Certification of tax transparency and responsibility as a means of neutralisation of global tax avoidance schemes[1]

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1. Introduction: Tax transparency in the focus

In the today's global environment a public knowledge about the ways through which capital flows represents a cornerstone of any modern democratic system[3]. Faced with the problem of global corporate tax avoidance, formal as well as informal international institutions (World

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[3] Piketty, T., Le Capital au XXIe siècle, Éditions du Seuil, Paris, 2013, p. 840.

Economic Forum[4], OECD[5], the European Union[6]) all converge towards a solution based on tax transparency.

However, these public institutions struggle to accept propositions of academia[7] and practitioners[8] going in the same direction due to their overreliance on traditional command and control approach with an exaggerated accent on hard prescriptive rules. Yet, due to a large sovereignty of states in the fiscal area, it is very difficult to design prescriptive rules at the international or European level level which would be resistant to circumvention which is at the heart of corporate tax avoidance practices.

2. The traps of prescriptive rules and virtues of behavioural approach

Corporate tax avoidance practices make use of exactly those inconsistencies and loopholes left in international law instruments which result from the trade-off between consensus and effectiveness usually made in the process of their adoption. Resulting lack of coherence of laws of different countries, is further exacerbated by the absence of a uniform international tax enforcement authority and the fact that the economic incentive to carry out corporate tax avoidance practices will, exist as long as corporate tax rates and corporate tax bases of individual countries in the world are different and multinational corporations can reap benefits from these differences.

Therefore, in practice, hard prescriptive rules can never resolve the problem of corporate tax avoidance since the circumvention of the spirit of laws cannot be proscribed or punished. By

4 Reconstructing these complex corporate schemes and identifying who lies behind them, i.e. identifying their beneficial owners (BO), is considered to be essential to reveal the full extent of the criminal infrastructure and to prevent future criminal activities". (*World Economic Forum, Organised Crime Enablers (2013)*).

5 OECD, Report on Disclosure Initiatives - Tackling Aggressive Tax Planning Through Improved Transparency and Disclosure (2011), p. 19.

6 Under the Accounting Directive the Commission shall report by 21 July 2018 about the practices regarding the publication by companies of country-by-country reports on at least the profits made and tax on profits paid.

7 J.E. Stiglitz, J.E. and Pieth, M., "Overcoming the Shadow Economy", (2016) International Policy Analysis, Friedrich Ebert Stiftung, p. 9.

8 Kleinbard, E.D., Through a Latte Darkly: Starbucks' Stateless Income Planning, Tax Notes, June 2013 p. 1515 et seq.; Zucman, G., Taxing across Borders: Tracking Personal Wealth and Corporate Profits, Journal of Economic Perspectives, Volume 28, No. 4, Fall 2014, p. 121 et seq.

contrast, a situation where a certain behaviour – such as tax avoidance – is deemed immoral, but not illegal, is a *prima facie* indication that law lags behind principles of fairness. This sends a clear a signal that the existing legal framework is insufficient and the legislator has a duty to act. It is becoming more and more clear that the only feasible way of regulating legal, but illegitimate tax avoidance practices is to adopt a behavioural approach.

Behaviourally informed interventions aim to assist rather than to prohibit certain decisions, in keeping with the idea of regulatory policy as an enabler and facilitator to achieve positive outcomes[9]. Similarly to the regulation of excessive risks taken by certain banks leading to the financial crisis - which consisted in taking away the incentive to take such risks by reducing the amount of their bonuses dependent on these risks - , the regulation of corporate tax avoidance practices should take away the impetus to engage in these practices. Empirical studies confirm that a failure to effectively communicate the reasons for adopting a given tax strategy is a significant reputational risk for today's multinationals. 2014 Ernst & Young study of tax risk and controversy showed that 89% of the largest companies surveyed are concerned about media coverage of the taxes some companies are paying[10].

Second, businesses which are both transparent as far as their ownership structure is concerned and give out what they should from their profits to the state should be encouraged to continue to do so by positive motivation rules. Acting correctly should translate in a tangible competitive advantage allowing honest companies enhance their public image.

3. Taxparent solution explained and applied

The European Union is poised to grave in the stone a little revolution: very soon we will all know ultimate beneficial owners and ownership structures of all corporations in the EU[11]. Although this will help enormously in the fight against money-laundering, corruption and conflict of interest, if implemented properly, to eliminate also corporate tax avoidance practices, it is

9 Lunn, P., Regulatory Policy and Behavioural Economics, OECD (2014), p. 12.

10 Ernst & Young, Tax Insights for business leaders, no. 12, Focus – Transparency, November 2014, p. 40.

11 The fourth Anti-Money Laundering Directive (848/2015) obliges Member States to keep and maintain registers of ultimate beneficial owners of all companies registered in the EU Member States. The upcoming fifth Anti-Money Laundering Directive which is to be adopted in April or May 2018 will oblige Member States to make these registers open to the public.

necessary to make the second step: find out how much of corporate tax group of companies pay in each country in relation to their global profits. If we know the global corporate structures of companies, we can also easily find out what is their global effective corporate tax rate (GECTR).

This should not be such a difficult task since all the necessary information to determine the GECTR of groups of companies, i.e. revenues, profits and tax on profit (or loss) will be at least in the European Union available at the same place as the information on ultimate beneficial owners and the corporate structure of companies: in the public commercial or corporate registers[12].

At this point, the taxparent solution enters the stage. It converts those publicly available data into a set of information which would be simply understandable to the consumer. The key piece of information in this set is the global effective corporate tax rate (GECTR): an amount in percentage corresponding to the sum of tax on profits (or loss) paid in each jurisdiction by all companies within a group divided by the sum of profits generated by the same companies of the group, both at an annual basis. The other pieces of information show that the company has a transparent corporate ownership structure which is the necessary pre-condition for determination of the GECTR and how much the company paid in total in corporate tax in all EU Member States where it is present.

Following a simple mostly web based certification process, the company would receive an interactive taxparent e-trustmark which it should put on its website: when the visitor clicks it the corporate ownership structure and the GECTR of the company and the group to which it belongs will be displayed. The taxparent certification will be granted for the period of one year until the publication of the new accounting documents in the next year.

[12] Line 1 (Net turnover), line 14 (tax on profit (or loss) and line 15 (profit or loss after taxation) of the profit and loss account template set out in Annex V of the Accounting Directive 2013/34/EU (and the equivalent items in the IFRS and US GAAP rules for non-EU companies). In the EU, the Directive 2009/101/EC then obliges companies to make the profit and loss account public which is normally done via commercial or company registers of EU Member States.

4. Benefits of taxparent solution

The taxparent solution will help honest corporations to attract consumers to buy their products. Who gets the taxparent certification will have a competitive advantage of a better reputation with the consumers since it will be able to "sell" them the fact that it is transparent and pays its fair share in corporate tax.

Second, taxparent certification will create more level playing field for SMEs. To get the certification will be easy for the small companies with simple corporate structures. It will be slightly more time-consuming for larger corporations with more complex ownership structure. Yet, getting the certification will be non-discriminatory and proportionate to the size of the company.

Third, if authorities granting public funds could start to require that private companies which apply for public contracts and grants have the taxparent certification, the corruption and state capture would be reduced. To achieve a more robust reduction similar requirement could be applied to groups of companies contracting with public institutions or active in certain sensitive sectors, such as gambling, nuclear fuel or waste disposal, provision of offshore services etc.

Fourth and probably the most important benefit of the taxparent certification resides in its capability of turning payment of the corporate tax - which is today perceived by companies as a sunk cost - into an investment with adjustable positive returns.

Assuming that a certain number of companies in the given sector would obtain the taxparent certification, it can be expected that competitors would range themselves in several groupings with levels of more or less similar amount of GECTRs and number of stars – for the sake of simplicity, let us assume that these groupings would correspond to the size of the companies so that there would be a grouping of SMEs and a grouping of large companies in the given sector. Also, let us suppose that within the second group in a given Member State with a statutory corporate tax rate of 19% the GECTR of those companies oscillates around the level

of 15%[13], with certain companies having this rate, for example, at the level of 14%, other at the level of 16%.

The first expected reaction of companies with lower GECTRs would be the fear that they could be losing customers to companies with higher effective tax rates within the given group of competitors. The taxparent solution anticipates this and provides lower taxed companies with a possibility to make a special voluntary "top-up payment" to public budgets to raise their GECTR on the taxparent certification (for example, from 14% to 17%) and catch-up with higher tax rate competitors. Given the fact that the taxparent certification is based on annual financial accounts and thus needs to be renewed every year, the businesses would be able to test whether making a top-up payment and increasing the amount of GECTR on the taxparent certification pay out.

Those for whom this additional top-payment would make a positive return, i.e. the amount of additional revenues would exceed the amount of top-up payment made, could continue to voluntary pay more to the public budget – to those tax would change from a sunk cost to an investment with positive return; those for whom the aforementioned difference would be negative could decide in the next year not to make the additional top-up payment and return its GECTR to the previous level.

The second reaction which one could expect is that large companies would pay close attention to the fact whether the amount of stars on the taxparent certification they would receive would be higher than the amount received by their competitors in the SME sector. If it turned out that a company within the grouping of large enterprises had the same amount of stars on the taxparent certification as a company within the SME grouping, the large company could be immediately suspected from profit shifting practices. As such suspicion could damage their reputation, one can suppose that these companies would be less likely to engage in tax avoidance practices.

[13] As the GECTR is calculated from the accounting profits not from taxable profits it would mostly be lower than the statutory corporate tax rate. For groups in loss a special taxparent certification without the GECTR would be envisaged.

The special "top-up payment" facility would allow groups of companies with parts of their corporate structures in tax havens to avoid possibly costly restructuring two higher tax-rate jurisdictions (in order to raise their amount of the global effective corporate tax rate) as well as it would ensure that these top-up payments would flow into the budgets of states within the EU or the EU itself[14], not to third states.

If, in addition, to the creation of the voluntary part of the taxparent certification scheme, the EU or possibly some individual states, would like to boost their corporate tax revenues, they could establish an additional rule according to which a company or group of companies whose GECTR would be below 10%[15] would have to disclose its real corporate tax rate to the public. Thus, groups of companies with very low GECTR could continue to keep their aggressive tax planning structures, but would have to permanently disclose them to the public and, on top of that, put the following sign "My global effective corporate tax rate is 1 %" on all communications made to consumers, i.e. website, brochures, product wrappings etc.

On the basis of the aforementioned Ernst & Young study, it can be reasonably presumed that companies in the business-to-consumers sector would – out of fear of negative publicity or consumer boycott –prefer to make a "voluntary" top-up payment to the public budget to make sure that their global effective corporate tax rate is above 10% to and avoid a reputation damage. In reality, this top-up payment would be a "de facto" tax on offshore profits of EU corporations.

5. Conclusion: How to make taxparent solution work?

It would be a very false belief to think that the mission to breathe life to the taxparent certification scheme could be assumed by a public authority, whether national or international, although it may appear, at the first glance, that states and public authorities would be the most

14 This special top-up payment would be paid either to the budget of individual states in respect of which they would have received the taxparent certification or to the budget of the European Union or OECD for companies with more than one national version of the taxparent certification or to a global general transparent public good foundation.

15 In the history - during Middle Ages until the early modern times - the customary tax rate in the European cultural area which was considered to be moral was 10% (In Latin: decenia, in English: tithe, in French: dixième). Today it is the lowest statutory corporate tax of an EU Member State (Bulgaria).

evident beneficiaries of the taxparent certification scheme. A publicly available study of the EU suggests that the “"European Commission should not so much engage directly in the provision of trustmark services, but more leverage the trust-building role of neutral bodies."[16] In fact, consumer perception of credibility of an e-trustmark does not differ if such e-trustmark is granted by a non-profit organisation or a public authority.

Therefore, the taxparent certification scheme if it is to see the daylight has to be initiated by a credible non-governmental organisation, ideally a one with international outreach, and in parallel be embraced by business environment, in particular associations of SMEs, which would benefit most from the competitive advantages procured by the taxparent certification.

Yet, if states, European or international organisations wanted also to have their piece of cake, they would have to enshrine into a binding legal instrument, at least the compulsory disclosure rule for low taxed groups and of companies as well as the disclosure obligation for companies receiving public funds or active in specific sectors. And indeed, if in the past the European Union (European Economic Community) was the only player strong enough to ensure a long-term general piece, today it is the only actor which is able to throttle back multinational corporations and guarantee a long-term social piece.

[16] EU Online Trustmarks – Building Digital Confidence in Europe, Final Report, 2012, p. 5.