway and Yemen. Also, 50 of the world's largest oil, gas and mining companies support and actively participate in the EITI. The EITI process has gathered considerable momentum in the last couple of years, considering that it was just in 2007 that the first group of five countries were admitted as candidates.

Critics of the EITI suggest that it has had limited impact in encouraging a broad constituency of actors to comply due to its voluntary nature. That is one of the reasons why the amendment to the Dodd-Frank Act,²³ which makes it mandatory for companies in the extractive sector listed in the United States to publish all their payments to governments country by country, was recently legislated in the United States. This raises the issue if, and to which extent, disclosure should be voluntary, and if voluntary how could it be made more effective.

A particular problem here is that concession contracts signed by firms in the extractive sector in some countries may have confidentiality clauses covering some or all payments to governments (including taxes). The penalty for disclosure can be the termination of the concession. Often the contracts waive the confidentiality obligations if disclosure is required by the law in the country of residence of the multinational corporation, which would effectively permit in that case voluntary disclosure.

In other cases it is not even clear if that waiver can be exercised. A vague definition of "state secrets", confidential under any circumstance, would be an example. In other situations contracts may simply require the company to notify the government if payments will be disclosed, but often there is little clarity whether such notice in reality means a request for approval.

²¹ <http://www.publishwhatyoupay.org/en/mission>.

²² WSJ.com, EITI adds 6 countries to "compliant" status. March 3, 2011.

²³ Section 1504 of the *Wall Street Reform and Consumer Protection Act*, passed in July 2010.

The experience under EITI, however, has been considered by participant multinational companies as a positive first step forward and conducive to a standard of license contracts which are not restrictive as to the information which may be released by the corporation without previous consent by the host government. Participating NGOs have also expressed satisfaction with EITI's progress, although they have welcomed Dodd-Frank legislation and some have indicated that EITI does not go far enough.²⁴

By contrast to EITI, the Dodd-Frank Act makes it compulsory for US listed companies in the extractive industry to disclose all payments to governments, country by country, including the United States. Thus, the Dodd-Frank Act goes where the EITI does not or cannot, for it requires transparency for US companies in countries that do not participate in EITI, and also for those that provide individual information to produce an EITI Report, but such Report would disclose only aggregated data. However, it is voluntary for companies to list themselves in the US and to that extent Dodd-Frank Act has its own limits.

The World Bank has indicated that there is room for improving EITI Reports.²⁵ Among the main issues to be noted:

- EITI Reports have not evenly presented the data they reconcile for each country. Sometimes the data is presented on an aggregate basis for the country as a whole, without revealing contributions and collections per individual companies. In some other cases the data is reported in a much more detailed fashion. The recommendation of the WB is that EITI should issue new policy guidance that sets out a clear position in favour of publishing disaggregated company reporting for every country.
- Analogous to the previous issue, it is also debated to what extent data on payments and revenues should be disaggregated according to revenue streams. It is generally accepted that the EITI criterion is that all material revenue streams should be reported individually. But this is not always the case. Countries may agree to apply the EITI process with less public reporting detail. It is also said that EITI reporting standards could be strengthened with supplemental disclosures that considered specially payments made to sub national levels.
- The EITI seeks consistency of data reported by taxpayers and governments to the external validator retained for the purposes of the EITI process. However, this process does not involve other government publications or reports. So, differences may appear between EITI and the official government budget. The recommendation here is that government provided data to EITI should match revenue information presented to parliaments or external agencies.

²⁴ See for example, *Oil and mining transparency initiative must meet challenges to remain relevant*, PWYP, March 2, 2011. <http://www.publishwhatyoupay.org/en/resources/oil-and-mining-transparency-initiative-must-meet-challenges-remain-relevant-says-publish-w>.

²⁵ The World Bank (2010), *Towards Strengthened EITI Reporting: Summary Report and Recommendation*.

3.1.1. Should disclosure vary by sector?

Applying the experience of the EITI to other sectors raises the question of whether any variations in the disclosures recommended by the EITI would be appropriate for companies operating in other sectors.²⁶ One obvious reason why the extractive industry may be considered to be a special case is the nature of the industry. It might reasonably be considered that the natural resources being extracted do not belong to the extracting company, but to the country in which they are located. This is commonly regarded to be a reasonable justification for levying a higher form of contribution from companies in the extractive industry. And partly because of this, it might also be regarded as a reason for the extractive industry also to be subject to greater reporting requirements. This was argued, for example, in the submission by PWYP to the International Accounting Standards Board (IASB).²⁷

Beyond this point, it might be argued that different types of disclosure might be appropriate depending on the sector concerned and which resources of the developing country are being utilised. For example the disclosure requirements for companies dealing with land or in agriculture may be different from those which are utilising labour only in the developing country. Those which use the developing country to provide a market may need to be subject to yet different requirements.

In considering greater disclosure along the lines of the EITI, for the purposes of combating corruption, there do not appear to be strong arguments for treating different sectors differently. The point here is to account for revenues received, possibly from a range of taxes and other payments. From this perspective, the main reasons for treating extractive industries differently are that they tend to be more important to some developing countries than other industries, and that they are exploiting what might be considered to be commonly-owned resources; the size and length of the investments would mark this sector out. But – especially where a sector contributes significantly to a local economy – there is a clear argument for not discriminating between sectors in applying this type of disclosure and possibly much that could be learnt by comparing different sectors all providing comparable information.²⁸

However, a more general question is whether this type of disclosure is likely to be useful in combating corruption.

3.1.2 Would this type of disclosure be useful?

A starting point here is the nature of the constitutional, legal and political situation in a country. A country with a system in which the domestic civil society is able to hold

²⁶ Exceptionally, Liberia has extended its EITI commitment to the forestry sector, which is indicative that the model could be applied to other natural resources beyond extractive industries. See EITI News, July 2010. See <http://eiti.org/files/EITI-Newsletter-2010-July.pdf>.

²⁷ See <http://www.ifrs.org/Current+Projects/IASB+Projects/Extractive+Activities/DPAp10/CL/CL123.htm>.

²⁸ The relative importance of the extractive sector has been associated with a greater risk of tax avoidance. See for example, TJN, *Extractive industries and development – reassessing the agenda*. January 6, 2010. <http://taxjustice.blogspot.com/2010/01/extractive-industries-and-development.html>. The discussion here notes that this is a presumption and that further study would be required to be in a position to single out any sector in this respect.

government to account is in any case less likely to suffer problems due to corruption. A key issue for countries without such a system is how to reform the constitutional, legal and political governance of the country. And countries without such a system are less likely to comply voluntarily with additional disclosure. However, this goes well beyond the scope of this report, except to the extent of perhaps considering the power of international pressures on individual governments.

Beyond these general points, how useful would disclosure along the EITI lines be, if extended to other sectors? While such disclosure may be useful, it clearly has limitations. Payments received from multinational companies are only part of total payments received by governments. To hold governments to account for the total payments received it would, in principle, be necessary to apply the disclosure requirements to all taxpayers. One way of achieving that would be for payments by all taxpayers to be declared publicly by both the taxpayer and the government. However, this would impose significant costs and is clearly unrealistic. A different approach would be for government accounting to be independently audited and compared to taxpayer records. But this might be regarded as a constitutional reform, rather than a reform of disclosure of tax payments.

The EITI is useful since in many cases multinational companies in the extractive industries control a significant part of the domestic economy, and make substantial payments to the domestic government. Expanding this approach further, but short of applying it to all taxpayers, is really an issue of materiality. From the perspective of the host country, how material are the payments by any individual taxpayer?

One approach here could be to apply the disclosure requirements to all multinational companies operating in the country. This might be a reasonable proxy for whether the total payments made are material or not. But this approach might exclude large domestic companies, and include multinationals with very small activities in the country. An alternative might be to require disclosure where total payments exceed a specific sum. Disclosure along the lines of the EITI might then be required from any taxpayer that exceeds this amount.

As explained before, corruption may operate in many ways. Cash payments to induce or secure the purchase of goods and services, or to influence a public tender, or to obtain special tax benefits or exemptions will not show as such in any public or corporate accounts. In some cases, such payments may be registered as a service expense by the subsidiary resident in the jurisdiction in question.²⁹ An important issue is therefore whether such payments would be included in the aggregate sum disclosed by multinational corporations. If they are not, then such forms of corruption would not be identified.

²⁹ Sometimes the expense will be disguised, for example, it may show as a payment of fees to local "consultants". See cases recently prosecuted by the U.S. Justice Department, E. Wyatt, "Oil and Gas Bribery Case Settled for \$236 Million", International Herald Tribune, 4 November 2010.

3.2. HOLDING CORPORATIONS TO ACCOUNT

Note that the discussion that follows on holding corporations to account and on profit shifting relates primarily to tax levied on corporate profit. The disclosure discussed in this section therefore differs fundamentally from that in the previous section, which concerns the total payments made by a corporation to the government and other state agencies in a country.

Attempting to hold corporations to account with respect to paying the amount of tax due in each country is considerably more complex than the question of holding governments accountable for the payments they receive. As noted above in the context of discretion over tax payments, this is because the notion of the "proper" amount of tax due is hard to define.

To hold governments to account, it is argued that there should be disclosure of total payments made to each government. But to hold companies to account, it would in principle be necessary to identify whether the amount of tax due has in fact been paid.

In the first place, even if commercial profits were known, the complexity of tax law properly applied, the allowances and reliefs available and timing issues make it very difficult to know the amount of tax due, and for a variety of reasons the tax paid in a particular year may not bear a strong relationship to the tax due with respect to the commercial profits earned that year.

Moreover, there may be genuine additional difficulties in identifying the correct amount of taxable profits and hence the amount of tax due, especially where the property dealt in is unique or unusual so that there are no direct comparable situations involving independent parties. Thus it is difficult for tax authorities to identify the amount of tax due, despite the very considerable powers that they have for requiring taxpayers to provide large amounts of information. Different tax authorities with the same facts available may disagree on the conclusions to be drawn and thus on the allocation of the profit. This is true for developed countries with large and experienced tax authorities and so it is even more likely that tax authorities in some developing countries will face significant challenges in dealing with these issues, especially if they are then combined with complex avoidance strategies.

It is important to note that developing countries face an asymmetry in information. The taxpayer in their jurisdiction will be typically a subsidiary of the multinational group, so when audited and required to provide information to the tax authority it may be able to respond only for itself, for it often has no legal ability to compel the production of information in the possession of affiliates in other territories which are third persons. It is different where

the audited entity is the headquarters of the multinational corporation; in that case it has the legal possibility to obtain any information regarding its subsidiaries simply because it materially owns them.³⁰

The question posed is therefore whether the information disclosed would allow for a useful analysis to be conducted. For example, would it allow revenue authorities to structure information requests to other jurisdictions that meet the standard of “foreseeable relevance”? Would it assist with the investigation of companies’ tax minimisation activities by civil society organisations or by revenue authorities? If, as has been suggested, companies would consider it necessary to publish a narrative explaining the reasons for the distribution of their tax payments, would this provide useful information? Would the disclosures have a deterrent effect with regard to tax minimisation activities stemming from the reputational risk associated with large profits being reported in “tax havens”? This raises the issue of what might be disclosed, and to whom. We discuss each issue in turn.

3.2.1 What to disclose

One quite extensive example of the public disclosure that might be required from a multinational company to satisfy the accountability objective has been put forward by the Task Force on Financial Integrity. TFFI has proposed the following disclosure for each multinational company:

- The name of each country in which it operates;
- The names of all its companies trading in each country in which it operates;
- What its financial performance is in every country in which it operates, without exception, including:
 - Its sales, both third party and with other group companies;
 - Purchases, split between third parties and intra-group transactions;
 - Labour costs and employee numbers;
 - Financing costs split between those paid to third parties and to other group members;
 - Pre-tax profit;
- Details of the cost and net book value of its physical fixed assets located in each country;
- Details of its gross and net assets in total for each country in which operates.

³⁰ The progress made in the area of exchange of information is no doubt very relevant here, but this subject was taken up by another Sub Group of the Task Force.

- The tax charge included in its accounts for the country in question split according to:
 - Tax charge for the year split between current and deferred tax;
 - Tax payments made to the government of the country in the period;
 - Liabilities (and assets, if relevant) owing for tax and equivalent charges at the beginning and end of each accounting period;
 - Deferred taxation liabilities for the country at the start and close of each accounting period.³¹

The TFFI example raises myriad questions about how such extensive disclosure could be implemented in practice. For example, what accounting standard(s) should be used? On the basis of what source rules would items such as sales, purchases, financing costs, pre-tax profit, gross and net assets, etc. be allocated to particular countries? What connection, if any, would there be between the accounting standards and source rules used for preparing this kind of information and the taxing jurisdiction of the countries involved under their tax laws and treaties? The group has not considered the answers to these questions.

It should also be pointed out that much of the information listed above, on an aggregated basis, is required to different extents within group companies’ accounts and their segment reporting accounts. Still, it may be considerably greater or more detailed than that required in tax filings in many countries. Such list could thus represent more than an initiative on transparency, as it could amount rather to a new information requirement.

Rather than analyse the TFFI example directly, let us instead consider a minimal disclosure, and then build on that to consider the benefits of disclosing additional factors.

A starting point is to consider what relevant material is already publicly disclosed.

3.2.2. Existing public disclosure

In countries where public disclosure of financial information by privately-held companies is a legal requirement, then the statutory unconsolidated financial reports of companies should be available. These are likely to be based on the local GAAP, and to be set out in the local currency. These reports for subsidiaries of multinational companies could relatively easily be collected into a single website. Where these financial reports exist, they do provide potentially useful information. This would generally include information, for example, on corporation tax liabilities, although not necessarily deferred tax, or tax payments. It would also generally include information on sales, although not often split between intra-group and third party sales and not broken down by the country of sale,³² and information on assets and their valuations, although not broken down by the situs of assets.

³¹ Richard Murphy (2009), op. cit.

³² IAS 24 covers disclosure of related party transactions, but subsidiaries are more often under local GAAP rather than IFRS. Moreover, IAS 24 has an exception for wholly owned subsidiaries. Local GAAP may require segregated data for companies with minority ownership. Some related party segregated data accounts are available for India, Ghana, Tanzania, and South Africa. Further research would be required to establish the norm prevailing in this respect among LDCs.

The group has made a preliminary investigation into the extent to which countries require publication of this information, and the extent to which information is comparable across countries through use of International Financial Reporting Standards (IFRS), although this information is not comprehensive.³³

This information might be useful in attempting to identify the distribution of a multinational's corporation tax payments between countries, although the usefulness of the information is hampered by the fact that no assumption could be made that the tax expense shown in the statutory financials was paid exclusively to the country where the relevant subsidiary was established. Moreover, there are clearly other drawbacks in simply using this information. First, since not all countries require public disclosure of statutory accounts, then the information is unlikely to be complete. Second, even if all unconsolidated accounts are brought together in a single place, it would typically be a very difficult task to analyse them to make reasonable calculations about the distribution of tax and profit across countries. For example, there are a number of potential differences between group consolidated financial statements and those of the subsidiaries that are consolidated. These include differences between local GAAP rules, company law, accounting reference dates, filing dates of statutory financial statements and tax returns, whether an audit is required and exchange rates. Third, as indicated above, these accounts typically do not allocate the items shown to the various jurisdictions within which the particular subsidiary may be operating, nor are they generally likely to disaggregate related party and unrelated party transactions. A final drawback is that for separate subsidiaries' results to be meaningful, centralised cost would have to be allocated, and disagreements about disaggregation methods are common. It would be an interesting exercise to see how much useful information could be gleaned from these sources for a sample of multinational companies.

Information on the names of subsidiaries of multinational companies is also often available publicly, although typically not in statutory financial reports. Also, indirect subsidiaries (that is, subsidiaries of subsidiaries) may not be recorded. However, it would probably be a relatively small step for a multinational company to declare on its website a list of all countries in which it operates, and the names of all direct and indirect companies that form part of the group. UK-registered large and medium-sized companies are obliged to include such a disclosure within their financial reports or annual filings at the corporate registry ("Companies House"). Note though that "company" needs to be defined here, in particular, whether it should include joint ventures, associates, minority interests and partnerships. Also, the notion of "operating" in a country would have to be defined, e.g. whether it was meant to have a subsidiary established there, to have a permanent establishment—as determined by some commonly accepted standard—there, to be making sales into that country, or something else.

³³ Information on the former is available at <http://ukdata.com/help/international-reports> and on the latter at <http://www.iasplus.com/country/useias.htm>. However, neither website provides comprehensive coverage.

Beyond this, consolidated statutory accounts of multinational groups provide information by sector. As described below, IFRS 8 requires information for each operating segment that contributes 10% or more of the entity's total sales, profits or assets. However, segments do not need to be geographic, and even those entities choosing to report geographically typically aggregate the information into larger regions rather than report country by country.

In summary, while required statutory accounts and the other information described above could be disclosed with limited cost to a company, the lack of comparability between different accounting standards may increase the risk of misinterpretation. Further work in this area is suggested in order to explore the net benefits of having such disclosure as a general standard.

3.2.3. Possible supplementary disclosure

What information could usefully be disclosed beyond these publicly-available sources?

Corporate tax payments and profits

A minimum disclosure would be of corporation tax payments made in each country. This information would be provided in local currency at least. The corporation tax payment on its own is one possible indicator of the existence of profit shifting. But there are clearly many factors which determine tax payments – most notably the level of profit. To the extent to which profits are shifted to tax havens with low or zero tax rates, then obviously little or no tax is paid in these jurisdictions. Even a complete distribution of tax payments is therefore not particularly informative.

This suggests that country-by-country disclosure of tax payments would not be very useful unless it included at least some measure of country-by-country profit. Ideally, for each company, such a measure would be aggregated to the level of each individual country, and would be presented on a comparable basis so that the international allocation of both profit and taxes could be observed. Ideally, too, the measures of profit could be aggregated to match the worldwide profit shown in the consolidated accounts. If such a measure were presented, then the proportion of the company's profit in each country could be identified. This ideal measure would certainly provide a better indicator of the possibility that profit had been shifted between jurisdictions than simply consideration of tax payments.

However, it would still only be a weak indicator. The allocation of profit between countries is complex, and depends on the valuation of cross border trade and income flows. If the tax and profit measures were comparable to each other (that is, if cross-border transfers were valued for the purposes of measuring profit in the same way that they were measured

for the purposes of identifying the tax liability), then comparison of tax and profit in each country would not necessarily provide any evidence of profit shifting. That is, if profit were shifted out of one country, then both profit and tax in that country would be low. That in itself would not provide a very informative indicator of profit shifting.

There is also a risk of misinterpretation, since in this case the measure of profit by country would not be comparable to that published in the local country accounts due to different accounting standards, currency conversions and other factors cited above. There is also usually a degree of timing mismatch between profits earned in an accounting period and tax paid in an accounting period, and differences in tax due and tax paid. More importantly, local GAAP may differ from global GAAP, which would follow international accounting standard practices. In some countries, in fact, consolidation at a national level may not even be performed.

Other accounting items

Disclosure of items beyond profit and tax payments may improve the possibility that a more reasonable indicator of profit shifting could be established. Information on the accounting tax charge could be useful, though is likely to be even more closely correlated with the measure of profit, and therefore would be unlikely to provide significant additional information on its own. In any case, both tax measures, paid and charged, could be relevant. Splitting the tax charge into its current and deferred elements would also increase the information available. The main effect, though, would probably be to help explain any difference between the accounting tax charge and the actual payment of tax. Furthermore, as the accounting tax charge, particularly the measure of deferred tax, is based on speculation regarding future events—including the likely outcomes of tax disputes—it may not represent useful data to construct a measure of tax compliance.

Other accounting items may help to put the measure of profit into perspective. For example, the location of fixed capital and labour across countries within the multinational group gives some indication of the scope of its activities in those countries. Where a country has a considerable share of the company's fixed capital, but a very small share of its profit, the two pieces of information could be taken as a possible indicator of profit shifting, especially in the presence of a converse pattern in a low-tax jurisdiction. Of course, as emphasised above, this is not conclusive, since profit is not simply a return to fixed capital and may reflect other factors, such as intangible capital. Where a country's tax administration has access both to information about a company's fixed capital and labour costs as registered in the tax return of the multinational group company operating there, as well as the group's public consolidated financial showing corresponding figures for the group as a whole, the tax authority could put the measure of profits into some

proportional perspective. This suggests that the revenue authority itself may be able to identify the possibility of profit shifting without any further public disclosure.

The value of other items may be to help identify specific ways in which profits may be shifted amongst countries. The Task Force on Financial Integrity presumably intends the information on sales, purchases and financing costs split between third party and intra-group to be useful in this. A country's tax administration can easily require reporting of that level of information for group members operating in that country, but not necessarily for the trading parties, and of course the disclosure would provide a much greater set of information for civil society. However, information on the value of related party sales and purchases cannot in itself identify whether the transfer prices at which intermediate goods have been bought and sold are reasonable or not. One cannot infer anything about transfer prices simply with that information alone.

Information on financing costs may be more directly relevant, in that a significant payment of interest (relative to profit) paid to another part of the multinational group may indicate too great a reliance on debt financing in the host country. It is less clear how to interpret this, however. Virtually all countries permit interest payments to be deductible in computing taxable profit, although some countries have introduced thin capitalisation rules to attempt to limit the extent to which profit can be shifted abroad in this way. In any event, this is information which is typically already available to the local tax authorities through normal tax filings or could be required for that purpose, but may not be publicly available.

3.2.4. Other disclosure issues

Other issues also arise in setting out a list of potential items for disclosure. These include:

- The extent to which disclosure should be governed by materiality – and if so, material to whom;
- The timing of disclosure (which may be partly determined by the form of disclosure, discussed below); and
- The coverage by country – in particular, whether the disclosure requirements should apply to all countries, or only a subset of countries.

Any disclosure should be normally governed by the need for materiality. But, if the aim of the disclosure is to provide information relevant to a specific country, then the measure of what is material should be related to its relevance to the country, rather than its relevance

to the company. Since some multinational companies are many times larger than the host countries in which they operate, the definition of materiality could be important.

By contrast, although tax authorities may welcome prompt disclosure to them of any information that could be useful to their enforcement work, there does not seem to be a pressing need for particularly prompt disclosure publicly. In any case, given variation in profit and tax payments over time, any items disclosed might be best analysed by examining the medium to long term position.

Finally, in order to build a more complete picture of where profit and tax is located within a multinational company it does seem necessary to apply any disclosure requirements to all countries. This is partly necessary in order to build a more complete picture of where profit and tax is located within a multinational company. For example, if some tax havens were excluded from the disclosure requirements, then the force of those requirements may be considerably weakened. And partly this is necessary in order not to put countries at a competitive disadvantage by requiring greater disclosure than countries with which they may compete.

3.2.5. Preliminary conclusion on what to disclose

In complex audits involving multinational companies, tax authorities routinely use many inspectors to analyse detailed information available to them. Even if all the data available to tax authorities were publicly disclosed, there would still be uncertainty about the degree of profit shifting. There is little prospect of public disclosure of all the information available to a tax authority (and if there was, the scale of data could likely make it unusable).

Any disclosure with the aim of holding corporations to account cannot therefore be based on the possibility of civil society being in a position to make an accurate statement about the extent of profit shifting. However, disclosure could perhaps generate a potential indicator of the possibility that profit shifting may have taken place. Given that, what could be disclosed that would be of some benefit?

One possibility is that disclosure of some measures of profit and tax liability by country could be a useful indicator of profit shifting. In an extreme case, for example, suppose that a multinational disclosed that 90% of its profit arose in a low tax jurisdiction, even though other information available indicated that all of its production plants were located in high-tax countries, particularly less developed countries. This could not be in any way conclusive evidence, but it may be relevant for risk analysis.

Nevertheless, the above does not necessarily mean that the appropriate amount of tax due has not been paid. If the company's profit were generated almost exclusively by its intellectual capital, and if that intellectual capital were located in a low tax jurisdiction and priced in accordance with the arm's length principle, then it is feasible that its profit as determined by OECD transfer pricing guidelines also arises there. This in turn may suggest the issue lies in competing national laws that allow for international tax rate arbitrage. A different situation is represented by countries which offer low taxation and no cooperation with regards to exchange of information. This last issue, the lack of exchange, has been the focus of the Global Forum on Transparency and Exchange of Information for Tax Purposes.³⁴

However, situations where income and profits seem at first sight geographically divorced from the main economic activity of the global corporation could be taken as an indicator useful to tax authorities of where it would be sensible to audit in detail. The company could, of course, provide a legitimate reason for its particular tax burden. We discuss this further in the next subsection. Enhanced relations or enhanced co-operation between taxpayers and tax authorities, as set out in the Cape Town declaration,³⁵ could assist such risk analysis.

A related issue is that if statutory accounts were generally available to the public, as occurs in some countries,³⁶ this would apply to both subsidiaries of multinational corporations and local independent firms as well, with which a public data base on independent local firms would be created that could go some way in remedying one of the most difficult practical problem in the application of transfer pricing in less developed countries. This indirect benefit of public disclosure should not be overlooked and should be a topic for further consideration of the Task Force.³⁷

3.3 TO WHOM SHOULD INFORMATION BE DISCLOSED?

It may be useful for tax authorities to have information on the breakdown of profit and tax between the countries in which a multinational company operates. For example, that information could be used in decisions as to which companies to audit. At present, it may be difficult for the tax authority of a developing country to demand information on the worldwide activities of a multinational company that owns a domestic subsidiary. Requiring disclosure of profits and taxation in each country could provide a useful tool for tax authorities. But what is the benefit of disclosing that information publicly?

³⁴ See The Global Forum on Transparency and Exchange of Information for Tax Purposes, A Background Information Brief (OECD) available at www.oecd.org/dataoecd/32/45/43757434.pdf.

³⁵ See <http://www.oecd.org/tax/transparency>. ³⁶ UK, Companies Act (2006), Chapter 10, section 441, *Filing of Accounts and Reports*. Directors of unlisted companies must deliver to the Registrar of companies (Companies House) the accounts and report of the firm for each financial year.

³⁷ Less developed countries have stock exchanges with relatively few listed companies, so they do not have much information on local independent firms that could serve as comparables in order to determine the arm's length price of controlled transactions. The use of information available to the tax authority but not to the public (secret comparables) is not recommended, since it would leave the taxpayer defenceless (OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 2010, paragraph 3.36). Making that information public would help in solving that problem. Note that related party transactions could not serve as market comparables.

Civil society could use such information in the same way that tax authorities could: to identify cases where there appears to be a higher probability that profit shifting has taken place. Civil society would not be in a position to be sure whether this was true or not, but it would provide information with which to ask further questions.

In that case, a legitimate concern of multinational companies might be that information disclosed could be used inappropriately: for example, to target companies on the basis that they that may have shifted profits to tax havens even though the complete evidence is lacking. There is a possibility that the information could be used in a “guilty until proven innocent” sense in the court of public opinion. (The argument that “if you have done nothing wrong, then you have nothing to worry about” would – apart from being objectionable in itself – not hold in this case).

On the other hand, companies may be challenged over their taxpaying behaviour whether additional information is disclosed or not, and indeed, it could be argued, as NGOs do, that the problem is that the information already in the public domain is incomplete, placing more information in the public domain would be a useful response.³⁸ The view that information should not be disclosed because it may be misused is rather seen by some as paternalistic. Such an argument could be used to argue against some information already required by accounting conventions. A more convincing argument is companies may feel obliged to produce considerably more information than that required by disclosure rules, in order to explain their pattern of tax payments. Of course, that should improve public understanding of their tax affairs. But it may also have a significant impact on costs, discussed below.

In any case, the way in which public disclosure could actually affect the amount of tax paid by multinational companies in specific countries would be to increase their reputational risk. The idea is that this would create an incentive for companies that might be pursuing aggressive tax avoidance strategies to refrain from doing so in order to avoid being targeted for censure by civil society. However, the difficulties of identifying such companies from any reasonable degree of public disclosure means that other companies may also suffer reputational risk. While public scrutiny may deter companies from undertaking tax minimisation activities, the best approach to ensuring that the amount of tax due under the law of the relevant country is paid must lie with ensuring that tax authorities have the appropriate means at their disposal.

³⁸ A recent example concerns Vodafone. Vodafone settled an outstanding case with the UK HMRC, agreeing a settlement of £1.25 billion. But an article in the magazine *Private Eye* on 15 October 2010 claimed that Vodafone should have paid around £6 billion in tax (see http://www.private-eye.co.uk/sections.php?section_link=in_the_back&issue=1273). The BBC reported that activists responding to this report and complaining of underpayment of tax closed 4 Vodafone shops in London, and also shops in Brighton, Bristol, Edinburgh, Glasgow, Hastings, Liverpool, Manchester, Oxford and York. Both Vodafone and the HMRC claimed that the right amount had been paid. The BBC quoted HMRC as saying: “We can’t comment on the details of the settlement but we can confirm that it was reached by HMRC following a rigorous examination of the facts. It was agreed that Vodafone’s liability was £1.25bn and at no point was the liability greater than that. There is no question of Vodafone having a tax liability of £6bn. That number is an urban myth.” (see <http://www.bbc.co.uk/news/business-11658950>). The question is what further information would have satisfied the protesters, and whether the company should be forced to reveal it to the public or whether scrutiny of the HMRC’s power to reach settlements should be a matter for institutional review. It has now been announced that the UK’s National Audit Office will be reviewing the settlements procedure between HMRC and large firms. (The Guardian, 19th Jan. 2011).

³⁹ See *Tackling Aggressive Tax Planning Through Improved Transparency and Disclosure* (OECD 2011). This document refers to mechanisms of direct disclosure to tax authorities.

Any effort to increase tax agencies’ capacity to enforce tax regulations in less developed countries must be seen in a positive light. No doubt, efficient access to relevant and reliable information is a crucial element for tax agencies to do their work. Building a useful data base to examine the operations of multinational enterprises and training tax inspectors to use it effectively is not trivial, and surely there is much room for improvement in this respect in most developing countries, even in those with large economies that have reached middle income status.

The aspect of capacity building of tax authorities in developing countries, especially in those with more fragile states, is being explored specifically by another sub group formed by the Task Force on Tax and Development.

Even if much progress can be made in direct disclosure of tax relevant information to tax agencies,³⁹ the key question here is whether public disclosure can help tax compliance above and beyond what tax agencies can do for themselves. In other words, the question is whether public disclosure by itself can induce changes in behaviour in multinational companies and governments and can provide information to LDCs that otherwise would be very difficult or costly for them to obtain. This is clearly a matter which needs further study, as the above discussion has indicated.

4. COSTS

Whatever the possible benefits of the various forms for disclosure discussed above, it is important to take into account the costs which such disclosure might involve. In attempting to analyse these costs of greater disclosure, it should be acknowledged that they will fall mainly on multinational corporations who would have to prepare and disclose the additional information, and on governments, to the extent that they are also required to disclose payments received. If greater disclosure is successful in either of its main objectives, the benefits will be shared by society at large.

It might be argued that since much of the cost would be borne by multinational corporations, who some may argue are well able to bear them, then society should not be unduly concerned with their size, evidently, within certain limits. However, several points should be made.

Clearly, there needs to be a real expectation that the benefits of any further disclosures will outweigh the costs; otherwise the case for further disclosure is weak. Disclosure may take up real resources, which does represent a cost for society, both in developed and less developed societies, irrespective of who bears that cost. Without an assessment of the administrative cost that would be borne by multinational corporations, this point calls for further research. Also, and more subtly, it is possible that costs are passed on to other economic agents. Suppose, for example, that greater disclosure is required in only a subgroup of countries. In that case, the perceived costs of operating in those countries would be higher, and multinationals may respond by terminating their activities in those countries. In turn, that is likely to depress economic activity, and hence incomes, in those countries. That consideration points to disclosure being required in all countries, to avoid a competitive advantage being acquired by countries in which disclosure is not required.

Another consideration about the social costs of public disclosure of individual MNEs' financial information is whether it could involve revealing information that firms would view as commercially sensitive, that somehow could jeopardise their competitive position. This situation could potentially lead to a redeployment of the firm's business activities, especially if transparency requirements are not a universal standard. It could even cause corporate tax managers to take steps to decrease their companies' tax liabilities under pressure from shareholders and others who might have more information by which to benchmark the companies' tax rates against those of their competitors, causing a "race to the bottom" of tax rates.⁴⁰

⁴⁰ See David Lentner, Joel Slemrod and Douglas Shackelford, "Public disclosure of corporate tax return information: accounting, economics, and legal perspectives", *National Tax Journal*, 1 December 2003.

Some would point to the public policy principle of confidentiality of tax returns as an indication that privacy of tax information is in fact believed to induce tax compliance and to protect legitimate privacy interests. Indeed, most countries have legislation prohibiting government's disclosure of tax information. The reason behind this is easily understood for individual taxpayers. If it were known to them that their tax filing could be used for other purposes, there would be an incentive for changing their self assessed taxable income. For example, overtly tying tax reporting to needs-based government benefits may lead some individuals to underreport their income in order to qualify for such benefits, and some taxpayers would "be less inclined to voluntarily turn over sensitive financial information out of a fear of where it might ultimately land".⁴¹ By contrast, in Norway and Finland, for example, all tax returns – corporate and individual – are made publicly available, and it would be a matter of further study for this Sub Group whether this has had a negative effect on compliance.

When it was discussed in the US if corporate tax returns should be made public, the US Secretary of the Treasury responded to a Congressional inquiry that "... it is difficult to perceive how the general public would benefit from it. We have serious concerns that public disclosure of large corporate returns would cause considerable confusion among the public and would subject corporations to misinformed, inexpert analyses of their finances and operating practices. Such confusion ... could significantly... damage that corporation's standing among investors."⁴²

This possibility cannot be ignored in the discussion about the potential indirect costs to increased public disclosure of financial information. However, notwithstanding the reservations expressed above, the transparency on financial reporting discussed here does not relate to the tax returns as such, but to some subset of the information provided in the annual report to the corporate registrar or financial regulator of the corresponding stock exchange, information which would be fully revealed already if the company operated in one country alone. According to some, there should not be a different standard in this respect for national and transnational companies, while others believe that country by country reporting could potentially reveal global commercial strategies by transnational corporations (a problem not faced by national companies), and that governments should also seek to protect their confidentiality.

Equally relevant is that the set of information that could be revealed country by country in order to achieve the specified objectives could be considerably smaller than the full set contained in some annual reports, as discussed earlier.

⁴¹ US Dept. of the Treasury, Office of Tax Policy, *Report to the Congress on Scope and Use of Taxpayer Confidentiality and Disclosure Provisions*, October, 2000, available at <http://www.treasury.gov/resource-center/tax-policy/Documents/confide.pdf>.

⁴² Letter of Treasury Secretary to Senator Grassley, 16 August 2002, available at www.taxanalysts.com, 2002 TNT 196-18, Doc 2002-22905.

It is interesting to note as well that academic work in the area of tax confidentiality and tax compliance is quite scarce, but some preliminary results obtained from experimental exercises indicate that reported income is significantly higher under partial confidentiality when compared with full confidentiality treatment.⁴³

In other words, some empirical research would support the hypothesis that the release of tax information in some way would increase compliance with the system either to prevent embarrassment of public disclosure of non-compliance or because taxpayers believe that they are more likely to be caught for underreporting.⁴⁴ This is an area where more work might be required.

4.1 HOLDING GOVERNMENTS TO ACCOUNT

Disclosure of the type set out in the Appendix, covering total tax payments made in each country, would have relatively small costs for multinational corporations. Presumably a multinational could reasonably be expected to have records of the number and size of different payments made to host country governments, and to be able to aggregate them. Disclosing this information pre-aggregation is unlikely to involve additional costs, though there is again the concern that differences between tax due and tax paid may raise questions of interpretation. However, some may take the view that the costs to multinationals will depend on the number and types of taxes involved and how many different authorities they are paid to.

However, a considerable cost may fall on governments. The EITI, for example, encourages governments to disclose the total of all material payments received from a single multinational company for upstream oil and gas and mining activities. This would include taxes on profits, as well as royalties, licence fees, production entitlements and dividends. It would also include all payments made by all relevant subsidiaries and branches of the multinational company. So the government would be expected to engage in two forms of consolidation – across parts of the same multinational company and across different forms of revenue.

Undertaking both forms of consolidation could prove to be expensive. It is unclear, for example, whether most tax authorities even in developed countries would have such information readily available; even if they wanted to disclose it, they would also need to locate and aggregate it. Perhaps this is one reason why few governments have been deemed to be compliant with the EITI criteria. However, some would claim that the use of consistent taxpayer identification numbers should allow governments to do this.

⁴³ Susan Laury & Sally Wallace, “Tax confidentiality and Tax Compliance: An Experimental Analysis”, *National Tax Association Symposium*, May 19, 2005, p. 18. These experiments were conducted on individuals and their relevance to public companies is not straightforward.

⁴⁴ *Ibid.*, p. 5.

4.2 HOLDING CORPORATIONS TO ACCOUNT

The costs in holding corporations to account clearly depend on who is required to make disclosure and the extent of the disclosures. The scope could be limited to only multinationals, or it could include domestic companies.

The costs imposed on companies depend on the extent to which their records are already in a form that lends itself to collecting the required information. And it also clearly depends on what the disclosure requirements are, and whether the information needs to be audited.

The Group has attempted to identify in a preliminary way the relative size of costs for broad types of disclosure, but further research would need to be undertaken to attempt to establish more precisely the costs of various forms of disclosure.

Based on the group’s analysis to date, it is likely that for some forms of disclosure costs would be relatively small. These include: (a) collecting existing statutory accounts together in a single site; (b) providing information on the names of all subsidiaries and the countries in which they operate; and (c) providing information on corporation tax payments to each government.

Beyond that, costs of providing more information are likely to depend on how far the company’s systems and processes would have to change to produce the additional disclosures. Since country by country reporting is not currently required to be disclosed in compliance with IFRS, companies would need to collect and reconcile new information to produce the additional disclosures,. There will be initial “one off” costs of reconfiguring systems and changing internal processes and procedures; ongoing annual costs of the additional resource required for the further disclosures; and audit fees if the disclosures are required to be audited. The extent of such costs will depend on how many subsidiaries are affected, the number of countries in question, the extent of the additional disclosures, materiality limits and audit requirements.

Under IFRS, companies are required to report certain information by operating segment and these are defined as components of the company for which separate financial information is available and used regularly by senior management in assessing performance and making business decisions. Most multinational companies manage the business and report information by business division and not by geography and country financial information will not therefore be available in external or internal reporting.

Consolidated financial statements will not disclose all inter-company transactions as these are eliminated and there are exemptions from disclosing this information as part of related party disclosures. Therefore there is a cost associated if this information has to be collated centrally and reconciled to the group consolidated financial statements. In addition, subsidiary financial statements may not disclose all of this information in sufficient granularity. For example, total sales are generally disclosed but not the breakdown between third party and other group companies, or by country of sale. Payroll costs may be included within cost of sales and likewise may not be identified by country.

Any new information to be disclosed would need to be defined in some detail. For example, if purchases are to be disclosed, would that include expenses and capital items? Would financing costs include the fair-value movement of financial instruments? Would employee numbers include part-time employees? Would defined-benefit pension costs and share-based payments be included in labour costs? Another consideration would be what the disclosure regime's "source" rules might be for allocating items of income, expense, assets, liabilities, etc. to individual countries. If those rules differed from the ones in use for any other purpose, the regime would effectively be requiring companies to prepare an entirely new set of accounts.

More subtle costs may also arise if disclosure is not required of all companies. For example, the United States has recently passed the Dodd-Frank Act which, among other things, imposes new disclosure requirements on SEC registered companies in the extractive industries. Since the disclosure requirements do not apply to non-SEC registered companies, the SEC registered companies may be forced to publicly disclose commercially sensitive information that their competitors are not required to disclose. Furthermore, there is also a concern that multinationals may have to try to comply with multiple reporting methodologies (e.g. Dodd Frank, IASB, EITI, EU regulations). In addition to the increases to administration burden and preparation costs, this could lead to different types of disclosure for the same country that would be confusing for users of this information.⁴⁵ Companies might also find themselves in the position of being compliant with each methodology, but due to differences in approach, being vulnerable to claims that they have published contradictory or inaccurate reports. This suggests that ideally reporting methodologies should be implemented at global level.

⁴⁵ It should be noted, however, that the possibilities of revealing commercial secrets are more closely related with the obligation under Dodd-Frank of revealing payments on an individual project basis and the definition of individual projects has not been agreed yet by the SEC. It is too soon to identify the overlapping of regulatory requirements as the SEC regulations have not yet been published.

5. MECHANISM FOR REQUIRING DISCLOSURE

Two key possibilities here are (a) to propose a change in international accounting standards, and (b) to include eventually in the disclosure chapter of the OECD *Guidelines for Multinational Enterprises*⁴⁶ a reference to the public disclosure of specific financial data. Although these OECD guidelines are a set of voluntary principles, the National Contact Points with which they would operate would provide them with some teeth.⁴⁷

There is also a possibility of promoting voluntary disclosure, as with the EITI.

The analysis presented below is very preliminary and incomplete. The objectives of country-by-country reporting and the forms of disclosure required would need to first be determined before the mechanisms for disclosure could be adequately considered. Further work will be required here.

5.1. THE USE OF ACCOUNTING STANDARDS

In the past accounting standards have required public corporations to disclose their earnings according to geographic areas. This was a requirement in the United States under SFAS No. 14.⁴⁸ The standard did not go as far as requiring country by country disclosure of earnings, so firms could aggregate data for large geographic areas. This standard was changed in 1997; the new SFAS No. 131 replaced geographical area reporting by a so-called management approach to accounting, meaning that earnings instead had to be reported according to the lines or segments of business in which the firm is effectively separated for commercial reasons. The IFRS No. 8, which applies to about 100 countries outside the United States, is nearly identical to SFAS No. 131.

Both current standards require disclosure of information (revenues and assets) for the enterprise by individually material countries as well as for the enterprise's country of domicile and all foreign countries in the aggregate. SFAS 131 indicates that information on revenues from customers in different geographic areas would assist investors in understanding concentrations of risk and in assessing those risks in the countries where the firm has business interests.⁴⁹ However, this geographical breakdown does not report revenues according to the location of its affiliated entities; in fact, the standard refrains from requiring specific criteria for accounting geographical breakdown. Thus, for example,

⁴⁶ Current text is available at <http://www.oecd.org/dataoecd/56/36/1922428.pdf>.

⁴⁷ National Contact Points are senior officials or bodies delegated the responsibility by their governments to publicise and promote the effectiveness of the MNE Guidelines, including by helping to resolve issues of implementation in specific cases.

⁴⁸ *Financial Reporting for Segments of a Business Enterprise* (FASB 1976).

⁴⁹ SFAS No. 131, (FASB 1997), paragraphs 104 and 105.

the allocation could presumably be made based on where the enterprise concludes the contract of sale (whether or not in the customer's jurisdiction) or where title passes to the customer (whether or not in the customer's jurisdiction) on the location of the customer.

Since the change in these accounting standards in 1997, US multinational firms for the most part no longer disclose geographical earnings in their annual reports.⁵⁰ This has led to some debate in the accountancy literature whether reporting financial data by geographical area as required prior to 1997 provides important information for shareholders to determine their private valuation of their investment.⁵¹ According to some, decreased public information, i.e. non disclosure of geographic earnings, reduces the ability of investors to utilise or generate private information in conjunction with the public announcement of quarterly earnings, which dampens trading.⁵²

On the other hand, accounting standards have moved away from geographical reporting of earnings and one of the reasons was because under the old standards companies tended to group large geographical areas, such as whole continents, and analysts questioned the usefulness of that type of broad disclosure. The Statement also indicates that the burden implied on preparers due to reporting financial statement by geographical areas was a relevant element in the evolution of accounting standards.⁵³

Notwithstanding, some advocates of greater transparency propose that the IFRS should consider country by country reporting, possibly through an extension of IFRS 8 (segmental reporting). They argue that mandatory standards are needed to provide consistent and comparable data across the world. Whilst IFRS is not universal it is widespread and there is also a programme seeking convergence with national standards, primarily US GAAP.

IFRS 8 was issued in 2006 and replaces the previous standard IAS 14 for reporting periods beginning on or after 1 January 2009. Under IFRS 8 information must be reported for each (aggregated) operating segment that contributes 10% or more of the entity's total sales, profits or assets. The entity's management has considerable flexibility in identifying, measuring, and aggregating the results of reportable operating segments. Segments do not need to be geographic, and even those entities choosing to report geographically would likely aggregate the information into larger regions rather than report country by country. The reportable segments also do not need to comprise the entity's entire activities; only 75% of the entity's external turnover must be covered. As a result, IFRS 8 falls quite some distance short of requiring the type and level of information advocates of country-by-country reporting are seeking to enhance transparency.

⁵⁰ D. Herrmann and W. Thomas (2000), An analysis of segment disclosures under SFAS No. 131 and SFAS No.14, *Accounting Horizons* 14, report that 16% of firms sampled in their study continued to disclose geographic earnings after implementation of SFAS No. 131.

⁵¹ O.K. Hope, W.B. Thomas and G. Winterbotham, "Geographic Earnings Disclosure and Trading Volume" (2008); available at <http://ssrn.com/abstract=981237>.

⁵² Ibid.

⁵³ SFAS No. 131, Op. Cit.

On another front, the IASB is currently considering whether to add a project on the extractive industries to its standard-setting agenda. In April 2010 the IASB published for comment a preliminary discussion report on accounting standards for the extractive industries, one chapter of which was devoted to the PWYP country-by-country reporting proposals.

The IASB team examining the extractive industries project has commented that, while there is no clear definition of what is within the scope of financial reports – indeed the IASB is separately in the process of developing an improved conceptual framework for accounting standards, one element of which is to determine the boundaries and scope of financial reporting – they take their starting point to be that financial reporting should include financial information that:

- Helps users of financial reports to make decisions;
- Can reasonably be viewed as being within the scope of a complete set of financial statements; and
- Meets a cost-benefit test.

Comparability is desirable and is the objective of the IASB's programme. In The Conceptual Framework for Financial Reporting (2010), the IASB further states that the objective of financial reporting is directed towards meeting the needs of investors and lenders and that information that meets their needs may also be useful to other users. Also, it should be noted, in the discussion report on the extractive industries project, the IASB said that "further study is required to conclude on whether the country-by-country disclosure of payments to governments is justifiable on cost-benefit grounds".⁵⁴

According to an October 2010 IASB staff report summarising responses to the extractive industries discussion report, many respondents took the view that the PWYP country-by-country reporting proposals go beyond the scope of financial reporting because (a) the primary users of that information will be NGOs and other special interest groups; and (b) meeting their information needs is a public policy matter rather than a financial reporting matter. The report also noted strong, divergent views amongst respondents on whether the benefits to investors of country by country reporting of tax payments to governments would exceed the costs of preparing and auditing that information. This suggests that should the IASB ultimately decide to proceed with the extractive industries project, the PWYP component will be highly controversial.

⁵⁴ IASB Extractive Industries Discussion Paper DP/2010/1 (April 2010), paragraph 6.51 available at <http://www.ifrs.org/NR/rdonlyres/735F0CFC-2F50-43D3-B5A1-0D62EB5DDB99/0/DPExtractiveActivitiesApr10.pdf>. NGOs would argue that this cost-benefit analysis should evaluate the public interest, not just that of the investors.

5.2. THE USE OF MNE GUIDELINES PLUS GUIDANCE

The OECD member countries signed in 2000 a declaration on International Investment and Multinational Enterprises where they jointly recommend to multinational enterprises operating in or from their territories the observance of certain guidelines, known as the OECD Guidelines for Multinational Enterprises (“Guidelines”). These Guidelines have recently been revised by the Investment Committee of the OECD.

The Guidelines have a chapter on taxation and another on disclosure. The recommendations on taxation as they stand today are that multinational enterprises should make timely payments of their tax liabilities and that they should provide to the relevant authorities the information necessary for the correct determination of taxes.

The chapter on disclosure recommends that multinational enterprises should disclose information for the enterprise as whole and, where appropriate, along business lines or geographic areas. Among the basic data to be disclosed are the financial and operating results of the company.

The Guidelines do not currently have a specific recommendation regarding the disclosure of tax payments and the possibility of disclosure of financial and operating results segregated by geographic areas is left to the discretion of the relevant corporation.

Although the OECD Guidelines are not compulsory, there is significant reputational capital at risk for multinational enterprises that do not abide by them. The Guidelines have recently been revised. Nonetheless, the OECD Task Force could consider possible recommendations in this area in the future, keeping in mind that the Guidelines are drafted as very general principles of voluntary conduct, that it would not be practical for them to serve as a vehicle to encourage any specific form of reporting, and that some other mechanism would be needed to describe a set of disclosure standards with sufficient specificity to address the many questions outlined above.

6. CONCLUDING REMARKS

This report presents a preliminary evaluation of the fundamental issues in the debate about transparency on financial reporting by multinational enterprises. A key aspect of this debate is that greater transparency of information regarding tax payments and revenues, segregated by individual countries, is believed by some as a means to hold both governments and multinational enterprises more accountable.

Accountability is assumed to be a crucial element for better institutional and capacity building in less developed countries, so this is in turn considered very relevant for public resources to be put to the best uses.

The report makes the point that the various possible objectives of country-by-country reporting, including enhanced accountability of governments and multinational corporations, although all referring to taxes, have different underlying rationales and therefore differ in what may be required to implement them.

Also, the report notes that public information cannot replace the role of governments in the enforcement of tax laws. While governmental action requires direct disclosure of information to tax authorities, it does not follow that this information needs to be in the public domain.

The discussion reflects on the following issues:

- How exactly would greater transparency achieve the objectives of greater accountability,
- What would be the means to do it, and
- What would be the costs and benefits of the different measures that are today being proposed to further transparency in financial reporting?

Different initiatives are discussed in this context: the US Dodd-Frank Act, the EITI initiative for the extractive sector, the IASB consultation process, the EU consultation and the *OECD Guidelines for Multinational Enterprises*.

APPENDIX

EXAMPLE OF DISCLOSURE: RIO TINTO

(The information presented below is taken from the website of Rio Tinto, and is designed to comply with the requirements of the EITI. See: http://www.riotinto.com/ourapproach/17213_socioeconomic_development_17363.asp.)

When we invest in a project, the taxes we pay can have a major impact on the country in which we operate. Although federal governments collect most of these payments, a significant proportion of taxes were paid to local and regional governments.

Our analysis only captures where the tax payments are made, and not the internal redistribution of revenues that takes place within governments. How these payments are redistributed depends entirely on the fiscal and administrative structure of the host countries. For this reason, the ultimate effect of these payments at the local level is likely to be underestimated.

In 2009, our total tax and royalty payments were US\$4,825 million. This includes corporate income taxes, employment taxes, government royalties, transaction taxes and property taxes. Of this, US\$5,400 million was borne by the Group. In addition, taxes collected by the group of US\$953 million were remitted to governments and refunds of US\$1,528 million were received for indirect taxes paid to suppliers. The regional analysis is shown in the tables below. Rio Tinto does not earn material profits in any jurisdiction that is not specified in the list of countries below.

In addition, the Group's joint ventures and associates generated significant amounts of taxes on profits in the year which are not included in these numbers. The most significant additional contribution arises in Chile on the group's share of profits from its interest in Minera Escondida.

The taxes presented on this page represent all of the different types of taxes Rio Tinto paid in 2009. This total tax contribution exceeds tax amounts shown in the 2009 financial statements which include only taxes on profits, principally corporate income tax. The tax charge in the Income Statement for 2009 was US\$2,567 million, including US\$491

In summary, changes to accounting standards represent a possible mechanism for advancing disclosure of information on multinational company activity which could meet the objectives of country-by-country reporting. At present, however, these objectives may not be sufficiently compatible with the scope and objectives of financial reporting in its current form. Substantial changes would be required to existing standards, such as IFRS 8, and it seems unlikely that the IASB would move to consider country-by-country reporting before finalising the extractive industries project, even assuming the IASB ultimately does decide to take it on. There is also a risk that increasing the burden imposed by IFRS might deter some countries from adopting the standards or cause them to insist on waivers. This could decrease rather than increase comparability of financial reports.

Taxes paid directly to governments by country in 2009 (US\$ millions)

	Borne	Collected	Refunded ¹	Total
Australia	3,830	449	(1,306)	2,973
USA	591	53	0	644
Canada	441	310	(84)	667
France	152	63	(55)	160
UK	72	6	0	78
South Africa	68	28	(26)	70
Indonesia	69	0	0	69
Brazil	47	8	0	55
Chile	52	0	0	52
New Zealand	38	0	(15)	23
Switzerland	13	0	0	13
Iceland	7	-	-	7
Madagascar	3	2	-	5
Singapore	4	0	0	4
Germany	3	0	0	3
Zimbabwe	2	0	0	2
Japan	1	13	0	14
China	1	0	0	1
Namibia	21	13	(40)	(6)
Other	(12)	9	(2)	(5)
	5,403	955	(1,528)	4,830

Note 1 - These refunds relate to indirect taxes previously paid on invoices from suppliers, which the Group is entitled to recover. There is therefore no net loss to the governments from these refunds.

Taxes paid directly to governments by country in 2009 (US\$ millions)

	Australia / New Zealand	North America	South America	Africa	Asia	Europe	Other	Total
Corporate income tax	2,689	314	89	55	40	(45)	(12)	3,130
Property taxes	1	97	1	0	0	56	0	155
Payroll taxes paid	143	171	1	2	0	234	3	554
Government royalties	811	437	2	23	34	0	0	1,307
Other taxes	224	13	6	14	1	1	(3)	256
Total taxes borne	3,868	1,032	99	94	75	247	(12)	5,403
Taxes collected/ (refunded)	(872)	279	8	(23)	13	14	7	(573)
Total taxes	2,996	1,311	107	71	88	261	(5)	4,830

¹Taxes presented represent all the taxes Rio Tinto paid in 2009, compared to the corporate income tax charged to the income statement on the Economic contribution tab, which does not include all of the different types of taxes paid during the year.



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