To See or Not to See: That Is Not the Question

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1 Country-by-country reporting

The Organization for Economic Co-operation and Development/Group of Twenty (OECD/G20) and the European Commission measures to tackle tax avoidance and aggressive tax planning are focused on the aim of ensuring effective taxation where profits are generated. In order to improve Multi-national Enterprises (MNEs) compliance with national tax provisions, the OECD/Base Erosion and Profit Shifting (OECD/BEPS) initiative, supported by the G20, identifies the need for aligning transfer pricing outcomes with value creation and proposes that the MNEs report – amongst other things – country-by-country (CbC) information on certain items including, but not limited to net revenues, profits or losses, taxes paid and accrued, number of employees, certain assets, and the business activities. These reports should be addressed to the tax authorities involved so that in the interests of targeting tax audits, they are informed about transfer pricing risks, can identify other potential profit shifting channels, and can carry out statistical and economic analyses.

In addition, in pursuing its strategy on fair and efficient taxation of companies in the European Union, the European Commission believes in the importance of public transparency on corporate income taxes. Their intention is to resolve what is seen as lacking public scrutiny, to bring about reputational effects on the part of the companies, and to promote democratic debate. To this end, the European Commission requires that MNEs must make accessible tax-relevant CbC information via company registers and their own internet sites, when doing business in Europe.

2 Improved compliance

CbC reporting should provide tax authorities with additional information necessary for carrying out a risk-based transfer pricing audit. There can be no objections to this aim, since the OECD/G20 initiative can help to avoid superfluous duplication and to improve alignment of documentation requirements, which have increased worldwide. The perception that a group of companies is more than the sum of its individual parts has obviously become generally accepted. Since it is almost impossible to allocate appropriately integration benefits on the basis of market prices, a profit split or hypothetical arm's length calculations for identifying 'fair' profit allocation is necessary. However, the arm's length principle requires that the sources of such integration benefits are identified in detail. Basing this on key performance indicators such as net revenues and number of employees is neither helpful nor in line with the arm's length principle. Moreover, the description of the reporting items appears not to be well defined.

3 Transparency and public scrutiny

Against this background it is scarcely justifiable that in light of the possible collateral damages to the reputation and the competiveness of the businesses, the European Commission has been drawn into giving way to the demands for transparency in MNEs' tax matters in order to 'contribute to increasing public trust in the fairness of the tax systems' and 'informed democratic debate'. In order to create beneficial effects for the society and bring about informed decision with respect to businesses, we need *useful* information, even if it has to be said that the reporting standards employed up to now involve certain deficits especially in the less cooperative states. But it borders on admitting defeat if the means of states are insufficient to identify 'black sheep'. Moreover, it appears more than questionable if members of the civil society are to be mobilized in order to make businesses cease carrying out legal actions and behave as 'fairly' as it feels appropriate by the 'public'. Such members of the civil society are neither market nor a parliament and are not liable for collateral damage caused.

Notes

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INTERTAX, Volume 44, Issue 8 & 9

4 Geographically align corporate income taxes with actual economic activity?

The concerns are all the more serious since ensuring effective taxation where profits are generated is not a matter of course in economic terms. From an economic perspective, gross value added is the amount that is added to input through manufacturing activities. Correspondingly, net value added means the income of the production factors after depreciation, indirect taxes and subsidies. It is divided up into gross income from employment, interest on debt capital, interest on real estate and profit income. Leaving aside cross-border-commuters, according to the international allocation of taxing rights, income from employment is taxed where the work is carried out. Likewise, taxation of income from real estate accrues in the state of location if it is earned in the form of contract income paid to landlords or lessors. In contrast to this, for interest the right of taxation belongs primarily to investors' state of residence. The same applies in principle for profit. Such profit is also taxed at the level of subsidiaries. Since companies are liable for tax due to the fact that they are deemed to be independent legal persons, this legal feature does not, however, mean that they actually bear the tax burden nor does it appear to be justified that for reasons of fiscal equivalence the profit is to be taxed for the most part where the actual economic activities are carried out. The latter also holds for permanent establishments. A source state has a claim on compensation for the infrastructure it provides, furthermore it should be able to tax the income on real estate that is not paid in the form of rent or lease to a third party. But the source state builds neither schools nor hospital for legal persons, and nor does it provide them with social security. It may well be that it is possible to identify actual economic activity with the help of key performance indicators (the number of employees, the amount of turnover, the value of assets). However, these indicators do not show in a manner what will uphold the arm's length principle the amount of profit taxable where production takes place.