Development finance institutions (DFIs) and public country by country reporting (CBCR)

1. DFIs and responsible taxation

The role of Development Finance Institutions (DFIs) has increased dramatically in recent years. They are public institutions currently at the centre of a development agenda focused on supporting the private sector and mobilising additional private finance for development projects. Most DFIs are funded by donor governments’ development agencies, and can raise additional funds through private banks and capital markets. DFIs generally invest in or partner with a wide range of multinational enterprises (MNEs) – including intermediary banks, mining companies and private equity funds. As such, DFIs’ exposure to MNEs is significant and must be accompanied by effective safeguards to identify aggressive tax planning.

A major part of global cross-border trade happens between related parties in an MNE. Almost one third of global corporate investment stocks passes through offshore investment hubs.¹ This type of trade is susceptible to abusive exploitation of loopholes in domestic and international tax law that allow for aggressive corporate tax planning. MNEs are able to shift their profits out of the country where the economic activity takes place into low-tax jurisdictions. Although it is legal, this type of tax avoidance practice among MNEs often occurs at such a large scale that it substantially undermines domestic resource mobilisation in both developed and developing countries.

According to a 2015 paper published by the United Nations-supported Principles for Responsible Investment (PRI)² Initiative “aggressive corporate tax planning should be a concern to investors as it can create earnings risk and lead to governance problems; damage reputation and brand value; cause macroeconomic and societal distortions”. The paper argues that private investors already “started to be more vocal with their own concerns regarding aggressive tax planning (...) and in the public sphere”.³

Given their public backing and development mandate, DFIs should be at the forefront of investors’ practices by setting the tone of this discussion and adopting ambitious responsible tax policies that incorporate the concept of public country by country reporting (CBCR). This will safeguard DFI investments and activities. Only through public CBCR will DFIs be able to ensure and illustrate to the public that the investments they make are not linked to aggressive tax planning and tax avoidance.

2. Why implement public CBCR?

Public CBCR would give all stakeholders an overview of the nature of MNE activities in each jurisdiction where they operate, the value of their assets, sales and purchases, profit or loss before tax, tax on profit or loss, number of employees and public subsidies received. This would allow stakeholders to assess to what extent aggressive tax planning strategies seem to be in place and whether profit shifting is happening.

The PRI Initiative argues that “companies should be able to defend how they allocate profit to each country both to the tax authorities and the general public to avoid reputational risk and investor backlash”.⁴ Furthermore, an impact assessment of public CBCR for banks in the EU prepared by PwC for the European Commission states that “public CBCR of information (...) is not expected to have
significant negative economic impact, in particular on competitiveness, investment, credit availability or the stability of the financial system. On the contrary, it seems that there could be some limited positive impact.  

Public CBCR by MNEs therefore:

- Acts as a deterrent to engage in aggressive tax planning in the first place;
- Enables key stakeholders to determine whether an MNE is engaged in profit shifting; rewards MNEs that are not shifting their profits and puts pressure on those that have not changed their practices; and
- Ensures access to information about tax payments of activities, which is crucial to track from a development impact and financing for development perspective.

The table below indicates that several types of DFI clients are already required by law to report on a country by country basis – some of them even publicly. Others, such as private equity firms and funds, are not influenced by external legislation yet.

3. Recommendations on how DFIs can integrate public CBCR in their activities

CSOs have repeatedly argued that DFIs should take a more active role in promoting public CBCR. These calls have been reiterated by the European Parliament. For example, in March 2014 the Parliament called for “the EIB to follow the country-by-country reporting in order to combat the financing of illegal activities” and considered that “in order to be eligible for EIB financing, all beneficiaries, whether corporations or financial intermediaries, that are incorporated in different jurisdictions must be obliged to disclose country-level information about their sales, assets, employees, profits and tax payments in each country in which they operate in their audited annual reports”.

In the long term, DFIs should strive towards making public CBCR a key eligibility criteria for all:

- Multinational clients approaching them for direct financing;
- Multinational financial intermediaries that receive DFI support to on-lend to sub-clients;
- Multinational sub-clients receiving financial support from financial intermediaries; and
- Multinational companies that partner with DFIs to form joint ventures.

All things considered, it is important that DFIs take into account the following recommendations:

- DFIs should make a clear public statement in support of public CBCR and set a deadline for when they will ensure that all their multinational clients and partners annually publish country by country data.
- DFIs should also make sure that MNEs serving as financial intermediaries – such as commercial banks and private equity funds – and MNEs to which financial intermediaries on-lend are publishing country by country data on an annual basis. This can be done by including provisions in the contracts with these types of MNEs. In the event of non-compliance by the financial intermediary or its multinational sub-clients, DFIs must be mandated to intervene in any on-lending decisions made by the financial intermediary.
- To follow up on the annual publication of country by country data by their multinational clients and partners, DFIs must integrate a tax indicator in their monitoring and evaluation systems to assess ex-post their multinational clients’ contribution to domestic resource mobilisation and impact on base erosion and profit shifting.
## Annex: DFI clients and CBCR requirements

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<thead>
<tr>
<th>DFI client</th>
<th>What the legislation says</th>
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<td><strong>Banks</strong></td>
<td>- At the EU level, on 1 January 2015, the Capital Requirements Directive IV (CRDIV) introduced the obligation for credit institutions and investment firms to publicly disclose on an annual basis the following information for every country where they operate: institution’s name, country, tax on profit or loss, profit or loss before tax, turnover, nature of activities and geographical location, number of employees and public subsidies received.7</td>
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<td><strong>Mining and logging companies</strong></td>
<td>- The EU’s Accounting Directive introduced a new obligation for large extractive and logging companies to report the payments they make to governments. Article 44 of the EU’s Accounting Directive obliges “large undertakings and public-interest entities which are active in the extractive industry or logging of primary forests” to “disclose material payments made to governments in the countries in which they operate in a separate report, on an annual basis”. Article 45 states that “the report should incorporate disclosures on a country and project basis”. 8</td>
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<td><strong>Other MNEs</strong></td>
<td>- Non-public CBCR: As part of its Base Erosion and Profit Shifting (BEPS) project, the OECD adopted a “CBCR template” for MNEs with an annual turnover of at least €750 million to report on a country by country basis information – including: revenue, profit before income tax, income tax, income tax paid and accrued, the location of the economic activity, all the constituent entities and the nature of the main business activities. The OECD guidelines do not require public CBCR. 10 EU Finance Ministers formally adopted the CBCR template on 25 May 2016.</td>
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<td></td>
<td>- Public CBCR:</td>
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<td>- On 8 July 2015, the European Parliament voted for a stronger public CBCR proposal within the Shareholders Rights Directive. The amendments include a requirement for “large undertakings” and “public-interest entities” (PIEs) 11 to publicly disclose country by country information. 12</td>
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<td>- On April 12, the European Commission made a proposal in favor of public CBCR, but limited to the EU and a (yet to be developed) list of ‘uncooperative jurisdictions’. The proposal does not cover all countries where MNEs operate, and will therefore be insufficient to disclose profit shifting and tax avoidance practices. It also leaves out the vast majority of MNEs by setting a high threshold for companies covered by the requirement (only companies with an annual turnover of minimum €750 million are covered). The European Parliament and the Council are currently reviewing the proposal.</td>
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<td><strong>Private equity funds and firms</strong></td>
<td>No requirements</td>
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<tr>
<td><strong>Local companies/SMEs</strong></td>
<td>No requirements. Most small- and medium-sized enterprises (SMEs) do not operate in more than one country.</td>
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Endnotes


2 “United Nations-supported Principles for Responsible Investment (PRI) Initiative is an international network of investors working together to put six Principles for Responsible Investment into practice. Its goal is to understand the implications of sustainability for investors and support signatories to incorporate environmental, social, and corporate governance (ESG) issues into their investment decision making and ownership practices.” See: http://www.unpri.org/about-pri/about-pri/


4 Ibid.


9 The country by country reporting element in the Dodd-Frank Act has never been challenged on constitutional grounds. It has been vacated (set aside) on narrow procedural grounds and is expected to be reintroduced with a more thorough justification as required under a US law called the Administrative Procedure Act. See: http://eurodad.org/files/pdf/559a8b67d89e5.pdf


11 The EU defines PIEs as listed companies, credit institutions and insurance undertakings. Member States can also designate as PIEs other undertakings that are of significant public relevance, because of the nature of their business, their size or the number of their employees. See: http://europa.eu/rapid/press-release_MEMO-14-256_en.htm

12 More specifically, the amendments require large undertakings and public-interest entities to “disclose, specifying by Member State and by third country in which they have an establishment, the following information on a consolidated basis for the financial year: (a) name(s), nature of activities and geographical location; (b) turnover; (c) number of employees on a full time equivalent basis; (d) value of assets and annual cost of maintaining those assets; (e) sales and purchases; (f) profit or loss before tax; (g) tax on profit or loss; (h) public subsidies received; (i) parent companies shall provide a list of subsidiaries operating in each Member State or third country alongside the relevant data.” In addition, “large undertakings shall publicly disclose essential elements of and information regarding tax rulings, providing a break-down by Member State and by third country in which the large undertaking in question has a subsidiary”. See: http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P8-TA-2015-0257+0+DOC+XML+V0//EN