To what extent do companies report on their tax payments?

Introduction

Numerous scandals have emerged in recent years revealing large companies' involvement in tax havens and offshore centres – causing outrage amongst citizens and government organisations alike. NGOs have long called for transparency in the tax affairs of large corporations, criticising tax avoidance schemes which hamper both social and economic development.

In 2015, the OECD launched its Action Plan on Base Erosion and Profit Shifting (the 'BEPS Action Plan'), identifying 15 actions to address international tax avoidance and guaranteeing that profits are taxed where they are generated. Action 13 of the plan requires multinational companies with annual consolidated group revenue of EUR 750 million or more to provide tax authorities with a country by country report. The report should include revenue figures, profit or loss before income tax, income tax paid and accrued, stated capital, accumulated earnings, number of employees and tangible assets, as well as a list of every entity in the group, its jurisdiction of tax residence and the nature of its business[1]. European Union and United States regulations are now in line with OECD recommendations.

On 4th July 2017, the European Parliament adopted a proposal urging multinational companies to publish their tax reports, broken down by country. In Europe, public tax reporting is already compulsory for extractive companies and financial institutions.

Despite exorbitant costs to both developing and developed countries and efforts to encourage more tax transparency, fighting tax evasion remains a complex task and consensus is yet to be reached on a common list of countries considered as tax haven or offshore centres.

Taking recent legislative developments into account, along with civil society's expectations after numerous scandals linked to the tax avoidance abuses, tax havens, and a lack of transparency on the links between activities, profits and tax payments, companies are expected to provide, by country or area of activity, detailed information on their tax payment and their operational activities. They must also justify their physical presence or the presence of their assets in tax havens or in offshore centers.

This study is based on Equitics©, the exclusive methodology of analysis and rating developed by Vigeo Eiris in 2002. It identifies the tax reporting structures published by companies and gives some examples of detailed tax disclosures. It also describes examples of allegations, investigations or fines resulting from tax avoidance practices or tax fraudulent behaviours. Finally, it establishes a picture of recent developments to international standards.

Vigeo Eiris Key Findings

- Only 2.5% of companies report comprehensively on their tax payments. In line with action 13 from the OECD's 'Based Erosion and Profit Shifting' (BEPS) project, these companies provide a geographical breakdown of their tax payments and data on their operations, including sales,

[1] https://www.oecd.org/tax/beps/beps-action-13-on-country-by-country-reporting-peer-review-documents.pdf

operating profit or the number of employees in each zone of operation. They also disclose the actual tax rate they pay and explain differences between this rate and the statutory rate.

- Nearly 1 in 10 companies (9.1%) fails to disclose any information on their tax payments.

- 44.4% of companies only disclose partial information, generally limited to the gross amount of tax they pay, with no geographical breakdown by operating country or region.

- Less than half of companies provide a breakdown of the taxes they pay by country or region; for one third of these companies the reporting covers less than half their activities.

- Nearly a quarter of European companies (24.9%) and a fifth of American companies (18.3%) provide comprehensive information on their tax payments, sales, operational results and the number of employees.

- Banks, financial institutions and companies from the extractive sectors seem to disclose their tax payments most extensively, though companies in these sectors have been subject to specific regulation. For financial companies, the EU Capital Requirement Directive (CRD IV) concerning the prudential supervision of credit institutions and investment firms, require companies to disclose profits made, taxes paid and subsidies received, as well as turnover and number of employees on a country-by-country basis. In June 2017, the European Commission proposed new tax transparency rules for intermediaries that design or sell potentially harmful tax schemes to dissuade them from encouraging clients to adopt aggressive tax planning practices. In the extractive sector, the Extractive Industries Transparency Initiative (EITI) has set up a Standard requiring countries to publish information on key aspects of their natural resource management, based on companies' disclosure. This includes how licences are allocated, how much tax and social contribution companies pay and where this money ends up in both local and national government.

- Banks, financial institutions and extractive companies are also subject to the most controversies. 42.3% of tax controversy cases (142) concern banks and financial companies. They are either criticised, investigated or fined for tax avoidance practices, client tax planning schemes, tax fraud and even money laundering. 26.2% of cases (88) involve extractive companies and relate to disputes over royalties payments, tax fraudulent behaviours.

- Overall, 336 tax controversies have been identified representing nearly 4% of all cases observed in Vigeo Eiris' database. Two-thirds of them (224) are considered cases of high severity.

- 17.1% of companies face at least one tax controversy, and of these, 16.4 % have been fined.

- Tax controversies mainly concern European and American listed companies, with 53.6% of European and 34.8% of American companies facing controversies.

- The cost of aggressive tax planning practices is estimated to be between at least USD 70 billion and USD 120 billion per year in developing countries, around USD 135 million per year in the USA, and between EUR 50 to 70 million per year in the European Union.

Conclusion

The fact that only 2.5% of companies provide comprehensive tax disclosure reports, and that these companies mainly operate in sectors that are subject to more stringent regulatory frameworks, raises concern. These companies are also the most subject to controversies.

Preventing tax avoidance and reporting transparently on tax are a fiduciary duty for businesses, which have to exercise their social responsibility on these sensitive issues. It is part of companies' duty of vigilance to prevent tax avoidance, as well as to guarantee fair tax payment in countries where they operate. Corporate transparency is expected not only on tax payments, but also on the strategic motives behind local operations or the location of assets in offshore financial centres and secret jurisdictions.

Responsibility for ensuring tax transparency and preventing tax avoidance lies with executives and directors, and any assurances from external auditors should not prevent senior management from proactively addressing tax issues. Both should be integrated into risk management frameworks and corporate responsibility processes.

Tax avoidance and a lack of transparency not only represent risks for companies, investors and communities, but also for social and economic public order at global, regional and national levels. Such practices can affect corporate reputation and create legal risks, illustrated by the scandals and legal disputes that have emerged in recent years. These events also reveal increasing scrutiny from civil society, the media and regulators, as well as a desire to end the damaging and unfair practices that hamper local governments, distort competition and hinder sustainable development. Tax avoidance also reinforces inequalities among countries and citizens.

In coming years and in line with the OECD Base Erosion Profit Shifting project, regulations will demand transparency from large corporations on the taxes they pay. Anticipating these behaviour changes can be an asset for companies. However, as noted by civil society and different stakeholders, there is much work to be done to effectively tackle tax avoidance, harmful tax practices and to change current controversial behaviours. The participation and cooperation of all stakeholders, including companies, states and international organisations will be necessary to change such practices.

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