

Taxing solutions

How tighter tax rules for big
business could help end poverty

Executive summary

“Examining the companies’ published accounts over the last five years, ActionAid found that there appears to be an estimated shortfall of \$31.5 billion of tax revenue, an average of \$6.3 billion every year.”

The Millennium Development Goals (MDGs) have been hailed by world leaders as a blueprint for tackling global poverty. They include a bold agenda to halve the number of the extreme poor around the globe, halt the spread of HIV/AIDS and provide universal primary education for the world’s children.

But existing economic policies and practices are currently failing the world’s poorest people. Change on the scale that is needed to reach the goals will require all parts of the international community – including governments, business and civil society – to do more to provide the necessary financial, human and political resources.

Recognising this, the UK government has, alongside the UN and 14 other countries, launched the ‘Business Call to Action’ – an ambitious initiative to tap into the under-exploited potential of private companies, especially large multinational corporations, so that they can contribute to achieving the Millennium Goals.

Industry leaders have been challenged to use their companies’ global reach to help meet one or more of the MDG targets by launching new products and services related to their core business.

“We will have time to reach the Millennium Development Goals – worldwide and in most, or even all, individual countries – but only if we break with business as usual.”

Former UN Secretary General Kofi Annan

Tapping into large companies’ immense reserves of creative and financial resources to fight extreme poverty is a much needed and welcome idea. But in ActionAid’s view there are additional and potentially more effective ways in which big business could do more to help meet the MDG challenges.

Making tax count

One of the most effective routes companies could take is to pay full taxes in developing countries. Tax is the most reliable and consistent income that governments have, and is essential if they are to tackle hunger, provide health and education services, and invest in the infrastructure that is vital for development.

ActionAid believes that multinational companies should pay the going rate of corporate tax on their profits in the countries where they or their subsidiaries operate – something they do not all currently do.

In this report, ActionAid examines the recent¹ tax performance of 14 UK and US-based multinational companies that have signed up to the Call to Action. We compare the tax payments declared in their published accounts with the official rate of corporate tax in their home country.

Where profits have already been taxed in a subsidiary country, then they are only subject to a top-up tax to bring the overall tax paid on profits up to the corporation tax rate of the country of parent company incorporation. ActionAid would therefore expect the total tax paid on profits by multinational companies to equate with the tax rate in their home country.

Our initial findings suggest a shortfall of billions of pounds between the expected rate of tax and the actual tax paid.

We found that:

- In most cases, the tax paid over the last five years appears to be considerably less than the corporate tax rate in their home country – which was 30% for UK companies and 35% for US companies at the time.
- Over that five-year period, there appears to be an estimated shortfall of \$31.5 billion of taxed revenue, an average of \$6.3 billion every year.
- This represents a massive missed opportunity for governments to garner the financial resources needed to meet the MDGs. For example, the UN estimates that \$22 billion is needed to fund a comprehensive global strategy of prevention, treatment and care to combat HIV/AIDS in 2008. UNESCO has estimated that an additional \$5.6 billion a year would be enough to meet the targets on universal primary education and

The issue

gender parity.

The implications behind these findings are profound. If even a small fraction of this tax shortfall was redirected to governments in developing countries, it would mean a vital injection of extra public money that could be used to build health clinics and schools.

ActionAid believes that there is an urgent need for the UK government to explore the reasons why companies appear to be paying less tax than we would expect, given their profits and the rates of corporate taxation in the countries where they are based. ActionAid urges the UK to work with other governments, the United Nations, civil society and the companies themselves to promote greater accounting transparency, close legal tax loopholes and ensure that companies are contributing to poverty reduction through full tax contributions.

Increasing the tax that companies actually pay in developing countries represents an open goal for governments that could make a vast difference to raising the public finances needed to meet the MDGs.

Tax avoidance denies poor countries billions of dollars which they urgently need to fight poverty

The MDG Business Call to Action raises a vital development issue: how can companies, particularly large multinationals, best contribute to the fight against global poverty? One answer is obvious: by ensuring that they pay the full amount of tax on profits intended by the relevant laws of each country in which they have substantial operations.²

This research draws attention to a critical development issue: the failure of governments to capture revenue from multinationals at the headline rate of corporate tax. This is leading to lost potential public revenues that are desperately needed by developing countries if they are to meet the MDGs.

The UN has estimated that meeting the Millennium Development Goals will require \$189 billion annually in additional assistance by 2015.³ Given that, on current trends, official aid volumes are likely to fall a long way short of providing this, taking measures to stop the haemorrhaging of vitally needed public funds through legal tax avoidance schemes is perhaps the most critical way of filling the financing gap and meeting the MDGs.

Governments should require more information in company accounts so we can see what loopholes and accounting devices companies are using to reduce the tax they pay. And governments should make more effort to close the loopholes that allow companies to avoid tax perfectly legally.

Our methodology

Disclaimer

No comment, data or other information in this report suggests, or is intended to suggest, that any company to which it refers, or any officer of such company, or any auditor to those companies has in any way acted improperly or illegally. It is assumed that if a company is referred to directly or indirectly then the tax gaps to which this report refers arose because of the use of standard tax concessions and legal tax avoidance methods.

Rationale

The methodology used in this report was designed by Richard Murphy, a tax expert and chartered accountant who heads the independent research company, Tax Research LLP. The full methodology is published on ActionAid's website.⁴

The research published in this report is based on the published accounts of 14 UK and US companies that have signed up to the MDGs Business Call to Action. These accounts were examined to see whether the companies had paid the amount we would have expected them to pay given their profits and the corporate rate of tax in their parent country of incorporation.

All these companies have significant operations in the developing world, and given the scale of their operations, expected tax revenues from the profits they make in the developing world will be significant. Although tax on profits from subsidiary operations abroad may be paid at lower rates in those countries, the remaining profits repatriated to the parent company are subject to tax up to the headline tax rate of home country incorporation.⁵

Box 1 Companies joining the Business Call to Action examined in this report

Company	Country of incorporation
Anglo American Plc	UK
Cisco Systems	US
Citigroup Inc	US
Diageo Plc	UK
Federal Express Corp	US
General Electric Co	US
The Goldman Sachs Group Inc	US
Google Inc	US
Microsoft Corp	US
PepsiCo Inc	US
Reuters Group Plc	UK
SAB Miller Plc	UK
Vodafone Group Plc	UK
Wal Mart Stores Inc	US

However, it is extremely difficult and in most cases impossible to establish exactly how much tax on profits they pay in specific countries due to the current legal requirements about the way multinationals report their accounts. Information that would allow researchers to compare the taxes paid by multinationals in developing countries is not publicly available. One major recommendation of this report is that such information should become part of the mandatory reporting requirements for multinationals.⁶

The analysis is therefore based on the consolidated accounts published in the multinational's 'home' country, to determine whether, across their total global operations, they were paying the expected level of tax based on the rate of corporation tax in their home country.

- The information used is from the last comparable five years of published accounts⁷, to ensure it is a fair reflection of average performance. These accounts are independently audited and certified accurate by those auditors.
- The research is restricted to UK and US companies, as national tax laws are comparable in these jurisdictions.

The analysis follows standard procedures undertaken by these companies themselves, using their own data, to determine three things:

(a) What was the taxable profit of each company over the period studied?⁸

Even determining this figure is not straightforward. Accounting profit is published in the consolidated accounts. However, in practice this is not the same as taxable profit – the profit that tax authorities use when calculating an individual company's tax liability. Certain items included as expenses in the accounts are disallowed by tax authorities, such as charges for the use of fixed assets (depreciation) and must therefore be added to the accounting profit, whilst other items are classified as tax deductible and must be deducted.

Unfortunately, the only item for which information is regularly included in the consolidated accounts is goodwill amortisation, which is tax deductible. Therefore, the only valid adjustment based upon the data included in company accounts is to add back the goodwill amortisation charge shown in the accounts as this is not tax allowable. This is therefore the only adjustment made to accounting profit.

The figures are therefore the best possible estimate of the company's taxable profit. It is likely to be an underestimation.

Key findings

(b) How much tax had they paid over the period studied?

The tax payments detailed in the consolidated accounts are made up of (a) the current tax charge, and (b) the deferred tax charge. Only the current tax charge is included in these calculations, because the deferred tax figure bears little relation to actual tax paid. The deferred tax charge is an estimate of tax that might be due for activities conducted in the current year.

However, as other studies have shown, deferred tax charges are accounting entries in the financial statements of the companies in question, and do not represent real assets or liabilities that could, for example, be sold in the case of assets or might be paid in the case of liabilities. In practice including the deferred tax charge would give a very unrealistic picture of the actual tax paid by those companies: it is more accurate to exclude it.⁹

Both the above adjustments can be done using the published figures of the companies themselves.

(c) How does the tax paid as a percentage of profit compare with the rate of corporation tax set for companies?

The two calculations above were then used to establish what percentage of their actual taxable profit each company was paying in tax, for each of the five years. This actual tax rate paid by each company was then compared to the corporation tax rates in their home countries, to give an indication of the gap between the tax one might reasonably expect companies to pay, and the amount they actually have paid according to their published accounts.

Profits made by subsidiary companies are expected to be eventually remitted back to the home country, in order to be passed on to shareholders in the form of dividends. If these profits have already been taxed in the subsidiary's country, then they are only liable to a top-up tax to bring the overall tax paid on the profits up to the corporation tax rate of the country of parent company incorporation. One would therefore expect the total tax paid on profits by multinational companies to equate with the tax rate in their home country.

The companies' accounts were examined over a five year period, and only included aggregate figures for all 14 companies to ensure that any singular events which may provide unrepresentative figures for a particular company in a particular year are evened out.

How much tax do the companies pay?

We examined the published accounts of the 14 companies assessed in this report over five years and compared their effective current tax charges with those that would have been settled if they had paid at the rate set in their country of main incorporation. We found that there appears to be an estimated shortfall of \$31.5 billion of tax revenues to governments – an average of \$6.3 billion of tax per year.

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There are various possible explanations for such a shortfall in corporate tax revenues, eg specific business circumstances not revealed by the companies' published accounts, the use of standard tax offsets, tax breaks and legal tax avoidance measures. However, due to the lack of disaggregated data at the moment it is impossible to say exactly what the reasons are behind this estimated shortfall, nor how or where the gaps between expected and actual tax payments arise.

Conclusion and recommendations

One of the most important things global companies can do to help reduce poverty is to pay their full tax contributions. But ActionAid's research suggests that many large companies are paying less than the headline rate of corporate tax in the countries in which they are based, for reasons that are not clear from their published consolidated global accounts, and that require urgent investigation and explanation by public tax authorities.

A thorough analysis of the published accounts of 14 of the UK and US companies that have signed up to the Millennium Development Goals Business Call to Action has revealed an apparent tax shortfall of \$31.5 billion over a five year period, based on the tax these companies would be expected to pay – given the rates at the time – on their global operations, and what they have actually contributed.

Multinational company accounts do not provide detail by country, but it is reasonable to expect that some of the gaps arise in developing countries where these firms have substantial operations. And because this research has only looked at a handful of companies, the global figures are certain to be much higher. If multinationals were to pay just a fraction of this lost tax to developing country governments it could make a huge difference to achieving the Millennium Development Goals.

For example, the UN has calculated that \$22 billion could fund a comprehensive global strategy of prevention, treatment and care to combat HIV/AIDS in 2008.¹⁰ Meanwhile, UNESCO has estimated that an extra \$5.6 billion per annum is needed to provide universal access to primary education and meet gender goals by 2015.¹¹ While these sums represent a huge challenge, addressing the shortfalls in uncollected corporate tax provides enormous potential to meet these targets.

The figures revealed by this report are based on the best available information provided by the published consolidated global accounts of the companies highlighted. But there is a real problem around the current inability to gauge exact tax payments within every jurisdiction in which a company has a substantial subsidiary interest. Therefore, although the figures appear to be large, it is at the moment impossible to say precisely how much could be gained by poor country governments closing legal tax loopholes to help fund the MDGs.

As a first, urgent, step the UK and other governments should therefore ask questions about why this gap occurs, and what they can do to close it. They should require the published company accounts to show how much profit is made and how much tax is paid in each country in which a multinational operates. And they should support developing countries in their efforts to increase these tax revenues to their intended levels.

This could make a significant step towards establishing where the apparent tax gap stems from, and potentially enable public authorities to capture millions of dollars of corporate tax revenues that could make a substantial contribution to improving the lives of the world's poorest people.

As a first step the UK and other governments should ask urgent questions about why this gap occurs, and what they can do to close it

Footnotes

- 1** Last five comparable years of published accounts; i.e. 2002-2006
- 2** This report is concerned solely with loss of corporate tax revenues from tax breaks and legal tax avoidance schemes by companies, and the effect of this on government tax revenues. It is not concerned with the entirely separate phenomenon of illegal tax evasion
- 3** http://www.unmillenniumproject.org/reports/costs_benefits2.htm
- 4** www.actionaid.org.uk
- 5** For example, in 2006 the headline rate of corporate taxation in Bolivia was 25%, and in the UK was 30%. In this case, a Bolivian subsidiary of a UK company would have expected to pay 25% tax on their profits in Bolivia during that year, and an additional 5% tax on profits repatriated to the parent company in the UK
- 6** ActionAid is currently working with the Tax Justice Network on a detailed proposal for country by country reporting
- 7** 2002-2006
- 8** The basic formula is: Accounting Profit + Disallowables - Tax deductions = Taxable profit
- 9** See Appendix 4 *Company Taxation* in Murphy, R (2008) 'The Missing Billions. The UK tax Gap' (London)
- 10** UNAIDS (2007) 'Financial Resources Required to Achieve Universal Access to HIV Prevention, Treatment, Care and Support'
- 11** UNESCO 'Education for All Monitoring Report: 2005'



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Lead author Jesse Griffiths

Researcher Elvira Groll

Methodology and additional research Richard Murphy

Design Ben Serbutt

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We're ActionAid. We're people who are dedicated to ending the extreme poverty that kills 28 children every minute of every day. We're a charity and much more. We're a partnership between people in poor countries and people in rich countries – all working together to end poverty for good.

ActionAid UK
Hamlyn House
Macdonald Road
London N19 5PG
United Kingdom

Telephone

++44 (0)20 7561 7561

Facsimile

++44 (0)20 7272 0899

Email

mail@actionaid.org.uk

Website

www.actionaid.org.uk

International Secretariat

Johannesburg

Asia Region Office

Bangkok

Africa Region Office

Nairobi

Americas Region Office

Rio De Janeiro

Europe Office

Brussels

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