The global spotlight

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Chris Sanger and David Snell consider how public country-by-country reporting will put tax in the spotlight

Key Points

What is the issue?

Multinational enterprises which do not already do so will be required to publish details of the amounts of tax they pay in each EU country under ‘public country-by-country reporting’ (CbCR) rules.

What does it mean to me?

UK-based MNEs will be ‘non-EU based’ under the proposed CbCR rules. It remains to be seen whether the EU agreement reaches the multilateral threshold the UK government has in mind to introduce a requirement for additional UK legislation.

What can I take away?

Many MNEs will take positive steps towards greater tax transparency before public CbCR becomes mandatory, with some rethinking their entire approach to tax communications.

For a multinational enterprise (MNE), communicating its approach to taxation to stakeholders is becoming ever more important. The publication of additional information on tax, both voluntarily and through mandatory requirements, is on the rise.

In the latest development, MNEs which do not already do so will be required to publish details of the amounts of tax they pay in each European Union country. These ‘public country-by-country reporting’ (CbCR) rules will apply to over 550 UK-based MNEs. Businesses that span the energy, extractive, retail and financial services sectors are likely to be those most affected. Coverage extends beyond the previous Capital Requirements Directive (CRD IV) currently applying to credit institutions and investment firms, and differs from that in the Accounting (and Transparency) Directives (Country by Country Reporting) applying to the extractive and logging industry.

Moves towards tax transparency

The provision of tax information has been seen as going some way towards addressing concerns raised by non-governmental organisations (NGOs) as to how the corporate tax system operates today. It covers two core elements:

- the provision of information by taxpayers and third parties to tax administrations; and
- the publicati on of information by taxpayers (or tax administrations).

On the first point, there is general agreement that tax administrations should have the information that they need to undertake the role that governments require of them. But the tax administration should not want to obtain excess tax information, with the attendant costs of processing, compliance and increased confidenti ality risks.

The second issue – that of increasing demand for public information on taxation ('tax transparency') – is becoming one of the key challenges in modern tax administration. While NGOs often consider that greater transparency can only ever be positive, for some businesses the sharing of confidential information regarding contracts and operating models could be considered a risk to their competitiveness. Standard-setters and MNEs need to strike a balance between the right to confidentiality and the desire for transparency.

Increasingly, there seems to be a move towards promoting disclosure at the expense of privacy and confidentiality, with the EU's move just the latest example.

Debate concerning the global tax landscape has, for some time, been moving towards a new social contract between business and government. Governments, NGOs and elements of wider society are looking for businesses to justify their contribution to society by way of tax payments. Increased global government spending as a result of Covid-19 is leading to a greater focus on the alignment of where tax is paid and the MNE operates. This combines with an increasing recognition by some MNEs of the wider societal benefits generated from seeing the tax they pay in a country as a requirement of doing business in that country. Some investors are also encouraging business to demonstrate a responsible attitude towards taxation and recognise the financial returns from social stability. Proactively using tax transparency can generate a positive narrative for business, creating an opportunity to improve communications and adding long-term value.

Voluntary public tax transparency disclosures have been adopted by a wide range of businesses, although mandatory public disclosures apply to certain sectors or countries. Tax transparency standards and frameworks vary significantly in the scope of taxes covered, levels of disclosure and type of information required. There

are a wide range of voluntary initiatives such as:

- the World Economic Forum–International Business Council's
- 'Measuring Stakeholder Capitalism' report, which includes: total tax paid as a core metric; expanded tax metrics covering additional tax remitted; and total tax paid by country for significant locations;
- the Global Reporting Initiative's tax standard (GRI 207), which includes country-by-country reporting; and
- the B Team Responsible Tax Principles, which aim to establish an approach to taxation that companies can endorse to demonstrate responsibility and 'play their part in creating a stable, secure and sustainable society' (see bit.ly/38BLjwJ).

In recent years, we have seen an expansion in mandatory or quasi-mandatory but limited scope standards (such as CRD IV or the Extractive Industries Transparency Initiative), and the UK and Polish requirements for published tax strategies.

We can expect further developments, notably following the European Commission's May 2021 announcement that it plans to take forward the publication of effective tax rates paid by large companies, based on the methodology under discussion in Pillar 2 of the OECD. The United Nations High-Level Panel on International Financial Accountability, Transparency and Integrity (FACTI) has also recommended that 'all private multi national entities publish accounting and financial information on a country-by-country basis'.

Content of the EU's proposed public CbCR rules

The directive will apply to both EU-based MNEs and non-EU based MNEs doing business in the EU through a branch or subsidiary with a total consolidated revenue of more than €750 million in each of the last two consecutive financial years. They will be required to disclose publicly the income taxes paid in each member state and other tax-related information such as a breakdown of profits, revenue and employees per country. Provision is made to avoid double reporting for the banking sector MNEs, which report on all of their activities under CRD IV.

According to the final compromise text available from the EU (see bit.ly/3gXtJYJ), information to be disclosed will include:

- the name of the ultimate parent undertaking or the standalone undertaking, the financial year concerned and the currency used;
- the nature of the activities;
- the number of employees;
- the total net turnover made;
- the profit made before tax;
- the amount of income tax due in the country by reason of the profits made in the current year in that country;
- the amount of tax actually paid during that year; and
- the accumulated earnings.

Information must be separately listed for each EU member state where the group is active; and for each jurisdiction deemed non-cooperative by the EU or that has been on the EU's 'grey' list (i.e. Annex II of the EU list of non-cooperati ve jurisdictions for tax purposes) for a minimum of two years. All other jurisdictions can be aggregated.

Once the directive is formally agreed, member states will have up to 18 months to enact it in their domestic legislation. In practical terms, this means that if the directive is formally adopted on 30 September 2021 (say), the first financial year of reporting on income tax information will be the year starting on or after one year following the 18-month transposition deadline; i.e. the first financial year starting on or after 30 March 2024. This is a 'long stop' date, as individual member states would have the option to implement the rules earlier, as happened in some cases with the mandatory disclosure rules. Groups with calendar year-ends should not therefore automatically assume that they will only fall within the rules from 2025.

Could the UK follow the EU's lead?As the UK is now a third country, UK-based MNEs will be 'non-EU based' under the proposed CbCR rules. But could the UK introduce comparable rules on its own account? Following a cross-party initiative, the government accepted an amendment to the 2016 Finance Bill to enshrine in law support for the principle of public CbCR with the power for it to be introduced when appropriate. As yet, that power has not been exercised. In April 2021, prior to the EU reaching agreement, Jesse Norman MP, the Financial Secretary to the Treasury, said in Parliament that the UK government's position on public CbCR was as follows:

> ‘Only a multilateral approach to public country-by-country reporting with wide international support would be effective in achieving transparency objectives and avoiding disproportionate impacts on the UK’s competitiveness, or distortions regarding group structures. The government firmly believes that that should remain voluntary and that no further legislation is needed unless and until public country-by-country reporting is agreed on a multilateral basis.’

It remains to be seen whether the EU agreement reaches the multilateral threshold the government has in mind to introduce a requirement for additional UK legislation.

Financial statements not meeting tax transparency needs

All of this activity suggests that the tax-related disclosure within financial statements today falls short of full ‘tax transparency’. Financial statements have become so large and complex that some have argued they are of limited value to their users, including investors, management and external stakeholders. The perceived lack of transparency in financial reporting creates uncertainty, with implications for investors’ trust and their willingness to invest. There is a limit to the extent to which an MNE’s tax contribution can be captured through mandated reporting requirements alone.

Today, many of the world’s leading organisations look beyond pure financial results and wish to make a positive impact on society as a whole. This is increasingly becoming a prerequisite for their employees, customers and investors. Creating and communicating an MNE’s long-term value proposition to this wider stakeholder community is growing increasingly complex. Clarifying the drivers of long-term value, as reflected by the intangible value, is becoming a strategic and management priority. In response, most annual reports from MNEs go well beyond their minimum financial reporting obligations. They include messages explicitly meant to build confidence in the company’s future and setting out its contribution to wider society. Many would argue that those wider messages could encompass greater openness on tax, with the potential for MNEs to demonstrate the value added through their tax payments to society as a whole.

How can MNEs respond?

What is clear is that many MNEs will take positive steps towards greater tax transparency before public CbCR becomes mandatory, with some rethinking their entire approach to tax communications.

MNEs have options on how to respond to the pending requirements:

- Some companies may choose to make tax a central part of their long-term strategy and to communicate their tax strategy externally within a long-term value framework. Organisations that embed their purpose across the whole of their business, with a focus on creating a positive, sustainable impact across all of their stakeholders, are best positioned to benefit from, demonstrate and measure the long-term value they create.
- Others could communicate on tax issues as a standalone basis, considering whether they should go beyond the upcoming mandatory standards in their voluntary disclosure. The upcoming obligation to provide selected information on the role that taxes play creates an opportunity for MNEs to communicate the positive steps they are taking to all of their stakeholders. Several MNEs already publish detailed CbCR on a voluntary basis, seeing public disclosure as an opportunity to demonstrate their longstanding commitment to transparency.
- As a minimum, MNEs will need to monitor mandatory developments in the EU and elsewhere. Additional disclosures can be deferred for now but not ignored. Businesses taking this more reactive approach should start to consider how to collate and validate the necessary information, along with the implications for stakeholder engagement of additional disclosure in the future. When complying with public CbCR in the future, could competitors without substantial operations requiring disclosure in the EU exploit the information provided and obtain a competitive advantage?

Building a public tax transparency framework

It is likely that many MNEs will consider the first two options. They could take the opportunity created by public CbCR to enhance their public tax transparency framework. A typical approach would be to take the following steps:

1. Set objectives for public tax transparency: determine the overarching message with reference to the MNE’s corporate strategy, external environment and tax policy.

2. Determine how to deliver that message: within corporate social responsibility reporting, as a standalone publication or a dedicated web page.
3. Identify the target audience: engage with stakeholder groups to understand their interest and objectives.
4. Set a public tax transparency strategy: identify frameworks, standards and principles that mirror companies' and stakeholders' requirements for tax payment disclosure and support the MNE's overall objective. This may well extend beyond the EU's proposed public CbCR rules.
5. Implement systems and assure data accuracy: set up the process and leverage technology for preparation and assurance of tax reporting disclosures (working at a minimum to the EU proposed CbCR rules).
6. Monitor and refine the approach: improve disclosures and processes to reflect changes in the internal and external environment.

Developing an appropriate public tax transparency strategy for an MNE will be driven by company context, interested stakeholders' objectives, the value created and potential risks that could be raised. Choosing a strategy should also take into account peer practices, industry, regional and local practices.

It is said that the ideal time to plant a tree is 20 years ago, and the second best time is today. The same may be true for determining a tax transparency strategy. MNEs have a golden opportunity to take the lead, and drive positive change ahead of the imposed public CbCR. The clock is ticking and it is time to get planting.