OECD

Transparency in Financial Reporting: Is Country-by-Country Reporting Suitable To Combat International Profit Shifting?

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Issue: Bulletin for International Taxation, 2014 (Volume 68), No. 6/7
Published online: 15 April 2014

In this article, the authors contend that country-by-country reporting cannot be regarded as a convincing measure to combat international profit shifting. Instead, tax legislators should limit profit shifting by enforcing national and international tax rules and by closing gaps in tax law.

1. Introduction

The tax planning efforts of highly profitable US multinationals, such as Google, Apple or Amazon, and their extremely low effective tax rates on their non-US profits have recently become the subject of intense public debate. [1] The fact that these companies pay almost no corporate taxes in the foreign jurisdictions where they operate can most likely be attributed to activities aimed at shifting profits to tax havens. Companies effectively exploit gaps and loopholes in international tax law, but their practices are not generally classified as illegal. Yet, the acceptability of such activities from a social and ethical point of view is widely discussed; some call them “aggressive”, even though a clear distinction between “acceptable” and “aggressive” tax planning is hard to define.

Although there have been several attempts to quantify the scale of profit shifting, [2] no accurate estimate of the exact amount of profits transferred to low-tax jurisdictions exists to date. Nevertheless, empirical evidence clearly shows that profit shifting within multinationals does indeed take place, regardless of the specific industry sector. In that respect, two channels have been identified. On the one hand, international tax rate differences are found to be the major driver of profit shifting. [3] On the other hand, debt financing, transfer pricing in general and the licensing of intellectual property (IP) in particular are identified as the most important channels for relocating profits. [4] Here, transfer pricing rather than debt financing turns out to be the dominant channel for profit shifting. [5]

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1. For a detailed discussion see C. Fuest et al., Profit Shifting and “Aggressive” Tax Planning by Multinational Firms: Issues and Options for Reform, 5 World Tax J. 3 (2013), Journals IBFD.
2. Murphy assumes that tax evasion and tax avoidance costs the EU Member States EUR 1 trillion a year, see R. Murphy, Closing the European Tax Gap – A Report for Group of the Progressive Alliance of Socialists & Democrats in the European Parliament, Tax Research LLP, p. 2 (2012). According to Bach, in Germany the yearly revenue loss due to profit shifting amounts to about EUR 90 billion; see S. Bach, Unternehmensbesteuerung: Hohe Gewinne – mäßige Steuereinnahmen, DIW Wochenbericht, pp. 3-12 (2013). Heckemeyer and Spengel, however, assume the revenue loss in Germany to be less than EUR 10 billion, see J. H. Heckemeyer & C. Spengel, Ausmaß der Gewinnverlagerung multinationaler Unternehmen – empirische Evidenz und Implikationen für die deutsche Steuerpolitik, Perspektiven der Wirtschaftspolitik, p. 54 (2008). Oxfam calculates a revenue loss of USD 50 billion for developing countries; see, Oxfam, Tax Havens: Releasing the Hidden Billions for Poverty Eradication, Oxfam International Policy Paper (2000).
As a countermeasure to this issue, the OECD released a global Action Plan against Base Erosion and Profit Shifting (BEPS) in July 2013. This Action Plan was adopted by the G-20 leaders and, in principle, supported by the European Commission. Arguing that a lack of transparency in financial reporting facilitates profit shifting, the BEPS Action Plan also includes, among other things, specific actions (Actions 11-13) aimed at enhancing the disclosure quality of tax-related information. Several other international initiatives and political parties have likewise recently called for more transparency in financial accounting, especially by means of so-called country-by-country reporting (CbCR). This concept is based on the disclosure of key business information, such as profits and taxes paid for each country that a multinational operates in. The proponents of CbCR claim that the disclosure of such information might build up pressure on companies to pay a fair amount of tax in relation to their economic activity in each country. Furthermore, this kind of disclosure could serve the purpose of enhancing the efficiency of the administration of tax collection and of detecting abusive tax arrangements. If CbCR proves to be successful in limiting profit shifting, the expected benefits should exceed the related costs.

In this article, we argue that both CbCR and the related provisions requiring more detailed tax disclosure cannot be based on extended financial accounting standards – at least for the overwhelming number of countries in the world that exempt foreign income. Moreover, we argue that even special CbCR forms do not prevent multinationals from profit shifting and that the costs of CbCR exceed the expected benefits. We contend that first of all, tax legislators should take action to restrict profit shifting by closing loopholes with regard to the allocation of multinationals’ profits. In this regard, the area of transfer pricing seems to be promising. In essence, we argue for more standardized transfer pricing regulations which should be adopted at the international level.

The article is organized as follows. Section 2. provides an overview of the existing initiatives regarding CbCR. Section 3. discusses to what extent the required information could be integrated into the existing financial reporting framework and outlines costs and benefits of country-specific reporting. Section 4. examines alternative reform proposals. Section 5. concludes.


To date, there have been no extensive provisions prescribing a CbCR for all countries and industry sectors. However, numerous regulations in national and international tax law already require the disclosure of certain types of tax information. These regulations can be divided into: CbCR provisions for specific industries, public disclosure of tax information and internal documentation requirements, for example, for transfer prices (see Figure 1).

Figure 1: Tax disclosure: existing provisions and trends
Certain regulations requiring country-specific information have already been put in place, albeit only for the extractive sector (production of oil, natural gas and minerals) and the financial sector. It should be noted that these specific CbCR requirements are mainly outside the scope of financial reporting.

The most comprehensive rules apply to the extractive industry, not for tax reasons but due to a high risk of corruption in this sector. The Extractive Industries Transparency Initiative (EITI), an international standard which countries may sign up to voluntarily, aims at reconciling company and government payments. Participating countries have an obligation to produce a public report, but are entitled to decide on the exact form and scope of disclosure. In contrast, according to the Dodd-Frank Act, listed US companies operating in the extractive sector are obliged to publish payments made to governments on a country-by-country basis in a standardized way. Similarly, the Accounting and Transparency Directive (2013/34) implemented in July 2013 requires EU (listed and large non-listed) companies in the extractive and forestry sectors to disclose payments to national governments as part of their annual financial statements. Like the other two initiatives, it does not prescribe the presentation of country-specific profits and tax payments.

In July 2013, the EU Capital Requirements Directive IV ("CRD IV") was adopted. This is the first initiative governing country-by-country disclosure for financial institutions in the European Union. Primarily aimed at the enhancement of transparency, this directive stipulates that all companies covered by its provisions must publicly disclose their operations, turnover and the number of employees in every country, effective from 2014. Most important, however, is the country-specific data on profits/losses and tax payments, which will have to be reported only to the European Commission. The Commission plans to assess any negative consequences of publishing this information and then to decide whether to keep it confidential or to make it publicly accessible from 2015 onwards.

In general, most local generally accepted accounting principles (GAAPs) as well as the International Financial Reporting Standards (IFRS) stipulate the disclosure of certain information regarding current and future tax payments of multinational companies in the financial statements.\[^{14}\] In consolidated financial accounts, this information is usually only available at the parent level or per segment,\[^{19}\] but not necessarily at a regional or country level. Tax information in individual accounts can hardly be interpreted and compared due to the heterogeneity of local GAAPs. Tax returns showing tax payments to local tax authorities are not accessible in the majority of countries.\[^{16}\] Some GAAPs require an additional disclosure of very specific tax information. FIN 48 on Accounting for Uncertainty in Income Taxes (released in 2006) stipulates the publication of income tax risks of businesses adhering to US GAAPs. Companies have to assess the sustainability of their uncertain tax benefits (more-likely-than-not criterion) and establish tax reserves for tax positions which they find do not meet the more-likely-than-not criterion.\[^{17}\]

Following the OECD recommendation\[^{18}\] on the pricing of intra-group transactions, many countries have focused on the transfer pricing regulations in their national tax law. The scope of these provisions ranges from the simple requirement of the application of the arm’s length principle to detailed documentation requirements justifying intra-group prices and profit allocation to tax authorities (confidentially).\[^{19}\]

In summary, the description of the status quo of tax disclosure provisions reveals that a comprehensive country-by-country reporting has not been implemented so far. Nevertheless, the public debate indicates a strong demand for more transparency in financial reporting. In this regard, the BEPS Action Plan reflects this trend towards stricter and more extensive disclosure requirements for companies in all industry sectors. In particular, Actions 11 to 13 of the Plan address the collection of company-level data on BEPS and the disclosure of aggressive tax planning arrangements that companies may make use of. Moreover, the BEPS Action Plan calls for the disclosure of country-specific information. The Memorandum on transfer pricing documentation and CbCR, released in October 2013, specifies this concern by stipulating that CbCR should become a compulsory part of the transfer pricing documentation.\[^{20}\] Taxpayers should be obliged to report income, taxes paid and certain indicators of economic activity to governmental authorities, i.e. CbCR information should not be part of financial accounts and made public. The OECD has further announced that it intends to push this subject forward by developing a CbCR template by the end of 2014. Likewise, the European Commission has signalled its support for a comprehensive CbCR framework.\[^{21}\]

In addition, several networks and initiatives, such as the Task Force on Financial Integrity and Economic Development,\[^{22}\] have extensively worked on a concept for country-specific reporting for all multinational.\[^{23}\] Some political parties have also brought forward requests for such disclosure regulations. The Social Democratic Party of Germany and the German Green Party have addressed this matter in their national election campaign of 2013. In their common petition, they call for the publication of country-specific information on tax payments, profits, revenues, employees and total assets as part of local German GAAPs.\[^{24}\]

As an interim result, it can be concluded that CbCR already exists in particular cases, for example, in some industries, yet not necessarily within the framework of financial accounting. Against the background of the BEPS discussion, a comprehensive CbCR as a general standard for large multinational companies is being called for by various parties and international institutions to enhance transparency. However, the proposals vary with respect to the kind of disclosure. While some argue in favour of CbCR as a mandatory part of public financial reporting, others prefer reporting only to tax

\[^{14}\] For example, IAS 12.
\[^{15}\] For example, IAS 8.
\[^{16}\] Only some countries, e.g. Finland, Sweden and Norway, require tax returns to be publicly disclosed. In Japan, public disclosure of individual and corporate tax return data was mandatory from 1950-2004 (see M. Hasegawa, J.L. Hoopes, R. Ishida & J. Simser, *The Effect of Public Disclosure on Reported Taxable Income: Evidence from Individuals and Corporations in Japan*, National Tax Journal, p. 572 (2013)).
\[^{18}\] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2010), International Organizations’ Documentation IBFD.
\[^{19}\] See Lohse & Riedel, supra n. 4, at p. 2.
\[^{22}\] See Murphy, supra n. 9.
authorities within the framework of transfer pricing documentation. The following sections discuss which option seems to be more promising.

3. Comprehensive Country-by-Country Reporting (for All Industry Sectors)

3.1. Required information

The first question regarding the actual design of a comprehensive CbCR framework for all industry sectors concerns the required information for the identification of potentially tax-aggressive activities. Most importantly, data on profits and tax payments in the relevant countries for each entity should be provided to evaluate the appropriateness of the amounts paid. In addition, several further disclosures would serve the purpose of examining a company’s real economic activity in a country. As an example, Figure 2 lists items that should be disclosed within the framework of a CbCR for each country where the multinational operates.  

![Figure 2: Example of information requirements under CbCR](image)

- Name of each company and the country it operates in
- Financial performance
  - Sales, purchases, financing costs, royalties, marketing and R&D expenses
    - Intra-group
    - Third parties
  - Labour costs and number of employees
  - Pre-tax profit
- Details of cost and net book value of assets
- Details of gross and net assets
- Tax charge
  - Current and deferred taxes
  - Tax payments
  - (Deferred) tax assets and liabilities

Essentially, sales, purchases and financing costs, including royalties and other (overhead) costs, such as marketing and R&D expenses, should be split between intra-group and third-party transactions in order to shed light on profit shifting activities. In particular, intra-group transactions should be reported on a per-country basis. Moreover, the tax charge would have to be divided into current (i.e. cash and accrued) and deferred taxes since governments are most interested in cash payment of taxes.

3.2. Mechanisms for providing tax disclosure

3.2.1. Possible starting points

The second question relates to the specific mechanisms for providing this country-specific data. In particular, the question arises as to which framework could deliver this information. As a starting point, one could think of consolidated financial accounts (and thus the IFRS) as a platform for CbCR. Alternatively, individual financial statements could be used. A third alternative would be a tax-specific CbCR template independent from financial statements.

Sections 3.2.2., 3.2.3. and 3.2.4. examine the three alternatives. The evaluation is based on a simple example for intra-group profit shifting of multinationals which incorporate an IP-holding company in a low-tax jurisdiction (see Figure 3).

![Figure 3: Example of international profit shifting](image)

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25. See Murphy, supra n. 9; OECD, supra n. 20.
26. See Devereux, supra n. 23, at p. 39 et seq.; Fuest et al., supra n. 1, at p. 322; OECD, supra n. 20.
The example assumes a parent company (Parent Co) in Country P with a 100% holding in a subsidiary in high-tax jurisdiction S and an IP-holding in low-tax jurisdiction IP, where the group’s IP (e.g. a patent) is located. The IP is licensed to the subsidiary in Country S in exchange for a royalty payment reducing the subsidiary’s profit. Foreign profits and dividends are exempt from tax in Country P. Figure 3 displays the amounts of sales, costs and pre-tax profits as well as intra-group transactions and the nominal tax rates for each company and country. If the total profits of the group (EUR 2.2 billion) were taxed at the level of Parent Co, the tax would amount to EUR 0.66 billion (= 2.2*0.3). In our example, however, the tax is reduced by EUR 0.48 billion to EUR 0.18 billion. Above all, EUR 1.9 billion (from the total sales of EUR 2 billion made by the subsidiary in Country S) is shifted to IP-holding, yielding a tax saving of EUR 0.475 billion (= (0.3-0.05)*1.9). Considering the tax reduction in Country S, the total tax saving amounts to EUR 0.48 billion (= 0.1*(0.3-0.25) + 0.475).

3.2.2. Consolidated financial statements

According to the prevailing accounting standards (e.g. the IFRS), consolidated financial statements disclose tax information in the profit and loss statement, the tax reconciliation and the segmental reporting. However, building on consolidated accounts as a starting point for CbCR has several drawbacks and does not seem to be feasible.

Consolidated financial statements are supposed to provide useful information about a group of companies as a single economic entity. Therefore, intra-group transactions are consolidated and do not affect the overall profit. As Figure 4 shows, profit shifting activities by means of intra-group transactions are not visible in consolidated financial statements. This is due to the netting out of profits and expenses within the group (in our example: royalty income of IP-holding and payments of subsidiary of EUR 1.9 billion) and the aggregation of total tax payments (see Figure 4).

Figure 4: Intra-group profit shifting and consolidated financial accounts
The profit & loss statement only reveals sales (EUR 3 billion), costs (EUR 0.8 billion) and profits (EUR 2.2 billion) in aggregated form. The intra-group licensing arrangement is disregarded.

Tax reconciliations only disclose the total tax reduction (i.e. the low effective tax rate) due to operations in low-tax jurisdictions (EUR 0.48 billion), but do not specify the underlying profit shifting mechanisms or countries involved, as required by CbCR (in our example, the interposition of the IP-holding). Moreover, accounting standards follow a forward-looking approach, while CbCR is strictly backward-looking. This is relevant if deferred taxes are required to be reported. This part of the total tax liability is based on reliable expectations about the future and is, in principle, not relevant for CbCR. Accounting for deferred taxes on international operations is closely linked to the taxation of foreign income in the country where the multinational is headquartered. If the exemption method applies to foreign profits (this holds for the majority of countries in the world), a lower foreign tax becomes definite and does not trigger a deferred tax expense. The situation is different in, for example, the United States. Here, foreign profits are subject to US tax and a credit is granted for the underlying foreign tax. Following the concept of deferred taxes, a lower foreign tax should not be treated as a permanent difference (as under the exemption method). It should rather be treated as a temporary difference and should increase deferred taxes if profits are retained in low-tax jurisdictions. According to the so-called indefinite reversal exception under US financial reporting rules, a corporation that defers the repatriation of foreign profits might defer the repatriation tax charge until profits are distributed to the United States. Empirical evidence suggests that the indefinite reversal exception incentivizes the accumulation and retention of foreign profits abroad. Therefore, it is argued that a reform of US financial reporting rules could limit profit shifting into tax havens. However, this does not hold true if foreign profits are exempt from tax.

Segmental reporting (as part of consolidated accounts) does not deliver country-specific information either. According to the management approach (e.g. IFRS 8), data is disclosed on a business-unit level, yet not necessarily on a geographic or even per-country basis. In the context of our example, it could be possible that Parent Co, Subsidiary and IP-holding all belong to the same business unit and, therefore, no more detailed information would be provided. Hence, in order to reveal single intra-group transactions, it would be necessary to examine “de-consolidated” data. This, however, does not serve the purposes of reporting on group level. Furthermore, it is questionable to what extent the target group of CbCR and financial statements actually correspond to each other. In addition, financial statements contain data based on future prospects of the company, while CbCR is intended to detect profit shifting behaviour in the past periods. Therefore, it can be concluded that consolidated financial statements do not seem to be the appropriate platform to deliver CbCR information.

### 3.2.3. Individual financial statements

Alternatively, one could think of individual financial statements as a starting point for CbCR information. Although individual financial statements, as opposed to consolidated financial statements, contain unconsolidated data on a company level, such an approach would also have several drawbacks. First, the source and direction of intra-group transactions do not become evident on a per-country basis. Second, individual financial statements are generally prepared according to local GAAPs and might be quite heterogeneous and not comparable across countries. Third and most importantly, financial accounts neither reflect taxable income nor do they provide reliable estimates of the true value of assets. As a general rule, book-tax differences arise in most countries due to country-specific tax laws; the exemption from tax of certain types of income (in particular inter-company dividends and foreign source income) and non-deductible expenses are the most prominent examples. In addition, other reasons relating to different interrelations between financial accounting and national tax laws (for example, different tax accounting standards and provisions to allocate income and expenses) that are decisive for financial profits do not necessarily reflect taxable income. Certain assets, for example

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27. Please note that the example assumes that foreign profits are exempt from tax in the parent’s jurisdiction. To the authors’ knowledge, only 8 out of 34 OECD member countries apply the credit method; see G. Kofler, Indirect Credit versus Exemption: Double Taxation Relief for Intercompany Distributions, 66 Bull. Intl. Taxn. 2, sec. 4 (2012), Journals IBFD.
30. It could be argued that consolidated accounts are primarily relevant for investors and capital markets, whereas CbCR first and foremost benefits tax authorities.
31. See OECD, supra n. 20.
self-developed intangibles, might not be recorded at all or only at historical costs. According to the example in Figure 4, it might indeed be misleading if IP-holding had created the IP on its own and were to display no or a very low value for intangibles in its financial accounts but to report high taxable profits from royalties.

3.2.4. Interim conclusions: CbCR as a tax-specific template

Neither consolidated nor individual financial statements can serve as a suitable basis for CbCR. Therefore, it seems to be most reasonable to disclose this information in a separate tax-specific template, if at all. These findings are in line with the ongoing discussion on CbCR at the level of the OECD, which aims towards the disclosure of a CbC report as part of the transfer pricing documentation (see section 2.). However, in that case, it would be necessary to define standardized and harmonized rules with respect to the scope (eligible companies), methodology (determination of income and valuation of assets) as well as the obligation to provide the relevant information. Other important aspects include: the extent to which the disclosures should be mandatory or voluntary and whether they should be confidential or made accessible to the public. Finally, it has to be decided if and by whom the CbC report should be audited.

3.3. Expected costs and benefits

3.3.1. Opening comments

The CbCR can be useful if the expected benefits of any additional disclosure of tax information outweigh the expected costs. Yet, to date, little is known about the exact costs and benefits related to CbCR.

3.3.2. Costs

CbCR is suspected to be associated with several direct disclosure costs. In addition, implicit costs occur; the volume of such implicit costs is likely to exceed that of direct disclosure costs and depends on whether the disclosure is made public or only available to tax authorities.

First of all, direct disclosure costs would initially arise for adjusting the existing systems and processes to the requirements of CbCR. While some authors argue that many existing financial reporting systems are already technically able to deliver country-related data, the scope of initial costs is not exactly predictable and may depend on other factors, such as the complexity of the group structure. Direct reporting costs would also be incurred on a regular basis and would depend, for example, on the scope of disclosure requirements, (potential) materiality thresholds and the need for the auditing of the report. According to some authors, the necessary information already exists and can be taken from financial and internal accounts as well as from tax returns. CbCR could nevertheless become particularly expensive if it introduced a completely new set of reporting provisions independent from financial and tax accounting rules and if companies considered it necessary to justify and explain extensively their reports to the public.

Implicit costs of CbCR would primarily stem from disclosing the information to the public. Here, CbCR could be associated with considerable competitive disadvantages. Publishing commercially sensitive information would be particularly problematic if country-specific reporting were not mandatory for all companies (for example, not in all countries/regions or only for companies of a specific size). Moreover, disclosing data on tax payments could violate tax secrecy, which constitutes a guiding principle of tax law in most countries in the world.

In addition, international tax law is highly complex, so that parties without profound knowledge of the subject might be unable to appropriately process and interpret the information disclosed. For instance, low (or zero) tax payments may neither point to tax aggressiveness nor result from illegal operations. Nevertheless, wrong accusations against companies could be made.

33. See Devereux, supra n. 23, at p. 31 et seq.
34. The following discussion of possible costs of a CbCR is adapted from Devereux, supra n. 23, at pp. 34-38.
35. See Murphy, supra n. 9; at p. 21.
37. See Devereux, supra n. 23, at p. 32 et seq.
Another potential implicit cost of CbCR is associated with the danger of double taxation even in the absence of public disclosure: knowing all tax payments on a country-by-country basis could make tax authorities raise their own claims towards companies. [38]

3.3.3. Benefits

In contrast to the expected costs, the expected benefits from additional disclosure of tax information are less clear. Proponents of CbCR believe that companies would be urged to pay a fair amount of tax in relation to their economic activity in each country. In addition, CbCR could enhance the administrative efficiency of tax collection and detect abusive tax arrangements. Moreover, additional disclosure of tax information would be beneficial from the point of view of capital markets. Finally, customers could put pressure on multinationals to increase tax payments in different consumer markets. The following discussion reveals a missing theoretical foundation of these arguments and illustrates that CbCR information should not be made public but only transferred to tax authorities confidentially, if at all.

A major argument in favour of CbCR is that companies would be encouraged to pay taxes at an amount that truly reflects their economic activity and their utilization of public infrastructure in a particular country. [39] Yet, this reasoning is merely speculative, particularly since the common tax minimization strategies employed by multinationals are mostly based on the exploitation of loopholes in domestic and international tax laws and, therefore, are not illegal in themselves. Moreover, this argument cannot be based on theoretical foundations, since it is virtually impossible to properly allocate profits and costs to single affiliates of a group by means of transfer prices: by setting up an integrated group of companies, coordination of transactions via markets is abandoned in favour of coordination using intra-organizational hierarchies. The aim is to generate economies of integration, for example, by means of lower transaction costs, improvement of information flow or managerial efficiency. As a result, the profits of an integrated group of companies are higher than the aggregate profits earned by its separate entities. Since the excess profits accrue at group level, it is theoretically impossible to determine the source of these profits as they cannot be attributed to individual transactions either. [40]

In addition, the extent to which CbCR actually entails additional insights and benefits for tax authorities is also questionable. Tax authorities can be assumed to be already familiar with the common (legal) channels and arrangements used for profit shifting since the most prominent examples were available to the public. [41] CbCR might only provide hints as regards the question of which companies should be audited or examined with increased scrutiny. This might be relevant, particularly for inbound investments. In which case, however, it could be argued that it is not necessary to make country-by-country disclosures publicly accessible, i.e. it would be sufficient to make the information available only to tax authorities. This is also in line with the OECD’s proposal to integrate CbCR into the transfer pricing documentation framework.

Proponents of CbCR claim that the enlarged body of information (available to the public) would be beneficial from a capital market point of view. For instance, knowing which countries a multinational operates in could potentially enable investors to better assess the companies’ geopolitical risk and the sustainability of its tax liability. [42] However, some empirical evidence suggests that capital market participants already face an information overload and do not actually consider the full body of information available. [43]

It seems unlikely that CbCR will reduce tax minimization based on the utilization of beneficial tax regimes and constructional flaws in international tax law. Rather, public pressure resulting from CbCR would be expected in the case of illegal endeavours, which, however, are not usually the reason for the unusually low effective tax rates of multinationals.

39. See Deutscher Bundestag, supra n. 24, p. 1; Devereux, supra n. 23, at p. 7.
42. See Murphy, supra n. 9, at p. 14. Investors could see whether the tax liability is largely influenced by operations located in tax haven countries.
Moreover, empirical evidence is somewhat inconclusive with regard to the relationship between an enforced increase in the information to be disclosed by companies and tax-aggressive behaviour. Hasegawa and others (2013)\(^{44}\) assess the tax reform in Japan in 2004, which abolished mandatory disclosure of individual and corporate tax returns. They find that companies do not generally report higher profits once tax returns become confidential again. A change in behaviour with respect to tax planning activities can actually only be observed for non-listed companies. Therefore, their findings are inconclusive with regard to the hypothesis that enforced disclosure reduces tax aggressiveness. Their findings suggest that non-universal (unilateral) disclosure provisions would even trigger tax avoidance behaviour. Furthermore, they show that if there is a threshold for disclosure, many taxpayers would under-report so as to avoid disclosure. Mixed empirical evidence also exists with regard to the FIN 48 implementation. Gupta and others (2013)\(^{45}\) find that increased tax disclosure under FIN 48 reduced companies’ tax aggressiveness, at least at the state level. Similarly, Balakrishnan and others (2012)\(^{46}\) report that aggressive tax planning decreases corporate transparency, but also increases the volume of tax-related disclosure. Yet, Blouin and others (2010) observe that public companies appear to have taken action to avoid mandated disclosure under FIN 48.\(^{47}\) As a result, there is no clear empirical evidence showing that a change in disclosure provisions affects a company’s tax aggressiveness. If at all, this applies only to non-listed companies.

Lastly, since there is no clear empirical evidence yet showing that companies publicly accused of having engaged in aggressive tax planning suffer from damage to their reputation, it remains uncertain whether CbCR would actually have any impact at all on customers’ purchasing decisions.\(^{50}\)

### 3.3.4. Interim conclusions

To sum up, it can be concluded that expected benefits of CbCR lack a theoretical foundation and, according to empirical evidence, do not seem to outweigh the associated costs. Instead, it appears to be reasonable to combat tax aggressiveness by different means. It is, therefore, up to legislators to remove unintended gaps and loopholes in the tax laws.

### 4. Alternatives

Legal tax planning activities can hardly be combated by increasing transparency in financial reporting or by CbCR. Rather, it might be more effective to limit the leeway companies have with respect to constructing tax-minimizing group structures. Empirical evidence identifies intra-group financing and transfer pricing as the most prominent channels for multinationals to engage in profit shifting. In a recent meta-analysis, Heckemeyer and Overesch (2013)\(^{51}\) show that transfer pricing is by far the most dominant profit shifting channel. While transfer pricing explains 72% of the total share of shifted profits, the share of intra-group financing amounts to only 28%.\(^{51}\) Further empirical evidence shows that enforcing tax rules does indeed reduce the tax-aggressive behaviour of multinational companies.

One example for the sharpening of tax rules has been the enforcement of transfer pricing rules in the last few years. Lohse, Spengel and Riedel (2012)\(^{52}\) aim to generate a measure for the stringency and impact of transfer pricing rules showing that the regulations have become stricter over time. In that regard, Lohse and Riedel (2012)\(^{53}\) use these insights to demonstrate that transfer pricing regulations reduce profit shifting activities by up to 50% (measured by the sensitivity of corporate pre-tax profits to changes in the corporate income tax rate). In particular, penalties exert an

44. Hasegawa et al., supra n. 16.
45. For more details on FIN 48, see section 2.
47. Similar results have been obtained by O.-K. Hope, M. Ma & W.B. Thomas, Tax Avoidance and Geographic Earnings Disclosure, Journal of Accounting and Economics, pp. 170-189 (2013), for a different setting. They show that tax avoidance behaviour has increased after mandatory geographic earnings disclosure (SFAS No. 131) was abolished.
53. Lohse & Riedel, supra n. 4.
additional limiting effect on profit shifting behaviour. Furthermore, they argue that higher administrative costs arising from additional documentation requirements can be justified in the light of anticipated benefits. In addition, Luckhaupt and others (2012) point out the importance of a standardized set of transfer pricing rules in order to decrease complexity and to actually reduce the leeway for profit shifting. [54]

With regard to intra-group financing, studies have evaluated the effectiveness of thin capitalization rules. Buettner and others (2012) [55] find that thin capitalization rules effectively reduce the incentive for multinationals to make use of internal loans for international tax planning. Blouin and others (2013) [56] obtain similar results regarding the effectiveness of thin capitalization rules with respect to their impact on the capital structure of multinational companies (reduction of internal debt).

A promising solution might be to close gaps and loopholes and to reduce leeway in the application of domestic and international tax laws. However, in that case, it would be important to ensure that tightened regulations do not lead to double taxation, i.e. these regulations would have to be universally accepted by all countries. Here, a standardization of transfer pricing regulations might be more efficient in terms of limiting profit shifting and more in line with the goals of avoiding both double taxation and double non-taxation than tightening of thin capitalization rules. [57]

5. Conclusions

Aggressive tax planning efforts of highly profitable multinational companies have recently become the subject of an intense public debate. In response, several international initiatives and parties have called for more transparency in financial reporting, especially by means of a country-by-country reporting (CbCR).

Existing provisions require the disclosure of certain kinds of tax information (for example, on tax payments in individual and consolidated financial accounts or in transfer pricing documentation) to tax authorities. Furthermore, some regulations requiring country-specific information have been put in place for the extractive and financial sectors. However, no comprehensive CbCR for all countries and industry sectors has been implemented so far.

Several initiatives call for a comprehensive and public disclosure of specific information on tax payments and profits on a country-by-country basis. Our findings suggest that neither consolidated nor individual financial accounts seem to be an appropriate platform to provide such country-specific information. If at all, CbCR should be provided in a separate template. However, detailed and harmonized definitions and regulations would have to be determined to ensure comparability.

The discussion on benefits and costs of a potential CbCR has revealed that benefits are largely uncertain since current tax planning activities are mainly based on the legal exploitation of gaps and loopholes in national and international tax law. Moreover, expected benefits are not based on a theoretical foundation. Costs, however, seem to be significant. Therefore, CbCR cannot be regarded as a convincing measure to combat aggressive international tax planning of multinational companies.

Alternatively, greater enforcement of national and international tax rules should be considered. This is in accordance with recent empirical evidence demonstrating, in particular, the effectiveness of tightening transfer pricing rules.

55. Buettner et al., supra n. 4.
57. Id.