A critical analysis of public disclosure of OECD country-by-country reporting

GF Mbatha

orcid.org/0000-0003-0851-6653

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Supervisor: Prof P van der Zwan

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Student number: 29714745

ABSTRACT

Base Erosion and Profit Shifting (BEPS), tax transparency and public disclosure of company information have been contentious topics for world organisations and tax administrators globally for some time now. The discussions became more intense post the 2008 economic melt-down which started to see governments, in particular in the western world, take practical action to curb the flow of income to tax jurisdictions with lower tax rates. The European Union (EU) and the United States (US) governments drafted legislation to compel companies, especially large multinational enterprises, to start disclosing information, particularly tax related information, publicly for the benefit of the investors, governments and the public at large. This was the case with the Dodd-Frank Act in the US and the EU Article 89 of the Capital Requirement Directive in Europe. BEPS has been topical for years and took centre stage in 2015 when the country members of the Organisation of Economic Cooperation and Development (OECD) in 2015 agreed to implement the 15 part action plan to combat profit shifting caused mainly by the loopholes found in international tax law. One of the BEPS action plans relates to increased tax transparency and the disclosure of tax information relating to transfer pricing. The BEPS action 13 Country-by-Country report is currently only disclosed privately to tax administrators. There are strong arguments to have improved transparency. Like the EU Country-by-Country report for banks and the Dodd- Frank Act disclosure for MNEs, the report should be publicly disclosed. This study explores whether there are additional benefits of public disclosure of tax information in light of the profit shifting and tax avoidance goals in place.

KEYWORDS

Accountability

Base erosion

Confidentiality

Profit shifting

Tax planning

Transparency

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ACRONYMS

ATO	Australian Tax Office
BEPS	Base Erosion and Profit Shifting
CFC	Controlled Foreign Company
CbC	Country-by-Country
CbCR	Country by Country Report
CIT	Company Income Tax
CRD IV	Capital Requirements Directive IV
EITI	Extractive Industries Transparency Initiatives
EU	European Union
FTSE	Financial Times Stock Exchange
IFRS	International Financial Reporting Standards
LF	Local File
MCAA	Multilateral Competent Authority Agreement
MF	Masterfile
MNC	Multinational Corporations
MNE	Multinational Enterprise
NGO	Non-Govermental Organisation
OECD	Organisation for Economic Co-operation and Development
SARS	South African Revenue Service
TIEA	Tax Information Exchange Agreement
TTC	Tax Transparency Code
US	United State

CHAPTER 1: INTRODUCTION, PROBLEM STATEMENT, RESEARCH OBJECTIVES

1.1 Introduction

Tax revenues in general pay for public services, infrastructure, oversight institutions, and healthcare systems, amongst other goods and services that typically keep a country running in most countries. Fair tax regimes are critical to finance all the goods and services that competent states generally provide in fulfilling their obligations to citizens' rights to important services such as security, welfare and good education (Oxfam, 2018). This is why the discussion on equity, taxing rights and fairness is relevant. Tax revenues are necessary for the sovereignty of any nation as countries would cease to function without them. All taxes in a jurisdiction are mainly obtained from its residents or those that generate income in the country. It does occur that sometimes the jurisdiction cannot extract all taxes from its residents since the advent of a residence-based taxation system that has been adopted by many tax jurisdictions.

Globalisation, technology, and digitisation have resulted in corporates' income and profits being generated anywhere and can be transferred with ease. The place of economic activity is not easily determinable. This has affected trade and blurred the lines of residency and economic activities where profits are generated. This has resulted in profits being shifted between jurisdictions. Most corporate profits that are transferred to different jurisdictions are done within the boundaries of the law and cannot be referred to as tax evasion (Zuchman, 2014:122). But globalisation has also boosted cross country trade and improved foreign direct investments in numerous developing countries. South Africa with its growing democracy also must be part of such globalisation so that it can bring about much needed investments.

As such, South Africa is one of the developing countries that has joined the Organisation for Economic Co-operation and Development (OECD) and G20 countries to implement all 15 Action plans to curb income shifting. The BEPS Action plan includes Action 13 which is Country-by-Country reporting. Although globalisation is an invaluable process, it can impact a country's local tax regime and could lead to double taxation with a negative impact on growth of enterprises (OECD, 2013:10). After much discussion and deliberation of member states in 2013, the OECD and the G20 published the 15 Base Erosion and Profit Shifting action plans (OECD, 2013:2).

The OECD is an international organisation that "works to build better policies for better lives" (OECD, 2019:2). The OECD is an organisation consisting of 36 member countries that work with worldwide governments, citizens, and policymakers amongst other stakeholders to establish international norms and find solutions to a range of challenges that affect countries socially and economically. This includes improving economic performance, creating jobs and preventing tax evasion. The organisations' members are predominately western countries that are mainly developed English or French-speaking countries. The OECD also has seven key partners with non-member countries, including South Africa (OECD, 2019:2).

1.2 Background to the study

Tax avoidance activities are affected in various forms by Multinational Enterprises (MNEs), including through methods such as debt and transfer pricing. These have been cited as some of the key tax risks. Transfer pricing is one of the major ways tax avoidance is undertaken when it comes to cross country and inter-company transactions. The 15 BEPS Action plans that are all being applied concurrently to address these BEPS challenges include Action plan 1, a major plan as it addresses digitisation of commerce and the related tax issues. BEPS Action plans 2 - 4 address BEPS risks regarding tax planning and includes approaches to neutralise hybrid mismatches. Action plan 7 addresses the permanent establishment status issues which deal with the taxing of profits in foreign states. BEPS Action plans 8 - 10 address transfer pricing and the linkage of the profits of MNEs to economic activity and where value is created. Actions plan 11-13 addresses tax reporting and BEPS data analysis. These BEPS 15 action plans cover a broad range of international tax issues extending from the digital economy to the transfer pricing of intangibles across tax jurisdictions. The focus of this research is BEPS Action plan 13, which is part of the related plans 8- 13 which deal specifically with tax transparency and transfer pricing.

Due to the assimilation and globalisation of the world's economies, governments have found a need to cooperate, address tax avoidance collectively, and provide a more conducive environment to draw and maintain investment. BEPS Action plan 13 specifically addresses potential tax evasion through transfer pricing of MNEs that operate in different tax jurisdictions. Standardised Country-by-Country Report (CbCR) and other transfer pricing documentation requirements aim to give tax administrators of each

country a global depiction of where the economic activities, profits, tax of MNEs are reported, and the capacity to use this information to assess international tax and transfer pricing risks. This report would make it possible for tax administrators to assess where to allocate their often limited resources to (OECD, 2013:10). The overall objectives of OECD action plans are to provide tax administrators with domestic and international tools to target tax avoidance by implementing a current international tax model whereby income is taxed where it is earned and where value is created (OECD, 2015:9). The OECD aims to do this through BEPS Action plan 13, which seeks to re-examine the transfer pricing documentation by introducing a minimum standard on CbCR for MNEs operating in different tax jurisdiction or countries.

MNEs affected by BEPS Action plan 13 are the Ultimate Parent Entities (UPEs) which are residents in a tax jurisdiction of an MNE group with consolidated group revenue above €750m (R10 billion in South Africa) during the fiscal year immediately past the financial reporting year as reflected in its Consolidated Financial Statements. These MNEs will be required to file a CbCR (known as CbC01), a masterfile and a local file from December 2016 (Government Gazette, 2016:33).

1.3 Motivation for the topic

The OECD's BEPS Action plan 13 came about to address the lack of timely, inclusive and applicable information on aggressive tax approaches. Aggressive tax strategies employed by companies is one of the key obstacles cited by tax administrators globally. Early access to such information would allow the administrators to quickly respond to identified tax risks (OECD, 2015:9). It could be suggested that there is a measure that addresses tax planning and disclosure such as the BEPS Action plan 12 on mandatory reporting rules. Action plan 2 indirectly address the transparency issues by recommending to the tax administrators who enact legislation in their jurisdictions to compel disclosure by taxpayers based on the needs of their respective jurisdiction. However, BEPS Action plan 12 is only voluntary. Early evidence suggests that there already has been a significant reduction in the promotion of avoidance schemes since the start of disclosure regimes in 2004. While there are many potential reasons for this, disclosure has been cited as directly aiding this reduction (OECD, 2008:69).

How BEPS Action plan 13 works is that a report is prepared by MNEs that contains transfer pricing documentation is filed with the domestic tax authority. The domestic

authorities will then exchange the disclosed information with the foreign tax authorities where the MNE is operating. A few concerns have been raised by the MNEs and their representatives in the commentary submitted to the OECD on BEPS Action plan 13 prior to implementation. There are currently concerns mainly around the security and the confidentiality of the information being exchanged between the governments in the tax jurisdictions where the MNEs report.

BEPS has for many years, been perceived to be a problem, particularly in Africa where tax administrators may not have sufficient capacity to detect and measure loses through mispricing. The potential magnitude of the loss through BEPs in the world is large with estimates indicating that the global company income tax (CIT) income losses could be between four and ten percent of global CIT revenues, i.e. US$100 to 240 billion every year arising through BEPS (OECD, 2013:6). The reasons suggested for these losses include, among others, the lack of transparency and harmonization between global tax administrations (OECD, 2013:6). It is estimated that there are more than 91 multi-national companies operating in South Africa (Labour Research Service, 2016:10). Thus South Africa could be affected by mispricing in cross border transactions as a significant portion of revenue still comes from corporates. 19 percent of the total revenue collected by the South African Revenue Service (SARS) is from companies which makes it the third-largest contributor to tax revenue collected (SARS, 2018:150). In South Africa, the estimated loss to the fiscus through mispricing by MNEs was estimated to be around R1 billion in 2016 (Weir, 2018:1). This makes the topic of transfer pricing, base erosion and profit shifting relevant to the tax discussion.

There is the saying ''publish what you pay'', a notion which became popular with many governments after the 2008 economic meltdown against the background of a wider campaign for transparency and international collaboration on tax issues (Johannesen & Larsen, 2016:121). Strong calls have been made by lobbyist to have the BEPS CbCR publicly disclosed; however, the MNEs are opposed to this as they maintain that sensitive company information is included in the transfer pricing documentation which could affect the competitiveness of the MNE (Transparency International, 2016:15). Public compulsory disclosure has been welcomed by other third parties, such as civil lobby groups and other Non-Governmental Organisations (NGOs) as the disclosure requirements are perceived to be a move towards accountability for MNEs as well as tax jurisdictions (Knobel and Cobham, 2016:1). There are differing views on the matter of

public disclosure of the CbCR. More recently in a European Union (EU) Council meeting in 2019, the EU state finance ministers were unsuccessful in reaching an agreement in a majority vote on public disclosure. A majority of 16 countries needed to support the bid for it to advance. While the United Kingdom (UK) failed to vote and Germany abstained, 14 states, including, France, the Netherlands, and Spain, supported the motion and 12 states were against it, including Luxembourg and Ireland (Mehboob, 2019).

It would seem that public disclosure of tax information is costly for big corporations. Thus there is a reluctance to disclose it as was found in a 2014 survey conducted by EY *(as cited* by Dyreng *et al.,* 2016:3) indicated that reputational costs related to tax disclosure are significant and are a concern to the public offices of major MNEs. In the survey, it was also found that 89 of the more prominent companies were quite concerned about the media exposure, particularly media exposure covering their "tax activities". The disclosures can also affect relationships with government and customers the respondents said.

1.4 Problem statement

The purpose of the BEPS Action plan 13 CbCR is to address profit shifting through reporting, which is anticipated to increase transparency and accountability of MNEs. However, due to confidentiality requirements of the OECD CbC reporting standards, the MNEs are not required to disclose the reported information publicly. This non-disclosure to the public could hamper the obligation of firms to be transparent. Further to this, the OECD standards require that the jurisdiction use the information in an "appropriate" manner which means governments should not utilise the information reported by the jurisdiction in the tax jurisdictions to raise assessments (OECD, 2018:16).

The question that arises is whether the OECD BEPS Action plan 13 CbCR should be disclosed publicly for improved transparency?

1.5 Research question

What are the benefits and risks of public disclosure of the OECD BEPS Action plan 13 Country-by-Country report?

1.6 Research objectives

1.6.1 Primary objective

The research study's main objective was to critically analyse the BEPS Action plan 13 requirements in their current form by exploring the possibility of public disclosure by the MNEs of the CbCR as a further enhancement to the present disclosure requirements that only require reporting to the tax jurisdictions. Third parties that have interest do not have access to the disclosed information. This study also explored the benefits and risks, of public disclosure against the backdrop of existing private disclosure by MNEs of the CbCR to tax administrators.

1.6.2 Secondary objectives

The following secondary objectives were formulated to achieve the main objective:

- To provide an analysis of BEPS Action plan 13 and the purpose of CbC reporting and the reporting requirements thereof (addressed in chapter 2).

- To analyse transparency of tax information and disclosure regimes of public tax disclosure regimes through the literature review of studies which have researched the relationship between the public disclosure of tax information and tax avoidance (addressed in chapter 3).
- To identify and analyse potential benefits to the public disclosure of the CbCR (addressed in chapter 4).
- To identify and analyse the perceived risks that MNEs and other stakeholders foresee with publicly disclosing the information (addressed in chapter 5).

1.7 Philosophical paradigmatic perspectives

1.7.1 Ontological assumptions

Ontological assumptions relate to what constitutes reality; in other words, *what is*. Researchers are required to decide their perceptions of how things are and how things work (Scotland, 2012:9). According to Guba and Lincoln (*as cited by* Annells, 2015:283), the four basic research paradigms are positivism, post positivism, critical theory, and constructivists–interpretivists.

The ontological position of positivism is one of realism. According to Cohen *et al.* (*as cited by* Scotland, 2012:10), realism is the belief that objects have an existence free of the knower. On the other hand, the ontological position of interpretivism is relativism. Relativism is the belief that reality is subjective and is different from person to person (Guba and Lincoln *as cited by* Scotland, 2012:12). Finally, Guba and Lincoln (*as cited by* Scotland, 2012:13) describe the ontological stance of the critical paradigm as historical realism. Historical realism is the understanding that reality has been shaped by cultural, social, economic, and various other factors.

This study is categorised as constructive-interpretivist as the question of tax disclosure, transparency and accountability is influenced by the context of the individual. Constructivists "generate or inductively develop a theory or pattern of meanings" rather than starting with a theory (Creswell *as cited by* Mackenzie, N., Knipe, S. 2006). In the context of this study the theory on the benefits and negatives of public disclosure of public CbCR was determined through the understanding of the differing positions of the players interested in the subject of public disclosure of the tax information.

Throughout the research process, Interpretivist/Constructivist approaches to research have the intention of understanding "the world of human experience" (Cresswell 2003 *as cited* by Mackenzie, N and Knipe, S. 2006). In the context of this study, it was the understanding that was obtained of the viewpoints of both the MNE's and tax administrators.

1.7.2 Epistemological assumptions

According to Cohen *et al.* (*as cited by* Scotland, 2012:9) epistemology speaks to the nature and forms of knowledge. Epistemological assumptions are concerned with how knowledge can be created, acquired and communicated, i.e. *what it means to know.* The epistemological stance used in the study is constructionism. Constructionism is explained as the view that that all knowledge is contingent upon human practices, being constructed throughout human interaction, thus meaning is constructed rather than discovered (Crotty *as cited* by Amhed 2008:3)

Constructivists-interpretivists contemplate that there exist several, constructed realities (known as the *relativist* position), rather than only one true reality. Guba and Lincoln (*as cited by* Scotland, 2012:11) describe relativism as the interpretation that reality is

subjective and is different from person to person. Reality to the constructivist stance is subjective and influenced by the setting of the situation, namely the individual's experience, perceptions and the social situation. (Pommnterotto, 2005:129). This study explored the realities of the different parties (MNE's, tax administrators and the civil society) in relation to the possibility of public disclosure and an opinion was subsequently constructed.

1.7.3 Theoretical assumptions

The assumption made in an international tax study is that the main goals other than the revenue of the international tax system are the same ones generally championed for domestic tax policy which mainly are: equity efficiency and administrability (Ring, 2007:87). The components may even be difficult to size because of informational limits (for example, in efficiency-oriented analyses) or ambiguity in the normative aspect of the standard itself (what is considered equitable tax treatment).

1.8. Research methodology

The research approach/method chosen in this study was a qualitative method. A qualitative research method is a methodical way to describe experiences and situations from the person's viewpoint in the situation (Grove *et al.,* 2015:67). Furthermore, Gillham (2008:10) asserts that qualitative methods focus specifically on the kind of evidence that will aid the researcher to understand the meaning of what is going on. The qualitative research method was found to be appropriate in this study because the research sought to understand the influence that publicly disclosing or non-disclosure of transfer pricing transactions may have on the MNEs' decision to engage in tax planning or structuring that may be perceived or deemed to be tax avoidance. (Doz, 2011:528) further puts it that qualitative research may also allow one to discover the importance of a hitherto neglected phenomenon or the significance of a particular theoretical perspective to that phenomenon. It offers stimulation for innovation and research outlines (Doz, 2011:528). Through analysing existing studies which have researched the relationship between the public disclosure of tax information and the impact thereof, a new phenomenon was formed. This was achieved by reviewing studies on existing public disclosure mechanisms in various industries applied in tax jurisdictions.

1.8.1 Research design

The design of the study was a qualitative descriptive research. A qualitative design is described by Silverman (2011:67) as a technique of qualitative analysis whereby researchers develop inductive theoretical analyses from the data that they have collected and afterwards gather more data to check these analyses even further. The research design is explained by Dulock (1993:154) as a way to describe systematically and precisely the facts and features of a given population or area of interest. The purpose of descriptive research is to label a phenomenon and its individualities. This research design is generally associated with what happened rather than how or why something has occurred (Nassaji, 2015:129). Sandelowski (2000:335) explains a qualitative descriptive research design to be fundamentally qualitative and more interpretive than quantitative description. However, a basic qualitative description is not very interpretive in the sense that a researcher purposely elects to label an event in terms of a theoretical, philosophical, or other very abstract outline or system. The description in qualitative descriptive research involves the presentation of the facts of the case in ordinary terms. This design was most appropriate for this study because of the following theory of the design: Matters can be examined in detail and in-depth, and intricacies about the research subjects and/or topic are revealed that are often overlooked by more positivistic studies (Anderson, 2010:2).

Disclosure regimes studied included the successes in the disclosure regimes of the EU financial services firms through the capital requirement and the extractive industry sector for MNEs. This was done through the observation of the results of empirical studies which have been conducted by other researchers on the public disclosure of tax information. This selection of cases, as mentioned by Harrison *et al.* (2017) is based on the goal of the research and related to the theoretical proposals about the topic of interest. Harrison *et al.* (2017) recommends diligent scrutiny in selecting cases to guarantee specific applicability to the matters of interest and the use of repetition logic. Gufasston (2017) agrees that where the theory is built from cases, this is often considered the most interesting research. An analysis of literature of studies on the positive and negative consequences of disclosure of CbCR and public disclosure of tax information can inspire new ideas on the risks of public disclosure.

1.8.2 Data collection

Data collection for the qualitative study may comprise observations and examination of records, reports, and papers (Lambert & Lambert, 2012:256). For this study, data was collected from documents such as journals, legislation, and research papers written by tax researchers who studied and measured the impact of tax disclosure and their findings on each study.

1.8.3 Limitations

Atieno (2009:19) cites the main shortcoming of qualitative methods to corpus analysis is that their results cannot be extrapolated to wider populations with an equal degree of confidence that quantitative analyses can since the findings of the enquiry are not verified to determine whether they are statistically important or due to chance. Anderson (2010:2) also cites that one of the main limitations of qualitative research is that it is very reliant on the distinct skills of the researcher and is easily subjected to the researcher's personal partialities and eccentricities. Another restraint of qualitative research is that the size of data contributes in making the analysis and interpretation more time consuming and results can be more demanding and time consuming to describe in a pictorial way (Anderson, 2010:15).

1.9. Chapter overview

This chapter has addressed the problem statement which is the critical analysis of the public disclosure of the CbCR- The research question of the study and the objectives were addressed through the qualitative research method using a qualitative descriptive research design. The study is organised into various chapters, as follows:

(i) **Chapter 1: Introduction of the topic, research problem and the research objectives**

This chapter introduces the topic and the background of the problem statement and motivation for the study.

(ii) **Chapter 2**: **Background of BEPS Action plan 13 and reporting requirements**

This chapter goes into depth into the background and reporting requirements of the BEPS CbCR Action plan 13 as well as the implementation (Secondary objective one).

(iii) **Chapter 3: Literature review on existing public disclosure regimes**

This chapter specifically analyses the existing literature on the tax transparency of MNEs and the history thereof. An analysis is also performed on existing industries which are currently reporting publicly on their cross country establishments. Regimes analysed include the banks and investment firms in the EU which are reporting in terms of Capital Requirements Directive IV (Secondary objective 2).

(iv) **Chapter 4: Analysis of benefits of public disclosure**

The chapter identifies and analyses the potential benefits of the disclosure, which is evaluated against the benchmark of existing public disclosure regimes of taxes and documented studies of such (Secondary objective 3).

(v) **Chapter 5: Analysis of risk and negative consequences of public disclosure**

This chapter identifies and analyses the concerns and complexities raised specifically by concerned parties on public disclosure. The risks are analysed to gain an understanding of them and the validity thereof. Studies that are analysed describe risks such as costs of compliance and loss of competitiveness and mitigating solutions if any are available (Secondary objective 4).

(vi) **Chapter 6: Conclusion**

This chapter summarises the findings of the five chapters, and the research question is answered through the primary and secondary objectives of this study.

CHAPTER 2: AN ANALYSIS OF BEPS ACTION PLAN 13 AND THE REPORTING REQUIREMENTS

2.1 Introduction

There is persuasive evidence that tax avoidance through the use of aggressive tax planning for corporates is on the rise as, signalled by the decreasing effective tax rates of corporates. Notably in the US where it was found that the statutory corporate income tax is 21 percent; however, the effective rate recorded by corporates in 2017 averaged 11.3 per cent. This, of course, is attributed to deductions and credits allowed as well as to loopholes in the law (Stein, 2017). Some of the very large US corporates that feature in the Fortune 500 paid no taxes (Sherman, 2019). The low tax rates paid by some of the large MNEs can be attributed to aggressive tax planning and often enough cross border transactions, in particular transfer pricing which is utilised as part of tax planning (Habu, 2017:3). Profit shifting refers to the transferring of profits from high tax jurisdictions to low tax jurisdictions in order to reduce the complete tax liability (De Mooij & Liu, 2018:2). Tax motivated mispricing is always a profit shifting and transfer pricing risk, so BEPS Action plan 13 endeavours to address this risk. This chapter aims to provide an analysis of Base Erosion and Profit Shifting Action plan 13, the elements of the report, and the reporting requirements thereof.

2.2 15 BEPS Action Plans

Base Erosion and Profit Shifting, as explained by Tijdhof (2015:1) refers to tax planning strategies to exploit gaps and mismatches in tax legislation that allow companies to allocate profits to low tax regimes. There is a perception that there is a lot of profit shifting to avoid a tax liability that is undertaken by the MNEs. What exacerbates this narrative of substantial tax avoidance relating to cross border transactions are the accounts of well-known large corporates such as Google and Amazon that exercise such tax planning that they pay very little in relation to their substantial revenue raised (Rushe, 2019). There are also accounts of very wealthy individuals who store their wealth through offshore trusts and other similar instruments in so called ‘tax havens’, which was revealed through the leaked Panama Papers.

Researchers estimate a loss of two to three percent of tax revenue through aggressive tax planning for OECD countries and a further six to 13 percent for developing countries

(Knobel, 2016:2). Cobham and Janský (2018) calculated global revenue losses of around US$500 billion annually due to tax avoidance. The losses were mostly found in low-income and lower middle-income countries and across sub-Saharan Africa, Latin America and the Caribbean. Zucman (2014) calculated roughly eight percent (US$7.6 trillion) of the world's wealth lay in secretive offshore bank accounts in 2013. The success of these banks in having such lump sums being deposited into their bank accounts stems from the secrecy or anonymity that these banks and shell companies afford their clients. This indicates that there is a tax benefit that can be obtained from these offshore banks, which is not necessarily illegal.

Tax havens have gained popularity due to the apparent benefits that they offer and these benefits are aided by the veil of secrecy which is afforded by these countries to the often wealthy investors whether it be companies or individuals. These so called 'tax havens' have commercialised their dominance to provide a shield of secrecy for those seeking to conceal their fortunes by creating laws that invite financial companies and service providers to receive, hold and manage the assets of non-residents (Meinzer & Knobel, 2017:3). In other instances often developing countries may also offer tax incentives and benefits to potential non-resident investors with the noble intention of stimulating their economic growth. As econometric research has illustrated that taxation can under certain circumstances have a significant impact on a country's ability to attract foreign direct investments (Kransdorff, 2010:69). However, the results could all be the same as it could motivate aggressive tax planning by potential investors.

These examples above which are possibly anecdotal suggest that tax evasion on cross-border income is common, at least as long as there is no effective information reporting mechanism on that taxable income flow taking place. From the examples provided above it is clear that under declaration, in particular in territories foreign in relation to taxpayers, is problem. This is primarily because there is no mechanism that the tax authorities in jurisdictions where the taxpayers are resident could use to determine potential income which could possibly be taxable in their own jurisdictions.

The overall OECD action plans' purpose is to strive for transparency and fairness through the BEPS action plan package to remedy the existing rules that have exposed weaknesses that have created opportunities for BEPS. As the OECD puts it, *"where the*

*interaction of different tax rules leads to double non-taxation or less than single taxation" (*OECD, 2015).

2.3 Analysis of BEPS Action plan 13

Transfer pricing is fundamentally aimed at tax jurisdictions with very low tax rates. Tax avoidance is mainly attributable to the transfer pricing of income flow to tax havens. Tax havens generally provide tax environments that seems to promote profit shifting through transfer pricing.

Habu (2017:3) found in a study that sought to determine how aggressive foreign MNEs reduce their company tax liability, that a large section of foreign multinational subsidiaries report nil or close to nil taxable income than domestic stand-alone companies. In particular, 85 percent of the average difference in the ratio of taxable profits to total assets between foreign multinational subsidiaries and domestic individual companies could be attributed to foreign multinational subsidiaries reporting nil taxable income. One likely explanation provided for a big number of nil taxable profit reporting MNE is that foreign multi-national subsidiaries, unlike domestic companies, have the opportunity to utilise methods of profits shifting, such as debt shifting, royalty or patent location or transfer pricing to reduce their taxable profits (tax base) (Habu, 2017; Palansky, 2019). In the same research it was found that, for instance, foreign MNE subsidiaries headquartered in tax havens reported far lower taxable income in the UK in comparison to peer domestic companies than foreign MNE subsidiaries headquartered in higher tax countries (Habu, 2017:3).

The overall goal of CbC reporting is to assist the tax administrators in tax jurisdictions in identifying transfer pricing risk of MNEs for auditing purposes and, in addition to this, to provide clarity on transfer pricing documentation.

The OECD (2015) specifically lists the objectives of the CbCR as follows:

- To ensure that taxpayers can evaluate their compliance with the arm's-length principle,
- To capacitate tax authorities with the information necessary to conduct an informed transfer pricing risk assessment,

- To capacitate tax authorities with useful information to employ in conducting an appropriate transfer pricing audit. (OECD, 2015).

The OECD's reasoning behind the BEPS Action plan 13 is that it attributed the lack of quality data on company tax as a key limitation to assessing the fiscal and economic impact of tax avoidance, making it a challenge for tax authorities to carry out transfer pricing evaluations on trade between connected companies (OECD, 2019). The OECD believes that this BEPS Action plan should assist the tax authorities in conducting high level risks assessments for transfer pricing and BEPS (OECD, 2019). The CbCR objectives listed above assist jurisdictions in monitoring and assessing their transfer pricing regulations. Most governments in tax jurisdictions have implemented transfer pricing regulations to limit mispricing. The methods implemented by the governments include limiting methods allowed to assess arm's-length prices by MNEs, prescribing documentation requirements, and setting penalties in the case of non-compliance or mispricing should it be detected (Mooij & Liu, 2018:2). Non-compliance to transfer pricing regulations is set to be restricted to just a limited number of large MNEs which could be curbed by enforcement (Davies *et al.*, 2014:3). This is where the CbCR can be of use. The CbCR can assist with the objectives of the BEPS Action plan 13 as the information contained in the tiered files (explained further below) plays a pivotal role in assessing the transfer pricing strategies of MNEs for auditing or risk assessments purposes. Risk analysis is a fundamental component of transfer pricing analysis: the more assets used and the more risks assumed, the more the expected profitability of a company should increase (Monsalve, 2018).

The BEPS Action plan 13 is key to the overall fight and combatting of profit shifting using transfer pricing between jurisdictions. Profit shifting often occurs without the knowledge of the local tax regulators hence the agreement by the OECD members and associates for the swift application of the BEPS action plan in their respective countries with the agreement to implement it by the fiscal year commencing in 2016 (OECD, 2019:5). The OECD aimed to have as many nations as possible implement this BEPS Action plan so that the plan could succeed as information of MNEs in all nations would now be accessible. Profit shifting could now be easily detected as transfer pricing was found to be the number one tool used to shift profits rather than through other means like debt (Evers *et al.*, 2016:1). The overall concept with the CbCR is to achieve tax transparency. The key component of this CbCR is the disclosure of profits paid, taxes paid, and the disclosure of key business tax-related information such as profits generated and taxes

paid for each jurisdiction in which a multinational conducts business (Evers *et al.*, 2016:2). As with other financial disclosures, disclosure about the locality and identity of specific subsidiaries can reveal explicit information about corporate tax behaviour given the major consequences and tax implications associated with the tax jurisdictions in which companies carry out operations. The significance of disclosure is that it reveals to interested external third parties about the MNEs' use of tax havens and geographic exposure (Dyreng, 2014:2).

This BEPS action plan is highlighted as the first of its kind because it compels disclosure in all countries for MNEs operating outside their jurisdiction. CbCR now provides domestic tax authorities with information on business activity in foreign countries which was previously unavailable (De Simone, 2019:12). The information is also available across all industries which is also new as initially there has been only industry specific disclosure rules such as the EU Capital Requirements Directive IV (CRD IV) for banking firms and the disclosure requirements in the extractive industry (Evers *et al.*, 2016:2). Both of these disclosure regimes are discussed later in the study.

The CbCR poses an additional risk of detection of tax avoidance for multinationals. De Simone *et al.* (2019:3) suggest that companies could respond in two ways to the amplified risk given that the tax authority will be able to detect and contest their tax avoidance activities. Firstly, companies could reduce tax avoidance activities in response to CbCR. Evidence of reduced tax avoidance includes decreasing the use of tax haven subsidiaries, increasing tax payments, and reducing evidence of tax-motivated profit shifting. Secondly, the MNEs could participate in undertakings intended to better corroborate their existing tax avoidance practices in response to greater enforcement and detection risk. The question is how firms would respond to public disclosure of the CbCR.

The next section will analyse the reporting requirements and elements of the CbCR from the reporting threshold to the information that is required to be filed and provide an assessment of the requirements of the report for the suitability for public disclosure.

2.4 Reporting requirements for the Country-by-Country report

The requirements of the BEPS Action plan 13 have been a contentious issue between the parties that have to disclose and the MNEs and the activists who are proponents for

this type of disclosure in terms of the rigours and the cumbersomeness of the required information. The required information is listed and interrogated below.

2.4.1 Financial data

The data on income and tax payments in the various countries is intended to assess the correctness of the amounts of taxes paid in each tax jurisdiction. In addition to assessing tax payments, several further disclosures aim to examine a company's real economic activity in a country. More significantly, the template comprises income tax paid and income tax accrued in the countries where they specifically operate (Evers *et al.*, 2016:5).

When it comes to the disclosure of financial information, comparability is imperative as that is the only way different companies can be measured and evaluated. The type of data and source of the information disclosed needs to be consistent for all the MNEs that disclose for accuracy and to an extent for fairness as the data on the profits related payments in the applicable jurisdictions is envisioned to assess the appropriateness of the tax amount paid (Evers *et al.*, 2016:5).

2.4.1.1 Group structure

CbC reporting requirements were envisioned to be effected for financial years beginning on or after 1 January 2016 and are applicable subject to a 2020 review of MNEs with annual group revenue equal to or more than EUR 750 million (OECD, 2015:10). Particularly in South Africa, the CbC reporting rules only apply to MNE groups as defined in the local regulations. The group has a total consolidated group revenue of more than R10 billion during the financial year preceding the reporting financial year after January of 2016.

In the context of South Africa, the SARS regulations under Section 257 of the Tax Administration Act No. 28 of 2011, specifying the changes to the CbC reporting standard for MNEs determines the following: the "Reporting Country" to be a "Constituent Country". The reporting entity may be the Ultimate Parent Entity, the Surrogate Parent Entity, or any entity described in paragraph 2 of Article 2 of the regulations for the resolve of paragraph *(b)* of the definition of "international tax standard" in Section 1 of the Tax Administration Act (No. 28 of 2011).

If one applies the government regulations to the MNEs which mainly use the International Financial Reporting Standards (IFRS) for reporting purposes, one can deduce that all companies in which the MNEs exercise “control” as explained in IFRS 10 in the different jurisdictions would constitute a ‘Constituent Entity’.

2.4.1.2 Revenue

The revenue threshold is €750 million for an MNE to be obligated to file. This section analysis this revenue threshold's appropriateness and how this amount is determined due to the possible varying financial reporting standards used in the different countries as local Generally Accepted Accounting Practice could be used to report. It is implied that revenue must be deduced with reference to the applicable accounting standards governing the measurement and recognition of revenue in the country of the filing subsidiary of the MNE Group (Thiart & Nel, 2018:8).

The OECD (2015:22) reporting requires that MNEs should use the same sources of data consistently every year in completing the reporting template. MNEs may decide to use data from their accounting consolidation reporting packages, from separate entity statutory financial statements, or from internal management accounts. This is likely to cause inconsistency in comparisons per jurisdiction as the different MNEs reporting in a jurisdiction would be using different sources. The OECD (2015:22) also does not require that the revenue and profit reported by MNEs be reconciled to the consolidated financial statements. The information would be presented in a stand-alone report, and the intracompany transactions would be eliminated during the consolidation process (Evers *et al.*, 2016:5).

What makes financial statements particularly the balance sheet inappropriate is that they contain data based on future projections of the company which is the IFRS reporting basis whilst CbCR is intended to detect profit shifting behaviour in previous periods (Evers *et al.*, 2014:7). Segmental reporting as an additional part of consolidated reporting does not reveal information specific to each tax jurisdiction. According to the way management accounts performance (e.g. IFRS 8) data is disclosed on a trading-operation level and not necessarily on a geographic or even per country basis. Therefore, in order to reveal single intra-group transactions, it would be essential to examine “de-consolidated” records.

There are sometimes different interrelations between financial accounting and domestic tax laws. Financial accounts generally reflect taxable profits, but they do not provide reliable estimates for the true value of assets. This lack of harmonisation of information may lead to unreliable data being reported. A study conducted by Spengel *et al.* (2012:42) found that without harmonization of company income tax rates, the difference in the effective tax rates in the 27 EU member states remained significantly high which strengthens the case for a common reporting standard for those countries which will be reporting on a Country-by-Country basis. The revenue threshold for MNEs to start reporting is €750 million. This is roughly 90 percent of the global revenue for MNEs, but this covers only around 10 - 15 percent of all MNEs globally (Trade Union Advisory Committee, 2017). This has been a criticism of the report in that it covers very few MNEs, and this does not add to the transparency agenda, which is another aspect that this report seeks to address.

2.4.2 Three-tiered files

For MNEs to comply with the BEPS action plan requirements, the information that is to be reported to tax authorities has to be collected, stored and maintained in the local file, the masterfile and the CbC file. The three-tier approach for transfer pricing documentation has its benefits. It forces firms to express their transfer pricing strategies and firm structure to tax authorities which should enlighten the tax authorities about the overall company's business, operations and strategy (Hanlon, 2018:5). The three-tiered approach is explained in detail below.

2.4.2.1 Country-by-Country file

The simple application of the standard CbCR is that the Ultimate Parent Entity of an MNE group will first prepare and then file its CbCR with the tax authorities in its respective country of tax residence. The tax administrators would then automatically exchange the CbCR with the tax administrators in the tax jurisdictions listed in the CbCR as being a jurisdiction in which the MNE has a constituent entity resident for tax purposes (OECD, 2018:11). This list includes the country of incorporation and the nature of the main business operations run by that constituent entity (OECD, 2015:12). CbC reporting requirements are to be implemented for the fiscal years beginning after 1 January 2016. For the MNEs to be fully compliant with the requirements of the BEPS action plan, information that is to be reported to tax administrators has to be collected, stored and

maintained in the local file, the masterfile and in the CbCR which are expanded on in the sections below.

2.4.2.2 Masterfile

The purpose of the masterfile is to provide a summary of an MNE's global operations and its main transfer pricing strategies. It should also show the group's financial activities and the allocation of economic activities. SARS (2018:18) succinctly explains the purpose of the file which is to provide a summary or blueprint of an MNE's worldwide business model, specifically the MNE's intangibles, the MNE's intercompany financial undertakings, and its tax positions. The masterfile is not necessarily filed with the tax authorities; however, the information stored in it could be requested at any time. The concern with this file is the confidentiality of the information stored here, which could be requested. Some of the information could refer to sensitive information such as the core trade of corporates like intangibles. The concern is with the security of the further information requested by the other tax authorities after obtaining the CbCR that is filed. There are legitimate concerns by MNEs that the information systems of the authorities are not necessarily the same, and the safety of such sensitive information is not guaranteed.

2.4.2.3 Local file

The local file includes more comprehensive information at transaction level such as intragroup transactions, any royalties, interest payments and receipts for the local company in its specific tax jurisdiction. The information specifically requires, among other things, the following:

- An explanation of the organisational structure of the local company which should include a local organisation chart;
- A detailed explanation of the business strategy pursued by the local company including whether the local entity has been involved in business restructurings; and
- The inter-group payments and receipts for each type of transaction involving the local company, a process of identifying associated companies related to each category of controlled transactions, an indication of the most suitable transfer pricing technique with regard to the category of the transaction and the motivation

for selecting that technique as well as the assumptions applied in the transfer pricing methodology (KPMG, 2016). Again the concern as with the masterfile may be the safe-keeping of this sensitive information.

Overall it is illustrated that there is quite extensive data to be collected and disclosed within the three files. There are questions on the usefulness of all the reported information. De Simone and Olbert (2019:11) assert that the tax authorities in the different tax jurisdictions already have access to the company returns filed in their jurisdiction on which they conduct regular audits and any further information can be requested.

2.4.3 Automatic exchange of information

In order for the exchange of information to happen between tax jurisdictions, there has to be tax information exchange agreements (TIEA) in place (OECD, 2017). To enable the automatic exchange of information between various tax authorities, there has to be multi-lateral instruments in place. The Multilateral Competent Authority Agreement (MCAA) is a multilateral model agreement that offers a standardised mechanism to facilitate the automatic exchange of information in line with the Standard for Automatic Exchange of Financial Information in Tax Matters (OECD, 2015:20).

To an extent, automatic exchange of information has facilitated tax transparency. Some jurisdictions around the globe have already, recently, begun automatically exchanging taxpayers' relevant financial information. According to the OECD, this CbC exchange has been "the largest tax information exchange event in history". The OECD revealed that data was exchanged on more than 47 million financial records valued around €4.9 trillion (US$5.5 trillion) to date. The OECD has in addition also pointed out that international financial institutions have started to see a resulting decline in deposits of approximately 20 -25 percent in the past ten years or so (Bunn, 2019).

The biggest challenge currently regarding the competent agreements to be addressed is to ascertain that the rules of the multilateral instrument effectually modify all tax treaties without activating undesirable effects. Although many of the tax treaties follow the OECD Model and/or the UN Model and are not unified, their sections often use different terminology and have different numbering styles, different terms, and more importantly, different scopes (Bravo, 2016:281). Without unifying the multilateral tax instrument, the

automatic exchange of information between some jurisdictions may be a setback. Multilateral tax treaties have the prospects to mend some of the restrictions generally found in information exchange. A multilateral treaty has the capacity to allow multiple tax authorities in different countries to work to collaborate in audits of a group of companies that carry operations in several of those jurisdictions. Additionally, they could also allow countries to share tax information, within limits, set by the treaty agreements (Schlenther, 2013:135).

2.5 Public disclosure of the report

In addition to the three objectives raised by the OECD on the CbCR, proponents of public disclosure further maintain that public disclosure could play a bigger role than risk assessment to enhance transparency. Transparency in this regard would not only mean disclosure to the public, but other groups which could have much interest in the reported information would also gain sight of the report, groups such as the media and activists. These groups could assist in making the MNEs accountable for the reported information. Public disclosure of the report is discussed in Chapter 3.

The high revenue threshold could hinder the transparency of many MNEs. The high revenue threshold of €750 million means that most multinationals in actual fact do not need to prepare and file this CbCR. The OECD (2015:4) estimates that between 85 and 90 percent of MNEs would not be required to prepare and file this report. The implication is that public disclosure, aimed at improving transparency and accountability, would result in just a handful albeit large corporates being 'accountable'.

2.6 Implementation status

The status of the implementation of the BEPS Action plan 13 changes every day as jurisdictions that have agreed to be part of the OECD BEPS Action plans make progress in complying. As at April 2019, a total of 77 countries had implemented the CbCR, five had drafted bills which are still to be implemented, and seven had no development at all in implementing this BEPS Action plan. A further 44 developing countries had not yet set an implementation date (OECD, 2019:1). The significance of the number of participants who have implemented this BEPS Action planning in their countries lies in the fact that tax jurisdictions should be able to exchange information with as many jurisdictions as possible. This BEPS Action plan would work best if many nations did undertake such

exchanges. The same would apply for public disclosure. The anticipated benefits of public disclosure should also be obtained if as many countries as possible did disclose.

2.7 Conclusion

It is clear that for the CbCR to achieve its objective for transparency, there needs to be a consistent data source that is applied by all that report in the tax jurisdictions for all the three files (Country-by-Country, Masterfile and local file) that are to be filed with the assistance of the competent authority. This ensures the automatic exchange of information between jurisdictions. The critical issue on this CbCR and its reporting elements is the suitability of the information that is to be filed and reported for public disclosure. The difficulty with the suitability for public disclosure is the sensitivity of some of the information that has to be disclosed even though the other files (masterfile and local files) are reported by the reporting parent. The information could be requested at any time by the local tax authorities, and so the security of this sensitive information is not guaranteed. Thus legitimate concerns have been raised on the appropriateness of the sharing of the sensitive information because some companies could face sustainability issues if some of the information contained in these files was leaked.

From the analysis in this chapter, there also appears to be a lack of uniformity in some of the information reported. A case in point is the revenue. If the definition of group of companies is not applied correctly nor consistently identified by the reporting entity, then revenue and other financial data could be incorrectly reported.

Many believe that CbCR by banks and companies is necessary, but insufficient to address the issue of tax dodging because the categories on which MNEs have to report Country-by-Country and project-by-project are restricted due to the revenue threshold and do not apply to all the different types of data necessary for tax regulation (Van Hees, 2015). Christensen (2015) contends that the OECD's proposed Common Reporting Standard as currently modelled does little to meet the needs of low-income developing countries because these countries are also required to sign up for the same conditions as the better resourced OECD countries. This means they will face the comprehensive, exhaustive confidentiality requirements which will enable jurisdictions that are secretive to opt-out of the arrangement for the reason that sensitive data need only be exchanged with reciprocal and thorough recipient tax administrators. Further to this, there are not any requirements for countries that refuse to exchange information with specific

jurisdictions. Public disclosure could assist in such scenarios as the authorities with less resources could access the information.

There is limited research available on the actual impact of this BEPS Action plan thus far; however, De Simone and Olbert (2019:11) in their study of the impact of private disclosure of Country-by-Country reporting found that there was a move by the MNEs to increase tax expenditure and increase economic activities in lower tax jurisdictions due to the disclosure.

The question is, what would be the result if the disclosure was public? It is worth asking whether the increased transparency makes a difference and at what cost. The next chapter analyses the history and importance of tax transparency as well as the public disclosure regime.

CHAPTER 3: LITERATURE REVIEW OF TAX TRANSPARENCY AND ANALYSIS OF EXISTING PUBLIC DISCLOSURE REGIMES

3.1 Introduction

Transparency is one of the core pillars of the OECD/G20 BEPS project. The lack of timely, complete and relevant data on aggressive tax planning strategies is one of the key challenges faced by governments (OECD, 2015:2). Transparency is explained as that which can be clearly seen through, easily understood, or free from disguise (Devos & Zachrisson, 2015). It has been perceived that public scrutiny has an impact on how a company conducts its affairs, particularly its tax activities (Hoopes *et al.,* 2018). This is particularly true for companies that hold public interest, such as large and public companies.

The urgent aim of the tax transparency movement is to improve public knowledge about the global income earned by multinationals, and more purposefully to spur widespread tax reform movements by societies (Christians, 2012). Hope *et al.* (2013:2) summarises the perception about MNEs on tax avoidance as follow: "The disclosure of abnormally high earnings in lower-tax jurisdictions is generally perceived as tax avoidance and potentially imposes reputational damage on the firm (attracts criticism from policymakers, angers citizen groups and could generate scrutiny from foreign tax authorities)".

This chapter mainly analyses the tax transparency in relation to the major public disclosure regime. It will further analyse the public disclosure of these regimes with the purpose of understanding whether public disclosure had any impact based on the objectives set by the different regimes. In all the disclosure regimes discussed, accountability and transparency are noted to be key to the objective of the public disclosure of the tax information. This is in light of the fight against tax avoidance and in bringing about tax accountability. The relationship between public disclosure of tax information and tax impact thereof is analysed using existing studies conducted by other researchers on this phenomenon.

3.2 Tax transparency

3.2.1 Background

Tax transparency is explained by the OECD (2018) as a way to reduce the possibility of tax evasion. Tax transparency has always mainly been promoted by advocacy and public interest groups. The media has also created a lot of scrutiny of and attention to taxes paid by big MNEs (PWC, 2018). There is a notion that corporates cannot be accountable unless they can be identifiable (Murphy, 2019). As one of the BEPS objectives is increased transparency of information in the public domain, Owens (2015:10) deemed the CbCR as a major first step towards transparency and trust in the system.

Tax transparency activism and advocacy commenced as a campaign by a few distinct activist groups. It has grown into a global tax transparency movement with backing globally from NGOs, government representatives, business representatives, and other participants of society (Christians, 2012). The worldwide financial crises around 2008, the increased tax budget gap and the widening inequality gap saw at the same time MNEs with world-wide operations reporting increased profits revenue yet a decreasing tax burden in the same period. It is against this backdrop that activism in tax transparency advocacy grew (Christians, 2012:289).

Tax transparency relating to transfer pricing between MNEs was initiated by Richard Murphy, a well-known United Kingdom accountant and economist who wrote a paper in 2003 which sought disclosure of information on global corporate structures, inter-company prices, and actual tax payments made in each tax jurisdiction in which companies undertake activities. Murphy subsequently termed these arching principles Country-by-Country reporting (Christians, 2012:5). Later at a summit which took place in London in April 2009, the governments of the G20 countries pledged steps to ‘end the era of banking secrecy’ by fast-tracking the work that OECD had already done to endorse international tax transparency. Subsequent to that, in September 2009, improvements to the OECD’s Global Forum on Transparency and Exchange of Information for tax purposes were proposed and settled on. The forum concluded that it would increase its membership, strengthen its peer-review system and fast-track the discussions of agreements on exchange of information (Woodward, 2016:104).

The next section analyses existing public disclosure regimes of tax information. The analysis is made against the backdrop of the disclosures being alternatives to public CbCR.

3.2.2 Public disclosure of tax information

From the early 2000s, there has been a growing movement for corporates to disclose their tax payment information (Johannesen & Larsen, 2016:121). Transparency advocates assert that numerous constituencies could use the information gathered through improved broad tax disclosure requirements to make better choices in the market (Christians, 2012:7). Proponents contend that reports that are publicly available influence public pressure and could most probably persuade firms to pay their "fair share of taxes" (Dutt *et al.*, 2019:6; Forstater, 2017). Several academics have in addition, found empirical evidence supporting these arguments in recent work. Hanlon (*as cited by* Joshi, 2019:9) noted a potential benefit of a behavioural response on corporates to limit income shifting once they had to disclose operation and profits on a Country-by-Country basis.

3.2.3 Disclosure regime: BEPS Action plan 12

BEPS action plan 12 was initiated by the OECD to assist member nations in formulating disclosure regimes for their nations (OECD, 2015:10). In this section, this BEPS action plan 12 is analysed together with the mandatory disclosure regime and a consideration is made on the possibility of it being a substitute for public disclosure of the CbCR.

The main purpose of the BEPS is to improve transparency by providing the tax authorities with timely information about tax planning which is potentially aggressive or abusive. This BEPS action plan is not just concerned with transactions that are tax-motivated but also ordinary transactions that may have a "potential tax effect" but are not necessarily motivated by tax planning (Norton Rose Fulbright, 2018). These tax arrangements have characteristics called hallmarks which initiate the transactions. The BEPS Action plan 12 report recommends that tax jurisdictions use certain hallmarks intended for their local environments.

The OECD (2015:23) indicates in its analysis that countries that have since adopted the disclosure regimes have deterred aggressive tax planning and have also improved the quality and efficiency of collection of tax information. The benefits of obtaining

information timely includes providing early warning for tax administrators regarding emerging tax risks (EY, 2018). The BEPS Action plan 12 serves to identify potential aggressive planning activities which are to be reported to the tax authorities. This disclosure to the tax authorities serves as an early warning to the authorities which would enable them to decide how to treat the said transaction. This BEPS action plan could also serve as a risk assessment tool, and with compulsory disclosure, it could serve in the same role of public disclosure due to the increased transparency and accountability. This raises a question of whether public disclosure would be necessary in light of the BEPS Action plan 12 being available for increased accountability and transparency for the reporting entity, albeit to tax authorities. However, due to the diverse reporting requirements that each country may employ, the disclosure may result in random reporting, which may even aggravate rather than alleviate BEPS (Brauner, 2014).

In the pursuit of increased transparency and to curb aggressive tax disclosure in the EU the BEP's Action plan has been adopted in the form of 'DAC 6'. The application thereof by the EU and how it contributes to tax transparency is analysed further in the next section.

3.2.4 EU Council Directive 2018/822/EU

On 5 June 2018, the Directive 2011/16/EU with respect to mandatory automatic exchange of information in the area of taxation in relation to reportable cross-border arrangements was amended by the Council of the European Union (EU) Directive 2018/822 of 25 May 2018. The directive is informally known as 'DAC 6' (Sixth version of the EU Directive of Administrative Cooperation). DAC 6 is the requirement for the reporting of European transactions or arrangements which are defined as 'tax aggressive' with an EU cross-border element by intermediaries (Norton Rose Fulbright, 2018). Cross-border reportable arrangements require that the date of application of the directive (1 July 2020) will have to be reported by 31 August 2020 and information must be exchanged between EU member countries by 31 October 2020. The range of the cross-border transactions to be reported is quite wide and may lead to exhaustive reporting obligations for both intermediaries and corporates. Reporting requirements for cross-border arrangements are triggered by meeting one of the five hallmarks or characteristics which are listed on the directive (Intertrust, 2019). These hallmarks address a rather broad range of cross-border transactions (EY, 2018). The details to be

disclosed include tax residence, name where necessary, and the connected persons of the taxpayer in question. Details of the relevant hallmark(s) of the transaction include a summary of relevant business operations and the value of the reportable cross-border arrangements, amongst other requirements (Norton Rose Fulbright, 2018).

Similarly to BEPS Action plan 12, the directive enforces a new obligation on EU-based tax advisors and other intermediaries to disclose any cross-border arrangements that contain any 'hallmarks'. Some of the hallmarks include a wide range of arrangements and transactions, including some payments which are duly deductible which are taxed at nil or close to nil when received, and connected party transactions which qualify as defined transfer pricing hallmarks, such as any transfer of difficult-to-appraise intangibles arrangements (EY, 2018). The EU directive goes even further by requiring automatic exchange of information of disclosed information with other EU member countries. The DAC Act is not yet in effect (at the time of writing). EU member states must alter DAC 6 into nationwide law by 31 December 2019. The new regulations are applicable from 1 July 2020 (Norton Rose Fulbright, 2018). Based on the purpose if this action plan, it would appear that the mandatory disclosure of "suspicious" tax avoidance transactions to tax authorities addresses the issue of transparency and could be an overlap with what the BEPS action plan 13 seeks to achieve even more with the public disclosure of CbCR.

The next sections evaluate a specific regime which, similarly to CbCR, deals with the public disclosure of tax information of MNEs; however, the disclosures made for the public are compulsory. This analysis is performed to assess the suitability of the CbCR for public disclosure based on the existing successes and challenges of the existing regime.

3.3 Public disclosure regimes

3.3.1 Background

The disclosure of the location and the identification of specific subsidiaries can reveal information on a firm's tax behaviour and tax planning strategy. This is important considering the significance of operations and tax results related to tax the jurisdictions in which firms place their business activities (Dyreng and Lindsey, 2009, *as cited by* Dyreng *et al.,* 2016:1). There are various disclosure regimes which are industry specific which currently require compulsory public disclosure of tax information for MNEs for

some information. Some of the regimes have been in existence for several years; thus it would be possible to analyse the results of the public disclosure of these regimes through the review of studies of the most common public regimes. There were two criteria used to select the regimes:

1. The disclosure regimes focus on MNEs that operate in numerous countries and/or tax jurisdictions; and
2. Public disclosure is required for the required specified information, whether it be tax information in the case of the EU Capital Directive or amounts paid to governments like in the case of the extractive industry. Further to this, the publicly reported information is done on a Country-by-Country basis.

Written studies of the selected public disclosure regimes have been reviewed. Regarding the selection specifically, Stiglingh (2017:9) analyses the Extractive Industries Transparency Initiatives (EITI), OECD BEPS action plan 12, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and the EU Article Capital Directive as the main tax transparency regimes. Forester (2017) and Ring (2017) cite disclosure regimes that address transparency and accountability as the EITI. These disclosures build trust for governance as the EU IV Capital Directive for banks. Finally, the disclosure of tax returns (in the context of this study case it would be the Australian disclosure of company and individual tax returns). The Trade Union Advisory Committee to the OECD in its study of public disclosure of the OECD CbCR analysed the EITI and the Dodd-Frank Act within the extractive industry as well as the EU Article 89 Capital Directive as the existing regimes of public tax disclosure of CbC reporting within the financial services. For purposes of this study, the Dodd-Frank Act (2010) is not analysed in this case due to the similarities of the tax disclosure to the EITI.The two criteria mentioned above are the basis for the selected regime to assess the outcome of the implemented public disclosure requirements.

This section analyses the disclosure regime's objectives and a special focus is made on the public disclosure aspect and the outcome of the regimes in relation to transparency. The disclosure regime selected is based on the significance and relevance to the objective of the study, which is to analyse public disclosure and its impact on tax avoidance.

The most prominent public disclosures selected based on literature searches are EITI, the EU Article 89 2013 Capital Directive and the Australian Tax.

3.3.2 Extractive industry

Similarly to the US Dodd-Frank Act (2010), Europe has legislation that compels companies in the extractive industries, specifically gas, mining and oil companies, to publicly disclose their tax expenses and payments on a Country-by-Country basis. The EITI is a worldwide initiative that emanated from the need to promote transparency in the extractive sector and is one of the 66 International Transparency and Accountability Initiatives concentrated on making natural resources companies more transparent and accountable in relation to their revenue payments and receipts. Established in 2002, the EITI has gained much popularity and influence and has become one of the most supported and implemented transparency initiatives within the natural resource environment. By 2016 nearly 60 countries had already committed to applying the EITI Standard (Lujala, 2018:preface).

At first it was intended as a voluntary system of extractive sector revenue disclosure for transactions and payments between companies and governments, but, the EITI has progressed into a wide-ranging mechanism seeking to enhance transparency and accountability within the entire natural resource management value chain environment. (Rustad *et al.*, 2017).

The EITI reinforces accountability and transparency and supports public trust through disclosure and reconciliation of payments by extractive companies to governments. This is done mainly at the national level of each member country through the tripartite Multi-Stakeholder Group validation system involving government, corporates, and civil society. The EITI Standard ensures disclosure of taxes and other payments made by companies in the extractive industry to governments. It also requires reporting on licencing, production, revenue collection and allocation (Poretti, 2019).

Although EITI membership is not enforced, a noteworthy number of countries and companies have been convinced to join through peer pressure and incentivised lobbying. Currently, 60 MNEs support it, and there are 52 countries that are implementing the EITI requirements (Poretti, 2019). The EITI endorses six fundamental criteria. The first three criteria deal with disclosure of information. First, it requires the ‘‘regular publication” of

“all material” mining expenditure by companies to governments, and all significant revenues received by governments from mining and related companies (Sovacool *et al.*, 2016:). The publication has to be distributed to a broad audience in a publicly accessible and comprehensible manner. Secondly, payments and revenues have to be subjected to a “credible, independent audit” of reputable “international standards”. Thirdly, reporting of expenditure and revenues has to be subjected to a verification process by an “independent administrator” who detects discrepancies should the exist (Sovacool *et al.*, 2016:180).

The EITI obliges disclosures to be “comprehensible, actively promoted, publicly accessible and to contribute to public debate”. The disclosure can reveal information such as who the beneficial owners of extractives companies are, who the holders of licences and permits are and what extractive revenues are levied. Such disclosures encourage better use of the monies paid (EITI, 2019). The policy clearly aims to enhance tax compliance, particularly in developing countries where tax income from natural resources is a major source of government revenue (UCTAD, 2015) and where concerns about company tax evasion are prevalent (Johannesen & Larsen, 2016:1).

With transparency, accountability is necessary for full impact. For any disclosure regime to have any impact as found in the case of the extractive industries, that is, there has to be some form of action taken on what has been disclosed. This assertion is made against the backdrop of developing countries where adverse disclosures were made with very little else done after the disclosures. The main shortfall with the EITI is that “EITI does not compel government that implement it to be open, accountable, and more engaged with its citizenry on the business of extractive revenues”. Therefore, it has been found to be effective only in those specific countries which are “prepared to enlighten groups of citizens to use this information to challenge government” (Sovacool *et al.,* 2016:188). What is key from the implementation in EITIs is that public disclosure is only effective if the public which is being disclosed to has a sense of awareness and is conscientised, i.e. has expectations on what the MNEs should be disclosing and thus can identify the ‘red flags’. Other than the lobby groups, it is not too certain if the citizenry of developing countries has such an awareness which is a major concern.

3.3.3 Article 89 2013 EU capital directive

After the economic crises that plagued the global financial markets in 2008, the EU embarked on a series of processes to tackle macro-economic activity, including introducing the introduction of Article 89 of the CRD IV (CRD IV) compels EU financial institutions to disclose, publicly, the revenue, the number of employees, profit or loss before tax, and tax on profit or loss respectively for every country in which operations are undertaken (Dyreng & Wolff, 2018:8; Jędrzejowska-Schiffauer *et al.,* 2019*)*.Additionally, the affected companies have to list the nature of activities of their subsidiaries and branches as well as the geographical location of each subsidiary and branch (Dutt *et al.*, 2019). The reporting requirement was effective from 1 January 2015 with the first disclosure relating to the 2019 fiscal year. Each financial institution and investment firm is obligated to disclose financial information on a Country-by-Country basis (Deloitte, 2013). Although the aim of CRD IV is to implement the Basel III model in Europe, the public CbCR requirements were a last-minute addition and were a part of wider tax transparency dialogues which were happening across government's worldwide and regulatory bodies globally (Joshi *et al.,* 2019). Just like the BEPS Action plan 13 CbCR is intended for transparency. Basel lll is an international regulatory measure introduced in 2009 after the 2007-2009 financial crises. The measures were primarily to strengthen the regulation and supervision of banks (Banks for International Settlement, 2021).

This mandatory introduction of a public CbCR - also known as CRD IV for European financial institutions - represents so far the best opportunity to assess transparency measures as anti-tax avoidance instruments (Overesch & Wolff, 2018) due to the compulsory public disclosure requirements. This disclosure regime served as the most important public disclosure regime example that was analysed for the purpose of this study as the disclosure by the banks was of tax information, and it was on a public Country-by-Country basis. When comparing the information to be reported according to the different disclosure regimes, the CbC reports of EU financial institutions comprises of more information on firms' income shifting activities than the disclosures of Australian firms and of EU firms in the extractive industries. The implementation of public CbCR for multinational financial institutions in the EU inspired the unending debate about tax avoidance particularly because in the past key figures such as effective tax payments per jurisdiction had been under the facade of "fiscal secrecy" (Overesch & Wolff, 2018:2). This newly available information has gathered much attention in the public spaces

(Overesch & Wolf, 2018:2). Like the OECD CbCR, the Article 89 of the CRD IV disclosure also requires the reporting firms to report on the name, geographical location and name of any subsidiary and branch, revenue, the average number of employees and profit or loss before tax per subsidiary (Deloitte, 2013). The goal of the CRD IV is to implement the Basel III into EU law to stabilise and reinforce the banking system, by making financial institutions to set aside more and higher quality capital as a buffer against.

The findings by Overesch and Wolff (2018:3) on the impact of CbC reporting on the banks of the EU support the stance that enforced transparency via CbC reporting limited tax avoidance of the EU multinational financial firms. Overesch and Wolff (2018) also confirmed a connection between information available publicly on international company structures and the opportunity for international tax avoidance, thus supporting the argument that tax transparency is instrumental in the fight against tax avoidance of MNEs. This enhanced transparency is emphasised by Dutt *et al.* (2019) in a similar study on public CbC reporting, which indicated that public disclosure did reveal a remarkable disconnect between reported profits and actual operations. Consequently, financial firms are less likely to partake in tax avoidance activities due to the pending public pressure which is expected from information published by CbCR. It was found tax havens account for about 18 percent of EU financial firms' total worldwide pre-tax profits, but they employ only five percent of their worldwide human capital. There has been a disconnect which has been generally observed: tax havens exhibited an average profit per employee that was 2.5 times as high as in other jurisdictions. The exposure of this mis-alignment in these CbCRs can be taken as one of the benefits of the CbCR frameworks, in particular the public disclosure. Overesch and Wolff (2018) suggest that a CbCR can further be an effective tool for policy makers to control cross-border tax planning; however, the benefits of the CbCR were expected to be limited, as found in a study by the European Union, due to the fact that financial institutions were already subject to a comparatively high disclosure requirement compared to other sectors, and it is uncertain whether the increase in disclosures would amount to additional valuable information for investors and the general public (European Commission, 2014:86). In the study by Joshi (2019) of private disclosure of banks in the EU it was found that the effective tax rates of EU financial institutions in the period post the implementation of the disclosure requirements were on average higher than those of EU domestic financial institutions. These results were similar to those of US/Canadian multinational financial institutions.

Regarding the concern of transparency and public interest, contrary to the expectation of huge public interest and pressure envisaged by lobby groups, the study commissioned by the European Commission on the public disclosure of the CbCR of the European banks indicated otherwise. Since the publication of first year disclosures in 2014, the study found limited public interest with only one significant comment appearing in the media concerning tax information disclosed by the multinational banks (European Commission, 2014:101). Without much investor reaction to the publicly disclosed information, this implies that there is not a distinctive increase in accountability demanded by investors and shareholders. This result is critical as the main objective of the legislated directive is to improve transparency against the backdrop of the global financial crisis. Linking tax planning to transparency, Overesch and Wolff (2018:34) could not establish how transparency affects tax planning behaviour which was a limitation in their study. Murphy *et al.* (2019:10) attributed the main shortcomings of the CRD IV CbCR disclosures to it not being able to reliably assess whether income had been appropriately apportioned by the reporting financial institutions to the tax jurisdictions in which they operate, and suggests that the BEPS CbCR could have similar shortcomings. Overall it can be concluded from the article EU CRD IV that public disclosure and increased tax transparency can deter income shifting.

3.3.4 Australian tax office public disclosure

The Australian disclosure tax regime example also serves as a significant one as it is a first where the tax authorities require all companies including MNEs above a certain threshold to publicly disclose tax related information.

To better inform public discussion about tax policy, the Australian Commissioner is required by legislation to produce an annual report of information about specific company tax (ATO, 2019). The corporate tax transparency population includes Australian public and foreign-owned firms with a total turnover of AUD 100 million or more, Australian-owned resident private firms with a total turnover of AUD 200 million or more, and firms that have petroleum resource rent tax that is payable (Hoopes *et al.*, 2018). The legislation was announced in 2015 and is applicable for the financial years on or after 1 July 2016 (PWC, 2018). The Australian Tax Office (ATO) has a statutory duty to report data about certain company tax under section 3C of the Taxation Administration Act of

1953 (ATO, 2019). Data in the report of company tax information is taken directly from the tax returns (ATO, 2019).

The Australian public disclosure regime also has the Tax Transparency Code (TTC) which is voluntary, and its principles are underpinned by transparency through public disclosure of information of medium and large companies (ATO, 2019). Implementation of the TTC is intended to supplement Australia's existing tax transparency initiatives (PWC, 2019). The TTC was planned to enthuse greater transparency in companies, particularly by multinationals, and to enlighten civil societies on the compliance levels of the corporate with Australia's tax laws (ATO, 2019).

What is notable about the Australian tax disclosure is that the disclosed information is just three figures which is the revenue, taxable income and the tax paid; no further information is revealed by the ATO. It was noted that most companies reported only what was minimally required. This does not provide much insight such as taxes paid per country; thus it makes this "weak transparency" (Colombo, 2019). Even though there is an option of voluntary disclosure of further information, the disclosure of minimal information could have serious implications of misrepresentation, especially where there is disclosure of little or no tax expense by an entity which has relatively high turnover with a plausible reason for the low tax expense (Butler, 2019). This is why the ATO introduced the TTC reports to curb this (Butler, 2019). These TTC reports generally include more detailed information on an entity's approach to tax and taxes paid. Potential users of information disclosed under the TTC regime may include the civil society, other interested users in the general public such as investors, business analysts, civil justice groups and the media. The TTC reports are public but they are not compulsory even though half of the Australian listed companies have volunteered to disclose, thus the disclosure is not analysed any further.

The main hindrance to the Australian tax transparency cited is that, even though the MNEs publicly disclose tax information, information can still be 'hidden' by entities reporting on their global figures which would also include the Australian figures (Butler, 2019). Thus the technical requirements are met but no further insights into the Australian operations are provided by the MNE nor is transparency achieved (Butler, 2019). Whilst the Australian Tax Authority admits that, due to statutory limits on the information that is included in their public disclosure, this entity-by-entity level report does not reveal actual

economic or accounting groupings (ATO, 2019). It is vital to note that the aggregate figures listed does not reveal the complexity of the tax system (ATO, 2019).

It was also observed in the Australian public disclosure that the disclosure can also deter compliance by companies instead of enhancing it. It was found in the study of public disclosure of private companies in Australia that private companies took more action to avoid disclosure by using the minimum revenue threshold. The companies reported lower revenue. The other effect of public disclosure that Hoopes *et al.* (2018) found was that it appeared that the public companies lowered the tax payments as they were motivated by consumer reaction to the disclosure. Similarly Dyreng *et al.* (2016) found in the study of effects of public scrutiny locations of subsidiaries of MNEs to explore whether that increased scrutiny led to changes in tax avoidance activities of those companies, that some firms that were recently compelled to disclose actually decreased their tax avoidance activities and use of tax havens relative to companies that already disclosed a full subsidiary.

3.4. Conclusion

The BEPS Action plans are consensual, i.e. area "soft-law" instruments (not legally binding) and require countries which are participants to enact legislation to give effect to the BEPS action plans. The effectiveness of all the actions depends on the commitment and the cooperation of all the governments on the enactment of the necessary legislation; otherwise, action such as exchange of information will not be possible.

A recurring theme for all these public disclosure requirement regimes is that the disclosure requirement for the main remains largely applicable to very large multinationals due to the high value threshold. The question that arises then is what is the value of all these disclosure requirements if they are only applicable to a handful of corporations? An important feature picked up from the analysis of the Extractive Industries Transparency Initiative is that disclosure is made but then what? Without the necessary MNEs being accountable for the disclosed information to the governments and civil organisations as well as lack of enforcement renders the value obtained from the disclosure minimal. In the instance of the EITI programme it seems that the programme has built up a solid structure and support in the form of 90 companies as well as over 90 institutional investors with funds under management of US$19 trillion. More than 400 NGOs are currently engaged with the EITI and millions of dollars are

spent worldwide annually to support EITI reporting. However, key problems of the programme include a general lack of interest by civil society in the information offered by EITI to the general public, and the lack of a system for holding the public sector accountable for the use of profits (Forstater, 2017). This overall renders the public disclosure as ineffective with respect to accountability.

It has been illustrated in various studies of the CRD IV hat there is a benefit in public disclosure in relation to tax avoidance activities. This was confirmed by the decrease in the activities in tax havens. However, De Simone and Olbert (2019:7) in a very recent study of the effects of private disclosure of CbCR on tax planning strategies found that firms responded to this increased monitoring by reducing just the more aggressive tax schemes by means of tax havens. Whilst simultaneously shifting investments in human capital to tax jurisdictions where the disclosure regulations originated, particularly those with low corporate income tax rates because firms seem to adjust investments in response to modifications in tax-motivated profit shifting opportunities and regulations. There also are strong indications that companies equally respond to private disclosures to tax authorities and to increased detection and enforcement risk. This suggests that making such disclosures public could possibly not be the most ideal solution as some proponents of public CbCR claim.

From the Australian regime it has been demonstrated that the public disclosure can have the unintended consequences of non-compliance as some firms manipulate the situation to avoid public disclosure and other firms (public) may reduce their tax expense for the fear of investor reaction. This has a consequence of reducing transparency and accountability rather than improving it.

An important feature of transparency and disclosure is the objective that is sought with the disclosure. It could be increased accountability, better enforcement, greater effective taxes being paid or reduced aggressive planning. In the case of the BEPS Action plan 13, the objective is for transparency to allow enforcement authorities to perform effective transfer pricing risk assessments. Risk assessment can be performed without public disclosure, but the question is, are there further benefits that can be obtained through increased publicity which can ensure better transfer pricing risk assessments? Further to this, what are the risks and costs to MNEs of publicly disclosing?

CHAPTER 4: POTENTIAL BENEFITS OF PUBLIC DISCLOSURE

4.1 Introduction

The interest in public disclosure first became a strong one in 1929 after the market crash in the US exposed many rich owners of financial institutions had paid limited to no income tax in the years subsequent to the 1929 crash. Congress then proceeded to insert a publicity provision in the 1934 Revenue Act. But before 1924, newspapers across the country commonly printed the tax details including names and other details such as actual tax payments of large corporates, celebrities, and members of the local communities (Hasegawa *et al.*, 2013:575; Dyreng *et al.*, 2016:1). Dyreng *et al.* (2016) in their study on the public pressure and corporate tax behaviour found evidence that suggested that public scrutiny and pressure could improve both firm compliance and government implementation of existing laws. This evidence is consistent with other studies (Joshi *et al.*, 2019; Slemrod *et al.,* 2013) that demonstrate that companies react to external pressure. Managers would be less tax aggressive in their approach if they perceived substantial reputational implications linked to public disclosure regulations (Joshi, 2019:9).

There are countries that are currently implementing public disclosure of tax information, as seen in chapter 3. Australia currently implements a system of income tax disclosure (Hoopes *et al.*, 2018:1). The Australian Tax Office requires disclosure of tax information, primarily the taxable income and tax payable of both public and private firms and MNEs that exceed a certain revenue threshold (US$100 million). The Scandinavian countries such as Sweden, Finland and Norway all presently require some type of public disclosure of tax information (Hasagwa *et al.,* 2013:572; Bershidsky ,2019). The disclosure required in these countries includes the revenues of firms and the profits and taxes paid by large and/or state-owned companies. In some of the countries such as Norway even returns of private individuals are publicly available on the internet or upon request from tax authorities (Slemrod *et al.*, 2013). Europe has the compulsory public disclosure for MNE investment and banking firms (as analysed in chapter 3).

Proponents of public CbCR believe it would be more beneficial if the BEPS CbCR was public. Public tax disclosure has always been a policy debate in various tax jurisdictions, international tax institutions such as the EU and the OECD. The discussion of public disclosure is an age -old one and never gets settled, primarily because there are merits

to both public and private disclosure. Richard Murphy the founder of the concept of Country-by-Country reporting (*as cited by* the Trade Union Advisory Committee, 2017) insists that the public disclosure is not just for the benefit of the various government fiscus or the MNEs but ultimately benefits the wider economic environment in which MNEs function and to which they contribute through their conduct as the information contained within is of interest to a wide range of stakeholders in the worldwide economy. Richard Murphy *et al.* (2019) envisaged the CbCR to be of use to a wide variety of stakeholders which would reinforce efforts to monitor abusive practices, corporate governance, tax payments, and global trade flows. The report would also be useful to investors and for citizens particularly of developing and emerging nations to regulate the ownership of the corporations that are conducting business in their environments and perhaps most importantly to assess what tax they are paying.

This chapter evaluates the potential advantages public disclosure could provide as opposed to private disclosure of the CbCR. Chapter 3 evaluated the impact of various methods of public disclosure as found in other tax regimes which are similar to the CbCR. This chapter expands on these findings and other benefits that the public CbCRs could have.

4.2 Benefits

4.2.1 Transparency

Many countries do not require corporations to put their records on public display. That means that whatever a MNE does in a particular country is not an issue of public record. CbCR addresses this as what a company does is of interest to the country (Tax research, 2010). It is said that public disclosure would be of great value to NGOs, civil society and journalists amongst other interested stakeholders. Some have contributed much to research on company tax avoidance thus far, and are mostly exclusively responsible for spawning the political will to resolve the tax avoidance challenge (Trade Union Advisory Committee, 2017). Hanlon (2003) argues that public disclosure of company tax declarations would assist in intensifying political pressure for improved tax policy. Public disclosure can easily direct political and public pressure towards companies that report unusually high profits in low-tax jurisdictions with no accompanying ‘substance’ which is usually employees (people) or property (Joshi *et al.*, 2019). Although there may not be a connection between the two, policymakers often choose between higher tax

transparency and associated higher tax revenues than real investment activity (Bunn, 2019).

Increasing the amount of data available can be valuable if it reveals otherwise undetected problems (Freedman, 2019), as was seen to be the case in the Panama Paper leaks which eventually led to Panama and other jurisdictions signing up to the Common Reporting Standard. The Common Reporting Standard is a set of information standards developed by the OECD Council on 15 July 2014,to obtain information from their financial institutions in different jurisdiction and automatically exchange that information with other jurisdictions on an annual basis (OECD,2020). The EU CRD IV CbCR for banking firms is already bearing fruit in the aspect of increased transparency. Dutt *et al.* (2019) were able to identify a 'striking disconnect' between declared profits before tax and real operations. Regarding the reporting of human capital and the use of the public CbCR, it was seen that, whilst tax havens make up an estimated 18 percent of EU banks' global pre-tax profits, actual employees constitute only about five - ten percent of their global workforce and make up about ten percent of their global tax expense. This is an example of the information that tax administrators may be interested in, particularly in the conduct of audits. Public disclosure is also able to enhance transparency by uncovering data which revealed in the EU financial institutions that quite a substantial part of the worldwide spread of financial institutions' reported profits and actual operations had a remarkable disconnect. This disconnect between reported profits before tax and the actual operations was found in terms of human capital, particularly with regard to tax haven locations (Dutt *et al.*, 2019).

Currently, many countries, particularly developing economies, do not have access to MNEs' CbC data. There are only three African countries that are currently receiving CbCRs, which are Mauritius, Seychelles and South Africa, and in the broader context, only 57 of the 119 countries have activated their automatic exchange of information agreements (Tax Justice, 2020). This matter of a limited number of countries that can exchange reports was also highlighted as a setback in Chapter 2. With the CbCR being made public, this would assist the tax administrators and governments of all the countries that are not part of the automatic exchange of information agreements. Freedman (2019) also supports this because it was clear in recent years that bilateral tax treaties are inadequate to ensure that tax is collected in a way that the public (and many experts) interpret it to be 'fair' and this has further undermined trust in the taxation of MNEs.

Public disclosure also benefits investors who may want more tax related information on companies they wish to invest in. Where company disclosure is inadequate, shareholders may engage with companies to demand enhancements in their disclosure of tax-related strategies. As MNEs face more attention in relation to their tax positions, shareholders are also calling for increased transparency to appraise corporates' exposure to potential earnings, reputational, governance, and wider societal risks (Ravishankar, 2018). Christians (2017:8) found empirical evidence that suggests that the market responds rather positively to companies that are seen to be meeting corporate social responsibility goals.

This growing inclination for disclosure is what led to the OECD publishing BEPS Action plan 13 CbCR (PWC, 2015; Gribnau & Jallai, 2018:16). The CbCR is not publicly disclosed for various reasons. The legal challenge for achieving public disclosure is the question if any of this information, whether currently collected by tax authorities or not, constitutes public business which the general public has the right to know (Christians, 2012:7). The European Commission argues, "In the context of a broader strategy for a fair and efficient corporate tax system in the EU, the public scrutiny of tax payments is considered a necessary measure in view of reinforcing public trust and strengthening companies' corporate social responsibility" (Forstater, 2017:24). From the analysis of the EITI it was found that EITI procedures ensured that local civil groups monitor government and company reporting of royalties and revenue and assure outside validators that they received full and accurate data (Lujala, 2018:preface).

Devos and Zackrisson (2015) claim that pro-public disclosure arguments fall into two categories. Firstly, public disclosure of tax information can bring about a lot of attention to the tax returns and will generate tips or in other ways, alert tax administrators. Secondly, the shaming factor can make taxpayers provide correct information to the tax administrators. An EY survey showed that approximately 89 percent of the major respondent companies indicated that they are somewhat or significantly concerned about media attention on their company's tax practices (Dyreng *et al.*, 2016:4). Similarly, 49 per cent of CEOs in a PWC (2014) survey agreed that a lack of trust in corporates was hindering their prospects for growth. This is an upsurge from 37 percent from the previous year. Furthermore , 75 percent of those surveyed felt that it is right that corporates pay their fair share of taxes. In the latest PWC 2020 CEO survey there appears to be a divide on the question of whether governments are doing enough

regarding the legislation around data privacy and competitiveness. This concern that companies seemingly have about their public image may lead to improved compliance levels. The next section focuses on the disclosure of information, and the impact of public disclosure on compliance of MNEs to tax legislation.

4.2.2 Compliance

More transparency can influence tax compliance argues Hoopes *et al.* (2018:1). Dyreng *et al.* (as cited by Johannesen and Larsen 2016:1) maintain that there are at least two ways through which more comprehensive reporting of tax expenditure can affect tax compliance. Firstly, the disclosed information may enable the detection of tax evasion by authorities. Secondly, it may encourage public pressure on companies with low tax rates. Transparency in the form of public disclosure of this information could also assist in assessing the efficiency of government policies in taxation and other related areas (Financial Transparency, 2016). This benefit would most probably be felt in tax jurisdictions that lack capacity in their tax administrations, which mainly are developing countries. The civil activist groups could assist the system by digesting the mass of information filed by corporates and flag any indicators of risk to the appropriate authorities (Financial Transparency, 2016). The increased disclosures can improve tax enforcement if they can provide new information to the tax authorities regarding an entity's tax affairs (Joshi, 2019).

In tax compliance, there is a tax gap which is explained as the difference between what is paid and what should be paid in taxes to the fiscus. The United States' Internal Revenue Services (IRS) (2016) explains the gross tax gap as the amount of actual tax liability that is often not paid voluntarily and timely. The gross tax gap in 2006 was estimated to be approximately US$458 billion in the US. This is with the compliance rate calculated at 81.7 percent; however, the US is a developed country. The developed countries often collect almost twice as much taxes as developing countries. Developing countries, in turn, usually collect almost as little half as much as transitioning economies (Ortiz-Ospina & Roser, 2019). It is against this backdrop that tax transparency plays a role in addressing this tax gap as it can potentially be used to identify areas where there is possible non-compliance. Although existing tax rules require MNEs to disclose a detailed breakdown of the geographical location of their financial results to tax administrators in the resident jurisdiction, such information is generally not available to

tax authorities in other jurisdictions. Laury and Wallace (*as cited by* Slemrod *et al.*, 2013:5) used empirical methods to examine the relationship between the perception of confidentiality and taxpayer compliance rate and found some evidence that suggests that when individuals perceive a breach in confidentiality (disclosure), they improve their level of compliance. Slemrod *et al.* (2013:4) in their study about Norway where tax information such as tax returns for individuals is publicly disclosed found that disclosure affects tax reporting as taxpayers at times decrease reported taxable income to minimize the attention of the media. Disclosure of company tax return data could inspire improved compliance to an extent that the disclosure leads to better financial reporting, and this might promote enforcement of tax rules. The information presented on annual financial statements is often insufficient to determine a company's tax liability or payments, but public disclosure would aid in verifying and comparing numbers that are available publicly (Lenter *et al.*, 2003:34; Hanlon, 2003). This move could enhance the capacity of tax administrators and other government agencies to monitor MNE transfer pricing (Trade Union Advisory Committee, 2017).

Another benefit of the CbCR being public is the distrust that the public may have of the tax authorities themselves. Freedman (2019) insists that the public also needs a mechanism to enable it to check up on the tax authorities. Recent state aid decisions at EU level (still under appeal) highlighted the view of the European Commission that some tax authorities of member states are giving unwarranted tax rulings, raising the issue of distrust of national jurisdictions by a supra-national jurisdiction. Increased transparency can also enhance enforcement by tax authorities. Research has shown that tax related disclosures can aid the taxing authority in determining where to allocate enforcement resources which often are scarce. For example, in the US, the IRS finds FIN 48 disclosure which is a Financial Accounting interpretation standard intended to eliminate inconsistency in accounting for uncertain tax positions, handy for tax enforcement purposes (Dyreng, 2015).

Dyreng *et al.* (2015) found non-compliant firms actually did increase their subsidiary disclosures due to the public pressure that ensued after disclosure. Moreover, the subsequent disclosures uncovered disproportionately higher levels of tax haven usage compared to the previous incomplete disclosure regime. This suggests that the 'right' disclosure requirement is effective in tax avoidance activities. With public disclosure and the revelations that an 'inadequate' amount of tax has been paid, a reputational risk

follows due to the fact that tax contributions by companies could then be compared due to the public disclosure. Lavermicocca and Buchanan (2015) noted that companies do see an increasing need for companies to be seen as compliant; as demonstrated in a survey done in 2004 where 335 of the FTSE (Financial Times Stock Exchange) 350 companies responded that they want to be seen as compliant to tax rules. Companies are likely to trade off the benefits of tax avoidance with the reputational, political and proprietary costs that rise with increased public attention (Dyreng *et al.*, 2016:1). The ultimate purpose of public tax disclosure is to discourage tax avoidance and, to an extent, tax evasion. It is hoped that taxpayers will feel reputational pressure or otherwise of not wanting to be seen as non-compliant or not fulfilling their moral duties of paying what is due to the fiscus of the countries in which they are generating income. Ideally, the tax system should be fair, and a public view of this can be beneficial as public perception of fairness might increase voluntary compliance with tax laws. The converse could also be true: if disclosure eroded public confidence in the fairness of the tax system, then there would be less compliance (Lenter, 2003:34).

4.2.3 Tax collection

MNEs are inevitably big taxpayers because of their sheer size. They also have the resources to avoid paying taxes, particularly in developing countries. Bouvatier *et al.* (2017) found in the study of the banks in tax havens and CbCR in the EU that the public CbCR is an effective tool to enhance transparency as tax havens provide tax savings for the banking firms. The increased transparency for the EU Article 89 CRD IV has shown that the number of tax havens significantly decreases after the introduction of the public disclosure legislation, and the effective tax rates of tax havens increased. This is as a direct result of the public disclosure. To the extent that the international tax system permits structures that reduce tax liabilities, some companies will use these structures (Freedman, 2019). Given the opportunity in terms of financial treatment, companies decrease the extent of disclosures in an attempt to hide their tax avoidance behaviour. Specifically, by shifting profits from high tax jurisdiction to low foreign tax jurisdictions to avoid taxes, they would choose to lessen their transparency related to foreign operations to make tax avoidance behaviour difficult to detect (Hope *et al.*, 2013; Markle, 2014:6).

From a study that Bouvatier (2017) did on bank tax havens and CbCR, it was estimated that banks saved approximately between €1 billion and €3 billion in tax due to the

utilisation of tax havens with lower tax rates. With the decrease of the use of tax havens by banks seen in the EU after CbCR was implemented for the banks, it would be reasonable to assume that the effective tax rates of the banks increased the benefit of the jurisdictions that the banks operate in. Similarly, it was found that the effect disclosure of CbCR, in particular public disclosure, had on tax planning strategies was that companies generally increased monitoring by reducing exploitative tax strategies through tax havens and the like (De Simone & Olbert, 2019; Dutt *et al.*, 2019; Overesch & Wolf, 2018). Further to this, after the mandatory CbCR came into effect, the European multinational banks increased their tax expenses relative to banks unaffected by the regulation due to a higher probability of tax avoidance detection. Joshi's *et al.* (2019) found that higher detection risk, public pressure and enforcement improvement in the affiliate home jurisdiction resulted in a bigger decline in tax avoidance activities of participating banks.

Early evidence and the prediction of earlier studies on the outcomes of the EU CRD IV on the taxes paid by these multinational financial institutions have shown consistently that the tax rates of EU banks have increased subsequent to the introduction of Article 89 CRD IV (Dutt *et al.*, 2018:07; Joshi *et al.*, 2019*),* albeit a marginal increase was reported (Joshi *et al.,* 2019). The increase in the effective tax rate of those exposed banks was calculated by Overesch and Wolff (2018) to be 3.7 percent higher relative to other banks which were not located in European tax havens. Bouvatier *et al.* (2017) in a study of bank havens and CbCR in the EU also showed that banks in tax havens saved substantial amounts in taxes due to the reduced tax rates in the said havens, whilst interestingly enough private disclosure of the same CbC tax information to tax authorities has shown a similar decline on tax avoidance motivated profit shifting (Joshi, 2019).

It is no secret that big corporate taxpayers' emphasis on delivering a very low effective tax rate - just like operating costs - is treated as such (OECD, 2008). It was also illustrated quite clearly in the analysis in Chapter 3 that there is an increase in tax payments by MNEs when the tax information is made public. Hanlon (2010) analysed private tax return data to show that companies usually declare higher interest expenses on those tax returns than in their public financial accounts. This significantly supports the view that public disclosure does have a positive impact on tax payments.

4.2.4 Transfer pricing

One of the main ways MNEs achieve profit shifting is through transfer pricing (Colombo, 2019; Lohse & Riedel, 2013), hence the BEPS Action plan 13 focuses on the profit shifting risks through the use of transfer pricing. Some of the shifting means are related to the intentional distortion of prices for intra-company transactions, especially in MNEs with assets such as intangible property holdings. Many countries enact transfer-pricing legislation as a countermeasure to lessen transfer mispricing. Strict transfer pricing regulations may increase the cost of transfer mispricing and are generally effective in limiting the extent of profit shifting in developed economies (Liu *et al.*, 2017:6). Lohse & Riedel (2013) found in a paper that empirically assessed whether transfer pricing regulation is effective in reducing multinational income shifting behaviour that tighter transfer pricing regulations are effective in reducing profit shifting. For that purpose, information was collected on transfer price legislation in 26 European countries over the past ten years and was linked with panel data on multinational companies in Europe. The findings suggested that multinational income shifting activities were remarkably reduced when countries introduced or tightened transfer price documentation requirements. These results indicated a reduction of approximately 50 percent, with firmer rules prompting stronger declines in shifting activities. The BEPS Action plan 13 has transfer pricing rules specifically related to the minimum documentation to be maintained for transfer pricing transactions. A further step in public disclosure could further enhance the effect that these regulations have on documentation requirements.

Finally, comprehensive tax transparency through public disclosure of tax information has been discussed as an alternative approach for targeting tax avoidance (Overesch & Wolff, 2018:preface). There has been keen interest recently by policymakers at the OECD in the transparency of corporates on tax information and in particular the curbing of anti-avoidance by MNEs through the BEPS action plan project (Brauner, 2014). Corporate tax transparency regulation needs the disclosure of key financial data and actual tax expenditure and are envisioned to indirectly curb tax aggressiveness by putting pressure on chief officers and financial officers of MNEs.

4.3 Conclusion

Several MNEs are already voluntarily reporting their CbCR publicly, including (among others) Vodafone Plc and Unilever. These MNEs have not deemed the risks of public

disclosure (which are discussed in the next chapter) high enough for them not to disclose. The key benefit highlighted for public disclosure is improved tax collection and tax transparency. It was highlighted in Chapter 1 that Country-by-Country Reporting is part of the 15 BEPS action plans to curb challenges with profits shifting and tax planning policies to take advantage of gaps and mismatches in tax regulations. Specifically, the BEP's Action plan 13 aims to address the lack of comprehensive, relevant and timely information on exploitative aggressive tax planning. It would appear that public disclosure of the report does aid the overall objective of the BEPS Action plan as the increased transparency of public disclosure does have an overall impact on tax planning and tax avoidance of the MNEs as illustrated in this chapter.

Richard Murphy (2020) summarises the role of public disclosure as follows: "civil society needs this data, not least because civil society is the basis for all political accountability for tax legislators, tax authorities and the taxpayers who enjoy the right of limited liability that society alone grants and which multinational corporations enjoy. There is nothing in CbCR as originally proposed that should need to be secret, the business that says otherwise is asking to opt out of its responsibilities to society." Overall there seems to be a positive relationship between increased transparency through public disclosure and a decrease in international tax avoidance activities, and this is in tune with the purpose of the OECD BEPS Action plan.

As mentioned in Chapter 2, many countries that are part of the CbCR programme still do not have access to the reports because they are not party to the automatic exchange of information agreements. The public disclosure would capacitate those countries that ordinarily would not get the data as it would be available publicly because even countries with strong economies are not influential enough to adequately enforce their tax legislation pursuant to the current regime without collaboration and transparency (Brauner, 2014). This is mostly true for developing countries which lack the exchange agreement networks.

Sceptics of public CbCR contend that it is quite unclear whether, and to what extent, any public CbCR will result in further insights and benefits to the tax authorities, regulators, and the civil community (Evers *et al.*, 2016). Foreign operations of multinationals, especially those of banks, are currently already subject to numerous financial and regulatory disclosure requirements for tax and accounting purposes. Regulations in most

European Union countries already require private disclosure to authorities of specified tax information, including payments and transfer pricing documentation by companies (Joshi *et al.,* 2019). Joshi's (2019) study examined the MNEs' tax avoidance behaviour to private disclosure of tax activities. The importance of Joshi's (2019) study is that it illustrated that even with private disclosure a reduction in tax-motivated income shifting is associated with a corresponding decline in firms' level of tax avoidance.

The next chapter evaluates the risks that arise from disclosing the report publicly.

CHAPTER 5: CHALLENGES AND RISKS OF PUBLIC DISCLOSURE

5.1 Introduction

Section 4 of the Income Tax Act, Act 58 of 1962, as amended, contains peremptory provisions barring the Commissioner for the from revealing any taxpayer information to persons other than the taxpayer (SAICA, 2009). Taxpayer information confidentiality is one of the underpinning principles of any tax system. The South African tax administrator ensures privacy of taxpayer information by subjecting all SARS officials to an oath in terms of Section 67 – 69 of the Tax Administration Act (28 of 2011) Tax administrations have an obligation to keep safe tax information of its taxpayers. In South Africa, this right is enshrined in the Constitution of the Republic (108 of 1996). Section 14 of the Constitution speaks to the right to privacy of all persons. This includes taxpayer rights. Section 32 of the Constitution provides a contrasting right to the State to grant access to any information held by the State. It goes even further to grant the State the right to provide information that is held by another person and that is necessary for the exercise or protection of any rights (South Africa, 1996).

Privacy is necessary as it is a human right and is necessary for autonomy. Hence legal systems in different countries have regulations to protect the privacy of individuals except if there is a strong case for public interest (Forstater, 2017). Professor Westin (as cited by Forstater, 2017:24) contends that "privacy is a necessary element for the protection of organizational autonomy, gathering of information and advice, internal decision-making." Globally, other tax administrators have similar tax secrecy provisions. Since 1976 in the US, the founding rules governing disclosure and confidentiality are found in Section 6103 of the Internal Revenue Code. These rules ensure that IRS officials and specific state government officials have access to returns. Disclosure of this information is prohibited except under restricted special circumstances (Lenter *et al.,* 2003).

Public disclosure of the BEPs' CbCR has been anticipated for a while, especially after the EU CRD IV (discussed in Chapter 3) was made to be a public disclosure (Forstater, 2017; Joshi, 2018). As seen in the close vote in the EU for public disclosure, disagreements still exist regarding the benefits and risks of public disclosure globally. Governments across the globe have a split view as they see the need to balance a need for increased transparency as illustrated in Chapter 3 and the need to protect the exposure of MNEs operating in their tax jurisdiction as will be illustrated in this chapter.

It was noted in a Bo *et al.* (2014) study that the 'shaming effect' was more pronounced in the companies which were more 'reputation sensitive'. Many opponents of public disclosure bemoan the costs that would be incurred should the disclosure be public (Trade Union Advisory Committee, 2017; Forstater, 2017; Evers *et al.*, 2016). The biggest concern raised by the parties on public disclosure is the breach of confidentiality that could affect the competitiveness of the firms (Evers *et al.,* 2016; Forstater, 2017; Devos & Zachrisson, 2015).

Given the opinions on both sides of the discussion, there is no commonly accepted definition of tax avoidance (Hanlon, 2010). The benefits and risks of related topics on profit shifting are interpreted purely based on the view of the reader. The OECD refers to BEPS as instances where the interface of different tax rules leads to no taxation on one party or double non-taxation. It also relates to specific arrangements that result in no or low taxation by shifting income to countries with lower tax rates (OECD, 2013:10). As illustrated in Chapter 4 and to an extent in Chapter 3, there are benefits to the increased disclosure albeit mainly to the fiscus of the tax jurisdictions where the MNEs are operating. This chapter looks at the converse, i.e. the disadvantages for the MNEs that could arise from public disclosure of the CbCR.

Based on the benefits identified in chapter 4, this chapter explores how public disclosure is risky to the affected groups which are the MNEs, government authorities, investors, lobby groups and the general public. The potential disadvantages and risks mainly to the MNEs of public disclosure, are explored.

5.2 Risks of public disclosure

Forstater's (2017) view on transparency warns that as much as there is a need for more effective markets and a firm social agreement between the people and their governments, tax transparency is not an end in itself but the goal to achieve in terms of the list of complex problems it seeks to address (Oats, 2019:566). The major concerns with public disclosure stem from lack of confidentiality; however, there are other concerns regarding public disclosure. The costs of public disclosure are difficult to quantify due to the fact that the BEPs CbCR is still a relatively new regulation and the public CbCR requirement is not actually in existence. However, Forstater (2017) lists administrative costs, costs of publication and dissemination of information and, lastly, loss of confidentiality as the top three costs of public disclosure.

Evers *et al.* (2016) cites:

1. Competitive disadvantage as a cost for public disclosure due to the publishing of information which could potentially be sensitive commercially;
2. Opportunities for double taxation in particular in transfer pricing where the global formulary apportionment system could be applied; and
3. Some opponents of public disclosure assert that the public disclosure of corporate tax could result in the loss of proprietary information for firms (Hasegawa *et al.*, 2013).

Proponents of private disclosure of the CbCR cite confidentiality as a major challenge with public disclosure (Forstater, 2017; Evers *et al.*, 2016).

Based on the risks mentioned above, the risks assessed on public disclosure would violate secrecy, thus resulting in commercially sensitive information being exposed and thereby affecting competitiveness. The reputational risk of public disclosure would also increase, which includes transfer pricing risks. These risks are analysed in the next section.

5.2.1 Confidentiality

Confidentiality of taxpayer information is generally a founding ground of tax systems in all societies. In order for taxpayers to gain confidence and to comply with their tax obligations, taxpayers have to be assured that their private information is not disclosed unnecessarily and in an inappropriate manner. Failure to properly manage the responsibility of confidentiality can dent the integrity of the administration whose audit capacity the expert is working to build (Tax Inspectors without Borders, 2020).

There are arguments that public CbCRs would be unfairly used by competitors to gain insight into business practices of the entities required to disclose, therefore putting the disclosing entities at a disadvantage resulting in the loss of the competitive advantage that would have been gained from good tax planning. “It’s not just reputational risk, but wider business competitiveness” (Mehboob, 2019). One of the major obstacles cited by companies for public disclosure Country-by-Country reporting is the impact that the public disclosure could have on the competitiveness of the MNEs that would have to disclose (Transparency International, 2016; Trade Union Advisory Committee, 2016;

Evers *et al.,* 2016). Forstater (2017) also mentions the confidentiality risk to the MNEs as a cost to the public disclosure and a general decline in tax morale and trust of perhaps other taxpayers when they observe how much tax is paid by the major MNEs. The public disclosure could also result in unfair competition for the big MNEs as the smaller ones that are below the CbCR threshold would have a distinct advantage of not having to disclose their transfer pricing of commercially sensitive information. In contrast, public disclosure would be restricted to large MNEs in specific countries (Evers *et al.*, 2016). There were concerns raised by the countries who are against public disclosure in the EU vote for the public disclosure of the EU CbCR. The concerns raised were that it could put multinationals in European Union countries in a situation where they were very uncompetitive as compared with their MNE peers that did not have to disclose (Mehboob, 2019). Oats and Tuck (2019) contend that the petition for more transparency is actually the demand for more information which does not necessarily become translated into better understanding or even result in a change in attitudes towards tax. There is a fear that publishing CbCRs would lead to accusations and misunderstandings, feeding further public mistrust. In particular, there is a concern that additional disclosure would not adequately enhance public debate any further beyond the current status quo whereby companies facing public criticism claim that they are fully compliant with the tax laws (Forstater, 2017).

A contrasting view to confidentiality is that public disclosure assists as it prevents leakages like in the Lux leaks and Panama Papers. With the advanced technologies, it has been difficult to prevent leakages and prevent security breaches (Freedman, 2008). Thus it becomes difficult for the MNEs to control the narrative of their tax planning structures if the information is leaked by other parties.

The Trade Union Advisory Committee (2016) argues that the financial information to be disclosed, including records, is not necessarily a trade secret, business or other secrets. Evers *et al*. (2016) argues that even the private disclosure of tax data with the CbCR potentially violates tax privacy, a fundamental principle of tax law in many countries globally. Evers *et al.* (2016) also argue that the lack of confidentiality could spread to impact the competitiveness of the MNEs. Prior research shows that proprietary costs are the biggest form of disclosure costs, and these costs arise because a competitor might copy the proprietary information enclosed in publicized information (Bozanic *et al.*, 2017).

Transparency International (2016) completely refutes this claim on competitiveness in a study on the impact that public CbCR had on specific companies. The key findings were that the impact of public disclosure was not highlighted as a key feature or detractor from the performance by any of the companies assessed. In fact, in Europe, 43 percent of the CbC reporting MNEs assessed showed an improvement in their competitiveness. The research found that a wide list of factors influences the performance of MNE companies regardless of their listing origin or inclination for public CbCR. Further to this, most of the MNEs assessed in the study improved or at least maintained the same revenue performance during the assessment period.

There is case law on violation of secrecy of taxpayers' tax information such as Garner (Garner v. United States, 1974) and Sullivan (United States vs Sullivan,1927) where it was determined that the US government did not violate a criminal defendant's rights by providing the defendant's tax return as evidence to prove that the defendant had been participating in illegal gambling activities. In the Sullivan case it was determined that a taxpayer could not use confidentiality of tax returns to escape criminal prosecution when the defendant refused to file a tax return because their tax return would inevitably reveal income from unlawful activities. The two cases do not explicitly address whether public disclosure is a constitutional right. But the decisions in the two cases illustrate a need for balancing of interests in which the government has to consider administering the tax rules to balance individuals' privacy desires.

5.2.2 Reputational risk

The main argument against public disclosure is mostly centred on confidentiality and the invasion of individual privacy. Seeing that private CbCR can decrease profit shifting to tax, increasing financial transparency due to a new CbCR should see an increase in reputational costs (Hombach & Sellhorn, 2018). Reputational costs are a concern to companies such that Starbucks acknowledged that its reputation was affected by the accusation of tax evasion and that the perception did result in its sustainability in carrying on business in the UK being affected (Lavermicocca and Buchanan, 2015). Similarly the MNEs could face similar costs should the CbCR be made public. The cost of public perception for Starbucks was so much that it volunteered to pay £20 million in company tax between 2013 and 2014 despite this affecting the profitability of the entity for those

two years. This is an illustration that big corporates do consider public perception a concern.

A survey among taxation executives of U.S. companies suggested that managers are very much concerned with the reputational impact associated with corporate tax planning (Graham, Hanlon, Shevlin and Shroff, 2014). Lenter *et al.* (2003) and Hoopes *et al.* (2018) also support this as they detected changes in tax payments, investor confidence and company share prices after income tax returns were made public in Australia. The importance of transparency and trust was also highlighted in the 2014 PWC CEO survey where half of the participants had a concern about trust.

Costs of public disclosure can mean the cost related to harming the image of the MNE being seen as a tax evader. This has an impact on the consumer and may influence their willingness to patronize the company; this is called 'brand damage'. Bad publicity spreads quickly, and the reputational harm of such attention that public tax information could bring can prove to be very costly to the discloser (Dyreng *et al.*, 2016:3). The significance of these costs is not yet to be quantified due to the difficulty due to the nature of the costs (Weir & Reynolds, 2016:6). Company tax avoidance undertakings may imply underlying operational, reputational, legal, and financial and governance risks. Investors now recognise that corporates that pursue aggressive tax planning activities may signal the board's or management team's risk tolerance. High risk tolerance can lead to several damaging outcomes for the company (Ravishankar, 2018). In a study conducted on consumer perceptions on corporates after returns were disclosed publicly, 79 percent of the respondents indicated that they consider good corporate citizenship when making buying decisions of a company's product or service, and 71 percent consider the country of origin in deciding whether to buy a specific company's shares (Lenter *et al.,* 2003). However, there is no decisive evidence linking corporate performance to these consumer views. It is also not too clear how information from corporate tax returns would impact public perceptions (Lenter *et al.,* 2003).

Freedman (2019) argues that, despite all the information that has been leaked and that is now coming forward from new disclosure requirements, it is not clear whether the current public, media and political debate on taxation is sufficiently informed to interpret the disclosed information correctly. This could result in the information not being useful and serving the purposes of informing or educating the public. Lenter *et al.* (2003),

regarding increased public disclosure for MNEs, argue that increased disclosure would not necessarily result in a more informed public, as the comparison of the corporate tax returns to other publicly available information could prove to be a rather complex and onerous process. One of the examples of this point is the accounting versus tax treatment of financial transactions. While the accounting rules commonly require just over 50 percent, and require consolidation of foreign-controlled entities, tax rules differ as they instead require 70 percent holding in tax jurisdictions such as in South Africa. For these reasons, Lenter *et al.* (2003:25) assert that public disclosure of company tax returns "poses great potential for confusing rather than enlightening investors". However, Lenter *et al.* (2003:25*)* contend that with sufficient time and expert knowledge information of public returns could be of use when correctly interpreted. The appropriate response might be not to challenge increased disclosure, but rather to resolve the intricacies involved in tax. Generally, more disclosure and complete information can cause difficulties, but they are the foundations of a well-running economy.

The case of the extractive industry, as seen in Chapter 3 serves as such an example where additional disclosure has not resulted in much action from the broad stakeholders due to a lack of accountability. A similar pattern was observed with EU CRD IV, where the public interest has been seen to be limited after the public disclosure. There are concerns that transparency will not at all times increase trust and might even do the opposite. Sometimes transparency can result in misunderstanding and failure to understand or utilise adequately the information that is made available, with far-reaching consequences which perhaps can even lead to loss of trust (Freedman, 2019). Arguments for public disclosure calling for more disclosure may seem conflicting when there are growing concerns about privacy; however, Appelbaum (2019) argues that income taxation is an act of government, not an aspect of private life and should be like property tax whereby local governments may disclose the details such as the name of the property owner.

5.2.3 Other risk factors

5.2.3.1 Compliance costs

Research that examines the implementation or abolition of the transparency initiatives mentioned above commonly records that companies recognise the often significant costs associated with the nature of such disclosures and try as much as possible to avoid or

minimise the amount of information that is publicly disclosed (Hasgawa *et al.*, 2013; Hoopes *et al.*, 2018; Hope *et al.* 2013; Joshi, *et al.,* 2019). This is in line with what the Tax Foundation (2019) also found that CbCR policies can have several mechanisms that lead to a bigger tax burden on multinational companies. MNE's may simply decide to increase their tax burden just to avoid the increased scrutiny arising from the increased disclosure of their world-wide operations.

With public disclosure of the CbCR, both compliance costs linked with the CbC reporting and costs related to reputational risk monitoring and mitigation are most likely to increase (Koppel & Stauner, 2020). It was found in Chapters 3 and 4 that increased transparency can improve the compliance rate of taxpayers, but the same increased transparency mechanism can be counter-productive. Slemrod *et al.* (2013:4), in a study about Norway where tax information such as tax returns for individuals is publicly disclosed, found that disclosure affects tax reporting as taxpayers may be more inclined to avoid the scrutiny of the press and public arising from the reported tax returns. This was also found in the case of the Australian corporate tax disclosure regime as seen in Chapter 3 where private corporates had to publicly disclose financial information after a recent tax amendment which required public disclosure. Some firms reduced their tax payments because of the new disclosure requirements due to investor concerns which they have in mind. From the EITI mixed results on compliance were found. In December 2007 the EITI made a distinction between candidate and compliant countries. A country that has made very little progress in line with the requirements of EITI is termed a candidate country. The distinction between the two helped with compliance standards which improved EITI implementation.

There are concerns that, from the onset, the OECD's tax-transparency and information-exchange initiative has fostered conditions for artificial compliance due to the significant costs of non-cooperation; and third-party monitoring costs of compliance can be substantial. (Woodward, 2016:105). There are further potential 'indirect' costs of disclosure, such as possible litigation and proprietary costs (Grossman & Hart 1980; Merkley, 2013 as cited by Bozanic *et al.,* 2017). Bozanic *et al.* (2017) further argue that disclosing more information on a taxpayer's tax structuring position may strengthen the position of the authorities and weaken the company's bargaining power in the related tax disputes. In contradiction to the said costs of public CbCR, Owens (2015:6) maintains

that the costs linked with making CBCR public are “negligible”; publishing CbCR may prove to be cost-beneficial for MNEs and tax authorities.

5.2.4.2 Enforcement costs

Transparency is a costly regulatory strategy, not only for those required to disclose information but also for those who have to analyse it like tax administers who already have limited resources (Oats, 2014). Bozanic *et al.* (2017) examined how public and private disclosure requirements impacted tax enforcement and found that IRSs’ scrutiny increased following a rise in the public tax-disclosure requirements but decreased following a surge in private tax-disclosure requirements (e.g. uncertain tax benefits). Private disclosures increase tax enforcement only if they provide new information to tax administrators on a company’s tax affairs (Joshi, 2019:11). Therefore, this has an implication that no additional attention would be given by tax officials due to public disclosure.

In another evaluation of EITI and its main objective of transparency, Brunnschweiler *et al.* (2019) and Scanteam (2011:26) found that, based on their audited accounts, extractive industries seemed to be paying what is due, but, the state’s capacity to validate and regulate through tax assessments and audits was feeble and needed strengthening both at the agency level and systems levels. This speaks to the capacity issue as improved transparency could not be exploited by the regularity agents that should have been verifying such information.

There is a concern that the cost of public CbC reporting could also result in constraints in the enforcements as tax authorities may be inundated with lots of information to process; as it is, tax authorities globally are already overly constrained (Oats, 2019). Institutions such as tax administrators could use public information signals from companies, such as periodically filed financial disclosures, to consider its decision of whether, and to what extent, to audit a firm (Bozanic *et al.,* 2017:8; Oats, 2019). With the possible increased tax audits of MNEs that could be conducted due to the increased disclosure, the costs of complying with and monitoring tax transparency activities by tax authorities could eventually be borne by civil society as MNEs may seek to clawback the cost, for example through increased prices for the products or services they provide (Oats, 2014). Also, there are findings that suggest that increased monitoring by high-tax countries may not necessarily result in a reduction in tax avoidance activities but rather

induce companies to take actions to better support tax avoidance structures in non-haven and low-tax jurisdictions (De Simone, 2019).

5.2.4.3 Transfer pricing

The risk of tax administrators using the global formulary apportionment method rather than the arm's length principle which has been adopted by many countries when assessing transfer pricing exists. As much as the risk is always there, even with private CbCR however the risk is increased with public disclosure. There is a risk that the information may be abused, mainly by non-OECD countries, to adopt the more aggressive method, one that is based more on profit-split and pre-determined formulary re-apportionment as well (Evers *et al.,* 20160; Forstater, 2016). There are also fears that, without additional context, the taxpayer may be duly following the arms-length principle but may be seen in a negative light due to the additional information that is disclosed which may be misunderstood. Misunderstanding of the information contained in the CbCR or scant context are possible risks (Koppel & Stauter, 2020).

The worldwide transparency arising from CbC reporting, added with possibly incorrect applications of the BEPS concept by local tax authorities, may lead to considerable increases in controversy and audits (Koppel & Stauter, 2020). The OECD has provided procedures and guidelines on how the arm's length method can be determined. But, the arm's length prices can be problematic to follow, particularly for unique intangibles, and unusual or unfinished products and services (PWC, 2006). This difficulty in finding exact market price matches for inter-company transactions always leaves MNEs some discretion in determining the appropriate transfer prices (De Simone *et al.*, 2019:34). The disclosure of company financial data that comes with CbC reporting in combination with intensified awareness of transfer pricing resulting from the OECD BEPS project is anticipated to increase the number of tax disputes worldwide. Public disclosure may further increase these disputes (Koppel & Stauter, 2020). Due to the looming public disclosure, the MNEs could want to re-assess their existing transfer pricing strategies which they may want to change to avoid audits or for reputational reasons (Owen, 2015).

5.3 Conclusion

At times public disclosure transparency will not always grow trust and might even weaken it. Sometimes this loss of trust could very well be warranted and might assist in bringing

about necessary change, but at other times increased transparency can lead to gross misapprehension and the incapacity to correctly utilise the information that is being made available (O Neal as cited by Freedman, 2019:125).

There are compelling reasons for public disclosure, as illustrated in Chapter 4. This chapter provides evidence of the increased risk of the CbCR being public together with the increased tax paid, as seen in Chapter 4. In the same breath there are risks to the MNEs and to an extent even to the national fiscus. The risks and benefits differ according to the perspective of the reader. There is not a conclusive answer on whether the benefits justify the cost for public disclosure or, the other way around, whether the high costs of public disclosure justify only private disclosure. What is certain is that the costs are experienced differently by the affected parties.

Joshi's (2019) study examined the MNEs' tax avoidance behaviour to private disclosure of tax activities. The importance of the study is that it illustrates that even with private disclosure, a decrease in tax-motivated profit shifting is also associated with a corresponding decline in firms' level of tax avoidance. This reduction was supported by an increase in effective tax rates of European MNEs post the implementation period.

The evaluation of possible economic consequences of CbC reporting conducted by PWC showed that there is high expectation that the report could eventually be publicised (Mehboob, 2019). There are suggestions that firms should even start preparing information for the public CbCR now. The MNEs should prepare their CbCR in a manner that it could easily be disclosed in a public domain (Owens, 2015). Some tax regulators in jurisdictions globally already have access to all tax returns of taxpayers and access to non-tax information. This makes the argument for disclosing company tax returns from the tax administrator's point of view, less persuasive (Lenter *et al.,* 2003).

CHAPTER 6: CONCLUSION

6.1 Introduction

In 2015, the OCED adopted what is known as the 15 BEPS Action plans to address an increase in profit shifting activities used by MNEs to reduce their tax liability. Specifically, legal loopholes within the international legal framework are used to shift profits. Transfer pricing was found to be one of the ways that profit shifting is facilitated by MNEs that operate in high and low tax jurisdictions. A call was made by many governments in the EU as well as other states associated with the OECD. The OECD has been striving to improve international tax transparency. The BEPS Action plans 12 and 13 address the transparency agenda. BEPS Action plan 13 requires private disclosure to tax administrations; however, there are strong calls for the BEPS Action plan 13 CbCR to be published publicly as there is a belief that only then would the transparency mandate be sufficiently fulfilled. However, the OECD clearly states that the purpose of the reporting is to assist the tax authorities in tax jurisdictions in identifying transfer pricing risks of MNEs just for auditing purposes. The CbCR is said by the OECD to improve transparency by ensuring that the MNEs produce transfer pricing documents that will assist the tax authorities to conduct transfer pricing audits. The CbCR is private, and there have been calls from various lobbyists to make the disclosure public for the sake of increased transparency and accountability. Therein lies the whole purpose of the study which sought to explore the possibility of public disclosure by the MNEs of the CbC as well as the benefits and risks attached to it.

The debate on tax transparency has compelling arguments on both sides regarding the success of public CbCR in mitigating tax-motivated profit shifting. Proponents of public CbCR maintain that it has high potential to reduce tax-motivated income shifting by providing stakeholders with more consistent and precise information on the geographic breakdown of the tax liabilities of MNEs (Forstater, 2017). On the other hand, sceptics of public CbCR contend that it will not have much impact on the firms' tax avoidance practices because most European countries have already required multinational financial institutions to disclose wide-ranging tax information, including transfer pricing documentation and tax payments (Joshi *et al.,* 2019:2). Additionally, some contend that common tax planning strategies engaged by MNEs are mainly based on uncertainties in the tax regulations that are not themselves illegal (Evers *et al.*, 2016).

6.2 Findings from the chapters

Chapter 2 analysed the reporting requirements of the CbC report, and it was found in particularly with the revenue and the basis on which it is disclosed that there was a lack of consistency. This would ordinarily not be much of a concern save in the situation where information is disclosed publicly. The recipient of the public document could end up comparing incorrect information. For public disclosure to be possible, it would be imperative that reported information was comparable and easy to interpret. It was also found that public disclosure would be particularly beneficial for those countries that do not capacity due to the fact that they are not part of the automatic exchange of information networks.

Chapter 3 analysed prominent existing public disclosure of tax information for MNEs. The few studies that quantified the impact of tax expenses incurred by MNEs' public disclosure versus the non-public have found a minimal difference in the two. The difference, found specifically in tax related disclosure, was the reduction in the number of tax havens utilised by banks in response to the public Article 89 CRD IV. Another notable finding in the studies was the increase in the effective tax paid by the MNEs' financial firms that had to undergo public disclosure under Article 89 CRD IV compared to those that did not.

Chapters 4 and 5 analysed the potential costs and risks anticipated with public disclosures, and it was found that these are weighed differently by the different stakeholders. There is not a perfect science to determine whether the benefits outweigh the costs or the other way around. It was found that there were strong arguments for both public and private disclosure.

6.3 Conclusion

In the analysis of the benefits of public disclosure of the CbCR it was found that there would be an overall decline in tax avoidance activities after public disclosure, like the EU capital directive on banks when it became public. The tax rate of MNEs post public disclosure of various regimes saw a direct increase in the effective tax rates of the MNEs that had to publicly disclose unlike before. This is probably the most significant benefit of public disclosure when assessed against the target to reduce tax avoidances engaged by MNEs on cross border transactions.

The challenges with public disclosure were found to mainly concern the confidentiality of MNE information. The disclosure of certain transfer pricing information may undermine the competitiveness of MNEs through the possible disclosure of trade secrets. It could be a disadvantage to the MNEs that have to disclose as opposed to the ones that do not have to disclose similar information. Reputational risks are another cost that MNEs could incur through public disclosure due to the misrepresentation of the information that is disclosed, particularly to an uninformed public. MNEs may suffer discrimination from the public, potential investors, and even tax administers, which could result in increased tax disputes. Compliance may be increased as MNEs may increase their tax liability to avoid public and tax authority scrutiny. The MNEs could face increased scrutiny from tax authorities, particularly from ones not part of the OECD.

Based on the analyses from the chapters, it is concluded that public reporting would indeed make a difference regarding tax avoidance activities by MNEs using transfer pricing; however, the additional impact has been demonstrated to be minimal when compared to existing private disclosure . The issue of transparency has also been analysed, and the evidence of it is varied and opposing as it does seem that there would be benefits and disadvantages when it comes to the tax transparency agenda.

The objective of the research study was to critically analyse the BEPS Action plan 13 requirements with the possibility of public disclosure by the MNEs of the CbCR as a further enhancement to the current disclosure requirements. Chapter 1 established that the purpose of the OECD CbCR is to address profit shifting through reporting, which is anticipated to increase transparency and reduce tax avoidance of MNEs. In meeting the secondary objectives the content and requirements of the report were analysed and it was found that the data source of the reported information may not always be the same would result in reporting discrepancies in the type of information that is reported by each MNE. The sensitivity of the reported information was also found to be a matter of concern. In meeting the objective of analysing the importance of public disclosure of tax information, the relationship between the public disclosure and tax avoidance was explored extensively through the review of existing public disclosure regimes. The potential benefits and risk of public disclosure were analysed in meeting the final secondary objectives

6.4 Answer to the research question

The research question of this study was: Are there any benefits and risks of public disclosure of the OECD BEPS Action plan 13 Country-by-Country Report? The answer to that question based on the analysis performed in all the chapters of this study is that there is certainly a benefit to be obtained from the public disclosure because of the increased transparency. However, the benefit is marginal in relation to aggressive tax planning and avoidance activities; thus it does not appear as if the costs for this public disclosure outweigh the benefits.

6.5 Limitations to the study

The BEPS action plan 13 CbCR is actually private. It is therefore difficult to hypothesise about the benefits and challenges of something that has not actually happened. The study does not compare the actual impact of income shifting and tax avoidance activities from private disclosure to actual public disclosure of the BEPS CbCR, hence the use of other existing public disclosures as a comparison. The comparison with the extractive industry was limited as there has not been a period where the disclosure of the required information was private. Thus there is not pre- and post-public disclosure analysis that is available.

The first MNEs to report on the private CbCR did so from around 2017 as the first effective reporting deadline for MNEs was from 31 December 2016. Thus, there has been a limited time available to assess even the impact of private disclosure on profit shifting and tax avoidances.

There are very strong and opposing views on the subject of public disclosure of CbCR that it may not always be possible to obtain a balanced view form the literature data used. Further to this there is empirical data from data used that supports both positions.

6.6 Areas for future research

At the time of writing this conclusion, the Country-by-Country reporting would have been in existence for approximately three years now (since the year end 31 December 2016). It would be interesting to find out the impact this reporting requirement has had on both MNEs and on the tax authorities as the disclosures are currently made privately.

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