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From tax secrecy to tax transparency

Introducing public country-by-country reporting (CBCR) in the EU

Background and European Parliament's role

On 12 April 2016, the European Commission released an important legislative proposal on what is commonly referred to as public country-by country reporting (CBCR) for multinational corporations.[1] If implemented comprehensively, **public CBCR would increase corporate and tax transparency by enabling citizens worldwide to 'follow the money'**. It will also contribute to ensuring that taxes are paid where they are due, thus providing adequate revenue for critical public services.

On 4 July 2017, the European Parliament adopted its report on the draft proposal.[2] The European Parliament managed to substantially improve the draft legislation, though concerns remain about a loophole introduced that would allow certain multinationals to keep some of their activities in the dark. **In March 2019, the European Parliament closed the first reading of the file**, in recognition that the Council was unlikely to reach agreement before the European elections in May 2019. European citizens' support for public CBCR has remained high throughout the Parliamentary term and elections.[3]

Technical challenges

Unfortunately, despite the fact that the European Commission's initiative for increased tax transparency was welcomed, the legislative proposal did not fully live up to its expectations and included a number of shortcomings. Civil society recognised three key areas to be improved upon for the legislation to be effective and meaningful (see ANNEX for details):

1. Countries on which companies should report;
2. Companies which are subject to the legislation;
3. Information which needs to be reported on.

The European Parliament amended the draft legislation on some of the above-mentioned key areas.[4]

Political challenges

Civil society is highly concerned by the lack of consensus between EU Member States on this file, which has led to a **deadlock in the negotiations for the past two years**. Disagreements on the basic principle of public disclosure of financial data by large multinationals as well as on the legal basis of the legislative proposal have delayed the adoption of a 'general approach' by the EU Council.

Going forward, there is a clear risk that this issue becomes a 'forgotten file' or that the European Commission withdraws its legislative proposal due to a lack of progress. **The lack of progress on this file and the lack of ambition by previous Council Presidencies risks sending a very negative signal to European citizens** with regard to Member States' political will to tackle corporate tax avoidance beyond rhetorical statements, and their efforts to protect corporate interests. In turn, this risks fuelling the rise of a concerning populistic wave across Europe.

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[1] Amendment to *Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches* , available at the following link: http://www.europarl.europa.eu/RegData/docs_autres_institutions/commission_europeenne/com/2016/0198/COM_COM(2016)0198_EN.pdf

[2] Available at http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P8-TA-2017-0284

[3] Eurobarometer results show that three quarters of citizens want the EU to intervene more than at present in the fight against tax fraud in 2016 and 2018.: [3] European Parliament Research Service findings based on Eurobarometer 85.1-2016 and 89.2 – 2018. See European Parliament, Delivering on Europe, Citizens' view on the current and future EU action, 2018, available from http://www.europarl.europa.eu/at-your-service/files/be-heard/eurobarometer/2018/delivering_on_europe_citizens_views_on_current_and_future_eu_action/report.pdf and European Parliament, Survey: people reveal their priorities for the EU, 2016, available from http://www.europarl.europa.eu/news/en/headlines/eu-affairs/20160630STO34203/survey-people-reveal-their-priorities-for-the-eu ; During the European elections, thousands of citizens took action across the EU to ask candidates to support public CBCR through https//:taxpledge.eu

[4] More detailed information on each of these issues can be found in the annex.

Recommendations

It is crucial that the new European Parliament demonstrates its commitment to improving corporate tax transparency in the EU. This can be achieved by:

1. **Ensuring that public CBCR remains on the EU's political agenda and that the profile of the file is maintained;**
2. **Mobilising policy makers and members of Parliament in their respective Members States;**
3. **Increase pressure on the EU Council to ensure that a final negotiating position is adopted and trilogue negotiations may begin;**
4. **Push for ambitious legal requirements to be included in the final text of the Directive during trilogue negotiations with the European Commission and the EU Council.**

State of play

In the past year, the Council of EU Member States have discussed their proposed amendments to the Directive. A number of EU Member States remain opposed to the European Commission's proposal and to the basic principle of transparency on multinationals' financial information. Most Member States are also opposed to full disaggregation of data, which would require multinationals to report on all of their activities worldwide, not just EU countries and blacklisted tax havens.

In November 2016, the Council Legal Service called for a change to the legal basis of the proposal, from an accounting file to a tax file. A change in the legal basis to a tax file would mean that the European Parliament would be excluded from decision-making, and EU Member States would need to unanimously agree in order for the proposal to become law. While the Legal Service of the Council has argued that this change to the legal basis would be appropriate, it has been rejected by the Legal Affairs Committee of the European Parliament and by the European Commission. There is also a legal precedent for CBCR rules not to be considered a tax file – for instance, CBCR rules have already been introduced under the Capital Requirements Directive IV (Article 89 of CRD IV). In order to change the legal basis, a unanimity of Member States would need to agree – discussions on this topic remain on-going.

Over the years, amendments have been introduced by the different EU Presidencies, which further water down the European Commission's proposed rules. In January 2019, the Romanian Presidency of the Council of EU Member States introduced a new compromise text, which was very similar to the previous compromise position, introduced by the Bulgarian presidency in 2017. Despite having no material difference to the previous compromise, this updated text was referred to the Council Legal Service for an opinion on the legal basis again, further delaying progress. The Council Legal Service declined to update its position, stating that its previous assessment was still valid – i.e. they still consider the proposal to have a tax legal basis.

A lack of consensus between EU Member States about the European Commission's proposed rules and disagreements about the legal basis of the legislative proposal have delayed the adoption of a 'general approach', or a final negotiating position that would allow the commencement of trilogue negotiations with the European Parliament and the Commission.

ANNEX

Technical challenges in the public CBCR proposal

1. Scope of reporting and exemption clauses

The initial proposal obliged multinationals to publicly report information on a country-by-country basis only for their operations in EU member states and in yet-to-be determined tax havens. The European Parliament rightly amended this loophole by requiring large multinationals to report information and data for each country of operation. This is crucial for developing countries, who are particularly impacted by tax avoidance yet do not have the same access to information as European tax authorities do. Country specific information from public CBCR would help stakeholders in developing countries address harmful tax practices as well as assist policy makers in the EU to assess the policy coherence for development of their existing rules. Existing public CBCR for the financial sector requires large multinationals to report information and data for each country of operation and research has shown that this has disincentivised profit-shifting.[5]

However, the European Parliament also included a so called 'corporate get-out clause' for multinationals, which would allow them to avoid the reporting requirement.[6] This is supported by the Council, but contrary to the European Parliament's corporate get out clause, the Council's introduces a time limit that would require companies to publish CBCR information after a four-year period.

> According to the **'corporate-get-out-clause'**, companies would be allowed to receive a reporting exemption on the basis of protecting what they consider "commercially-sensitive information" and avoid the disclosure of that information for any tax jurisdiction. The clause requires national tax administrations to give multinationals prior authorisation on a yearly basis.

This is a highly problematic clause that should be removed. The clause, as written, could leave a great deal of discretion to multinational firms to decide whether they should omit information. The text of the Presidency compromise does not define what would be considered "seriously prejudicial to the commercial position of the undertakings," and there is a strong risk that multinationals could liberally apply this provision in order to delay publishing country-by-country information. This would seriously undermine the effectiveness of the legislation and significantly weaken the data.

Furthermore, the Council's compromise text introduces a comply-or-explain clause for non-EU multinationals, which would allow the subsidiaries or branches of non-EU parent companies to explain why they are not able to disclose information related to their non-EU activities. A comply-or-explain clause was first considered by the Dutch government in order to deal with concerns that EU subsidiaries cannot force their parent companies to provide them with the required data to compile their CBC reports, and that there may be no legal basis for enforcement actions by EU Member States targeting non-EU parents. But while the Dutch government first introduced this clause alongside a commitment to require worldwide reporting on disaggregated basis, the Presidency compromise introduces a comply-or-explain clause without extending the reporting obligation beyond the EU and blacklisted countries. In practice, this means that non-EU headquartered companies will be able to use the 'comply-or-explain' clause to avoid reporting on their activities in blacklisted tax jurisdictions outside of the European Union.

2. Companies falling under the scope of the legislation

The initial proposal set a threshold for companies required to report at €750 million in annual consolidated turnover. This would, according to OECD's estimates, exclude 85-90 per cent of multinationals from reporting.

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[5] Michael and Wolff, Hubertus, Financial Transparency to the Rescue: Effects of Country-by-Country Reporting in the EU Banking Sector on Tax Avoidance (July 1, 2018). Available at SSRN: https://ssrn.com/abstract=3075784 or http://dx.doi.org/10.2139/ssrn.3075784

[6] For more information, see *The European Parliament's 'get-out clause' for multinationals*: http://transparency.eu/get-out-clause/

While the European Parliament has adopted the same threshold in its final report, it also included a revision clause foreseeing an assessment of "*costs and benefits of lowering the consolidated net turnover threshold beyond which undertakings and branches are required to report on income tax information*".[7] A lower threshold would avoid that companies of significant size are omitted by the reporting requirement. It would also level the playing field among EU companies which already report on similar information.

Under the amendments proposed by the Council, a company would only be required to start reporting their CBCR information on a yearly basis once they exceed the €750m threshold for two consecutive financial years. Once companies exceed the two-year threshold, they would only be required to publish information with regards to the latter (i.e. the second) year.

3. Information to be reported by companies

The initial proposal left out many disclosure elements, which are critical for determining a company's economic activity, structure and tax payments in each country where it operates, such as assets, sales and a full list of subsidiaries, among others. Lack of information on the economic activity and assets of a multinational company in a jurisdiction makes it nearly impossible to assess its activities and tax payments. The European Parliament improved the European Commission's proposal by including a number of these important elements in the reporting template[8].

Moreover, the European Parliament also included a requirement for a common reporting template available free of charge in an open data format, in a public register to be managed by the European Commission.

Without these necessary changes to the European Commission's original proposal,
the EU will miss a key opportunity to increase tax transparency in Europe and worldwide.

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[7] Directive 2013/34/EU - Article 48i – paragraph 1, as adopted by the European Parliament on 4 July 2017
http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P8-TA-2017-0284

[8] Directive 2013/34/EU - Article 48c – paragraph 2, as adopted by the European Parliament on 4 July 2017
http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P8-TA-2017-0284
(a) the name of the ultimate undertaking and, where applicable, the list of all its subsidiaries, a brief description of the nature of their activities and their respective geographical location; (b)the number of employees on a full-time equivalent basis; (ba) fixed assets other than cash or cash equivalents;
(c) the amount of the net turnover, including a distinction between the turnover made with related parties and the turnover made with unrelated parties;
(d) the amount of profit or loss before income tax; (e) the amount of income tax accrued (current year) which is the current tax expense recognized on taxable profits or losses of the financial year by undertakings and branches resident for tax purposes in the relevant tax jurisdiction; (f) the amount of income tax paid which is the amount of income tax paid during the relevant financial year by undertakings and branches resident for tax purposes in the relevant tax jurisdiction; and (ga) stated capital; (gb) details of public subsidies received and any donations made to politicians, political organisations or political foundations; (gc) whether undertakings, subsidiaries or branches benefit from preferential tax treatment, from a patent box or equivalent regimes.