

NUMBER 3

CMI WORKING PAPER

MARCH 2017



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Beneficial openness?

Weighing the costs and benefits
of financial transparency

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CMI Working Paper number 3 2017

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Cover photo

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ISSN 0804-3639 (print)

ISSN 1890-5048 (PDF)

ISBN 978-82-8062-637-0 (print)

ISBN 978-82-8062-638-7 (PDF)

www.cmi.no

This paper is prepared for the research project "Taxation, institutions and participation", funded by the Research Council of Norway. The author would like to thank Kendra Dupuy, Jan Isaksen and Mats Stridsman for comments on earlier drafts. Views and conclusions expressed within this report are those of the author alone.

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ACRONYMS

AEOI	Automatic Exchange of Information
BEPS	Base Erosion and Profit Shifting
CBCR	Country by Country Reporting
CDD	Customer Due Diligence
CSP	Company Service Provider
EITI	Extractive Industry Transparency Initiative
EU	European Union
FATF	Financial Action Task Force
GMO	Genetically Modified Organism
KYC	Know Your Customer
NGO	Non Government Organisation
OECD	Organisation for Economic Cooperation and Development
PEP	Politically Exposed Person
PWC	PriceWaterhouseCoopers
TJN	Tax Justice Network

EXECUTIVE SUMMARY

Public financial transparency is increasingly advocated as a solution to concerns over **legal tax planning by multinational corporations**, and **illegal tax evasion, fraud and money laundering**. In particular there are calls for mandatory publication of **beneficial ownership** (the ultimate owners of companies and trusts), and **country-by-country reports** by multinational corporations (detailing revenues, assets, employment, profits and taxes paid in each jurisdiction). Other proposals include publication of tax rulings and profit and loss accounts for all companies.

The broad case is made that the problems are huge, and that public transparency is the only solution. However caution is warranted since the scale of revenues at stake are, in fact, smaller than is often perceived, while experience suggests that data transparency is not a simple route to accountability.

There are specific cases for financial transparency in key areas such as the extractive industries, fishing vessels and public contracts, however these cases do not require universal publication by all companies. Any mechanism which mandates publication of information about individuals and private entities raises privacy issues, which must be considered. The strategic view of transparency as a means to an end suggests that we should consider how best to achieve particular objectives, and assess possible approaches.

In the case of beneficial ownership transparency, the objective is to make it harder for criminals, fraudsters and corrupt officials to hide their financial affairs and easier for everyone else to manage counterparty risks. Key options are regulating company service providers to verify who is behind the companies they set up, or mandating that company owners self report to a central register. Evidence to date suggests that regulating CSPs is more effective. Different countries are trialling different approaches and it is critical to assess effectiveness and learn from what works.

In the case of country-by-country reporting, the OECD has agreed that these reports should be submitted in confidence to tax authorities, and shared between them. One case for publication is that it would allow developing country tax authorities easy access to the information. However, given that countries will increasingly be sharing large quantities of sensitive information on individual taxpayers through automatic exchange of information, building up confidence in these channels is not something that needs to be short-cut.

The other argument for mandating publication is to allow public and political scrutiny of whether companies are paying the 'right amount of tax', and more broadly to inform debates about the tax system and its implementation. However it is not clear that the CBC template provides information that is either necessary or adequate for this purpose.

For complex problems to gain political and public momentum, it is helpful to be able to point to simple, clear solutions. Public registers of beneficial ownership and country-by-country reporting have played this role for the issues of illicit financial flows and profit shifting. But there is a danger both for governments and civil society that iconic transparency measures provide 'form' rather than the 'function' in seeking to solve these problems. Ultimately the aim should be to iterate towards mechanisms that enable more responsive public institutions, trusted legal systems, more effective markets and a stronger social contract between governments and their people.

1 INTRODUCTION

International taxation has become a hot topic over recent years, driven by concern over **tax planning by multinational corporations** and by revelations about **tax evasion and money laundering** of the proceeds of crime and corruption using anonymous shell companies.

These concerns are long-standing, with international collaboration ongoing through the Organisation for Economic Cooperation and Development (OECD) and the Financial Action Task Force (FATF) respectively. International action has been accelerated by public and political attention, focused in particular on the tax affairs of major companies such as Google, Starbucks and Amazon, and by leaks of information, such as from PWC in Luxembourg ('Luxleaks') and from the law firm Mossack Fonseca ('The Panama Papers').

While the two sets of issues are separate (one concerns legal behaviour, and the other illegal), they are often joined together for advocacy purposes under the heading of 'tax dodging' or 'illicit financial flows'.¹

International collaboration to date has put in place mechanisms for authorities to collect and exchange financial information (on who owns which companies, what they have in their bank accounts, what they report in their tax returns, and in the EU most recently on tax rulings).² However some NGOs and governments are also arguing that pieces of financial information should be made routinely public, in particular:

- **Details of beneficial ownership** (who owns companies and trusts).
- **Country-by-country reports** by multinational corporations, detailing revenues, profits, employment and taxes in each country where they do business.

These arguments have been given particular impetus by the perception of large potential revenue gains, particularly for developing countries. Over 150 civil society organisations have joined the Financial Transparency Coalition and a number of governments and institutions such as the European Commission are backing elements of public financial transparency. Support for financial transparency mechanisms also aligns with the broad principle of open government, and the use of open data to support transparency and accountability.³

The general case for financial transparency that is often made is that it is cheap and easy, and that the impacts would be huge.⁴ It is sometimes viewed as having an inevitable momentum, as Pierre Moscovici European Commissioner for Economic and Financial Affairs, Taxation and Customs argues: "I can tell you that [public country by country reporting] will be achieved, because I think it simply follows the course of history. And one does not resist this trend".⁵ Dame Margaret Hodge arguing that the UK should impose a requirement for public registers of beneficial ownership on its overseas territories and crown dependencies says "It would be a terrible missed opportunity if we did not... I just cannot see an argument against it."⁶

However there are also reasons for caution – in particular we know that the revenues at stake are not as big as they have often been perceived to be⁷, while impacts from transparency mechanisms have proved difficult to generate.⁸ There is a strong case for public transparency mechanisms in areas such as the extractive industries, fisheries and

1 GFI/Tax Justice Network Africa (2017) Accelerating the IFF Agenda for African Countries.

2 Key standards are The Financial Action Task Force (FATF) Recommendations on anti money laundering the OECD Model Agreement on Exchange of Information on Tax Matters, the OECD Model Tax Convention, and the UN Model Tax Convention, The G20/OECD BEPS Action Plan, European Commission Action Plan for a Fair and Efficient Corporate Tax System and the European Commission's Tax Transparency Package.

3 Davies, T. and Gower T. (2016) Letting the Public In Opportunities and Standards for Open Data on Beneficial Ownership, Country-by-Country Reporting and Automatic Exchange of Financial Information. Financial Transparency Coalition.

4 See for example Cobham, A. (2014) Benefits and Costs of the IFF Targets for the Post-2015 Development Agenda, Copenhagen Consensus.

5 European Commission (2016), remarks from Commissioner Moscovici during the launch of the Anti Tax-Avoidance Package.

6 Hodge, M. (2016) Statement in Criminal Finances Bill Debate in the House of Commons. November 15th 2016. https://www.theyworkforyou.com/psc/2016-17/Criminal_Finances_Bill/02-0_2016-11-15b.63.1

7 Forstater, M. (2015) Can Stopping 'Tax Dodging' by Multinational Enterprises Close the Gap in Development Finance? Policy Paper 069, Center for Global Development.

8 GIZ (2016) Assessing the Effectiveness and Impact of the Extractive Industries Transparency Initiative

public contracting but it does not necessarily follow that similar transparency requirements should be imposed on all companies, or that maximum transparency approaches are the only or most effective means to address particular urgent objectives such as making anti-money laundering systems more effective and enhancing trust in the tax system.

Advocates for open government including Jonathan Fox⁹, Nathaniel Heller,¹⁰ Archon Fung,¹¹ Cass Sunstein, Tom Steinberg¹² and Martin Tisne¹³ are increasingly arguing that more attention should be paid to the objectives and design of transparency policies and initiatives, moving from an evangelical build-it-and-they-will-come approach, to one that identifies particular objectives, the data that is needed and the people and analytical approaches needed to make use of the data.

This paper applies this perspective to the proposals for public financial transparency on beneficial ownership and country-by-country reporting and looks at the potential costs and benefits of public transparency versus other options for achieving specific objectives.

9 Fox, J. (2016) Conversation with Professor Jonathan Fox. Global Partnership for Social Accountability <http://www.thegpsa.org/sa/news/conversation-prof-jonathan-fox-doing-accountability-differently>

10 Heller, N. (2016) Open Government: moving beyond arguments on 'the right thing to do'. Results for Development. November 2016. <http://www.r4d.org/blog/2016-11-07/open-government-moving-beyond-arguments-right-thing-do>

11 Fung, A. (2016) Four Frontier Issues for Further Investigation in Ideas for Future Work on Transparency and Accountability, Carnegie Endowment for International Peace.

12 Steinberg (2016) Debating Cass Sunstein on Transparency. Civicist. <http://civichall.org/civicist/debating-cass-sunstein-on-transparency/>

13 Tisne, M. (2016) From Tech-Driven to Human-Centred: Opengov has a Bright Future Ahead, Omidyar Network. <https://medium.com/positive-returns/from-tech-driven-to-human-centred-opengov-has-a-bright-future-ahead-374705b02e69#.oxuu38faf>

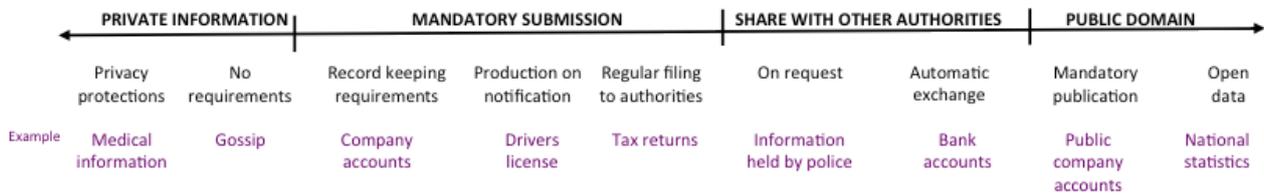
Box 1: Defining Financial Transparency

“Financial transparency” is broadly defined for the purpose of this paper as general rules or standards mandating the publication of information about the financial affairs of private entities. Such financial information can include *inter alia*, information on company ownership, profit and loss accounts, transactions and assets held via banks, tax return information, specific tax rulings and advanced pricing agreements.

We can think of a spectrum between privacy and openness, along which societies must determine how different types of information relating to individuals and private entities should be treated:

- **Treated as private:** No general requirements to disclose, can be protected by specific provisions (e.g. personal emails, information under lawyer-client privilege).
- **Submission mandated:** Information is required to be disclosed to particular authorities (e.g. requirement to submit an annual tax return, banks required to undertake ‘know your customer’ due diligence).
- **Information is shared:** Government agencies may share information with each other or with agencies in other jurisdictions (e.g. through mutual legal assistance).
- **Public domain:** Information is required to be published or displayed (e.g. published accounts under US SEC regulations).

Figure 1: Spectrum of approaches to information



Developed by author

Financial transparency then concerns moves to locate particular classes of financial information about individuals and/or private entities in the right hand section of this spectrum; either through mandatory publication or by creating open datasets (information that is made available to be freely used, shared and built-on by anyone, anywhere, for any purpose, usually in a machine readable, standardised format). In particular, this paper is concerned with general provisions for financial transparency – such as where details of all taxpayers are published, rather than specific requirements such as registers of interests for politicians, extractive industry transparency or calls for publication of the President’s tax return.

2 THE CASE FOR FINANCIAL TRANSPARENCY

2.1 Open by default?

Many governments are adopting commitments on **open government** and **open data** based on the general case that access to data should be expanded to enable governments, citizens, civil society and private sector organizations to make better-informed decisions, develop new insights and hold governments to account.¹⁴

This has been driven in part by possibilities enabled by advances in technology which have made it cheaper and easier to publish, find, use and combine data. Data standards such as the General Transit Feed Specification (for public transport timetables), the International Aid Transparency Initiative standard (IATI), and eXtensible Business Reporting Language (XBRL) demonstrate how information can be published in machine-readable publish-once-use-often formats rather than locked into hard tables and formats designed to meet a particular pre-determined use. If data is published in a machine-readable format then performing calculations and searches becomes easier. Furthermore shifting to using open formats can reduce the cost of organising information for existing needs. For example many countries have taken the step of publishing cadastral information on mining titles online.¹⁵ This enables public access to the information, but also importantly facilitates easy access across government departments, overcoming the tendency for information hoarding as a source of institutional power.

The costs of collection, calculation, auditing and verification of new information should not be underestimated. However if information has already been collected, arguments that it would be too costly to release data, or that ‘data dumps’ of large quantities of information would overwhelm users, are countered by the possibilities unleashed by ever cheaper computing power.

Thus there is a weak general case for transparency:

- **Transparency is good** (it’s the right thing to do)
- **Transparency is cheap** (technology changes the game)

Proponents of open data recognize, however, that there can be legitimate reasons for some data to remain outside of the public domain (particularly where it relates to individuals). Furthermore experience highlights that maximum transparency is not an unmitigated good. Unless transparency mechanisms are well designed (and able to evolve as we learn from what works) they can risk becoming iconic actions, institutionalised busy-work, or even have harmful perverse effects. For example rules which make government official’s emails subject to disclosure that have led to them avoiding having candid conversations using this medium and forced them into other workarounds.¹⁶ It has been argued that disclosure requirements on conflict minerals, ultimately produced an “embargo-in-fact” of the Democratic Republic of Congo, choking funds from warlord owned and legitimate businesses alike.¹⁷ Enforced disclosure can also be used as a punishment or a means to create fear, for example US President Donald Trump’s recent directive to publish a weekly list of crimes committed by foreign citizens in America.¹⁸ Similarly activists seeking to ban genetically modified organisms (GMOs) have long called for food labelling, while those who support the use of biotechnology have tended to oppose the measure as a form of fearmongering. The “public right to know” has generally won the day and the debate moved on to what kind of label should be used. However, as Mark Lynas notes, the ‘best’

¹⁴ <http://opendatacharter.net/principles/>

¹⁵ Girones, E. O., Pugachevsky, A. and Walser, G. (2009). Mineral Rights Cadastre: Promoting Transparent Access to Mineral Resources. Extractive Industries for Development Series #4. Washington DC: World Bank.

¹⁶ Ygesilas, M (2016). Against transparency. Government officials’ email should be private, just like their phone calls. VOX, Sep 6, 2016, <http://www.vox.com/2016/9/6/12732252/against-transparency>

¹⁷ Seay, L. (2002) What’s Wrong with Dodd-Frank 1502? Conflict Minerals, Civilian Livelihoods, and the Unintended Consequences of Western Advocacy. Working Paper 284. Center for Global Development.

¹⁸ US White House (2017). Executive Order: Enhancing Public Safety in the Interior of the United States. Jan 25 2017.

design of a labelling scheme depends on whether your objective is to assuage consumer concern or to build momentum and support towards an ultimate ban on GMOs.¹⁹

2.2 The broad case for financial transparency

Financial transparency differs from other areas of open government because it primarily concerns information about private entities (individuals, families, business and other organisations). It also tends to relate to the collection of new information rather than the release of existing datasets.²⁰ Therefore it cannot simply be covered by a blanket ‘open by default’ rationale.

In general a four-part case is made for financial transparency, with different aspects being emphasised in relation to different areas of information:

1. **Detering/ exposing cases of wrong-doing** – while corruption and criminality is primarily exposed by law enforcement, open financial data may constrain criminals seeking to carry out certain types of activity and may also inform public debate about activity that is not technically illegal, but nevertheless ethically questionable.²¹
2. **Enabling citizens to understand and hold governments to account** – open financial information, such as on tax payments and tax rulings can enable citizens to gain insight into how laws are being implemented in practice.²²
3. **Facilitating commercial relations** – people need to know who they are doing business with, and investing in, as Robert Lowe, the Vice-President of the UK Board of Trade of Trade, said when introducing the 1856 Companies Act, it was essential to give “the greatest publicity to the affairs of such companies, that everyone may know on what grounds he is dealing”.
4. **Building trust in governance** – for example the EU rules on country-by-country reporting by credit institutions (banks) was enacted after the financial crisis to “ensure that trust in the financial sector is regained”²³

Figure 2:
Arguments for public
financial transparency

Area	Deter/expose wrongdoers	Government accountability	Facilitate relations	Build trust in governance
Beneficial ownership	●		○	○
Company accounts			●	
Tax rulings	○	●	○	○
Country by country reports (banking)				●
Extractive industry transparency	○	●		○
Country by country reports (general)	○	○	○	
Tax information (individuals)				●

● Primary rationale

○ Secondary rationale

Developed by author, based on review of literature

Driven by these broad arguments different countries may take different approaches. Some countries such as Norway and Sweden have a tradition of publishing information on individual’s tax bills, as a means to build trust in the system but in most countries, this information is treated with strict confidentiality.²⁴

In the EU private companies are required to file annual accounts which are made publicly accessible, whereas this is not generally the case in the US and elsewhere, beyond listed securities and particular regulated industries. The EU approach is driven by a rationale of

19 Lynas, M. (2013) Why We Need to Label GMOs. <http://www.marklynas.org/2013/10/why-we-need-to-label-gmos/>.

20 Gray, J. and Davies, T. (2015) Fighting Phantom Firms in the UK: From Opening Up Datasets to Reshaping Data Infrastructures? Working paper presented at the Open Data Research Symposium at the 3rd International Open Government Data Conference in Ottawa, on May 27th 2015.

21 Goodrich, S (2015) How Open Data Can Help Tackle Corruption. Transparency International.

22 Christians, A. (2014) Lux Leaks: Revealing the Law, One Plain Brown Envelope at a Time Tax Notes International, Vol. 76, No. 12, 2014.

23 European Commission (2016). Impact Assessment: assessing the potential for further transparency on income tax information. http://ec.europa.eu/finance/company-reporting/country-by-country-reporting/index_en.htm

24 Doyle, A. and Scrutton, A. (2016) Privacy, what privacy? Many Nordic tax records are a phone call away. Reuters.

enabling easy access to information about businesses by all market participants, whereas the US approach, where accounts are generally not required to be filed, is driven by keeping the administrative burden on small businesses low. The rationale is that firms and public agencies can require information from their prospective business partners by agreement, or extract through litigation.²⁵

While different approaches represent the sovereign choices, legal and cultural tradition and competitive strategies of different governments they also offer a menu of options for internationally mobile capital and can become problematic if people and corporations are able to use opportunities for obscurity or secrecy in one jurisdiction as a getaway vehicle for crime and corruption, or to undermine the enforcement of rules, collection of taxes and operation of contracts in other countries. Thus international collaboration and standard setting are a means for closing down loopholes and preventing abuse.

2.3 Privacy matters

One reason why countries do not always opt for maximum financial transparency is because it infringes on privacy. Privacy is a human right, critical to individual autonomy, dignity and freedom. It enables us to protect ourselves from unwarranted interference in our lives. In most legal systems there are provisions to protect the privacy of individuals unless there is a clear public interest case.²⁶ Law enforcement agencies have specific powers to access otherwise private information when pursuing criminals or tracking terrorists, but caution about blanket surveillance, information sharing or enforced disclosure is also warranted. Information can be used for fraud or crime, or to maintain control and impinge on freedom. Confidentiality is critical to the relationships with those we entrust with sensitive information; such as doctors, lawyers, banks and tax authorities. Governments are by no means universally competent or benevolent. Without privacy, authoritarianism flourishes, as it can be impossible to organise any countervailing force. Arguments such as *“If you’ve got nothing to hide, you’ve got nothing to fear”* are sometimes used. But they can lead towards an authoritarian populism.²⁷

Commercial confidentiality too is important, although it should not be a blanket privilege. Professor Alan Westin, of Columbia Law School for example argues “privacy is a necessary element for the protection of organizational autonomy, gathering of information and advice, preparations of positions, internal decision-making, inter-organizational negotiations, and timing of disclosure. Privacy is thus not a luxury for organizational life; it is a vital lubricant of the organizational system in free societies.”²⁸

2.4 The big numbers: not so big

Broad arguments for financial transparency tend to be of the ‘Swiss army knife’ variety, highlighting many potential benefits. A number of studies have been undertaken which argue that public financial transparency measures are ‘high value, low cost’ due to large potential gains assumed, but their assessments have been severely limited. Usually they only consider a single preferred proposal and they weigh up the direct and administrative cost against hopes for large impacts, but with weak causal hypotheses about how these impacts would be achieved.²⁹

The issues of tax evasion, tax avoidance and illicit financial flows are real. However perceptions of the scale of the sums of money at stake are often exaggerated. Recent estimate by NGOs, academics and international organizations have shed light on the magnitudes, suggesting that while they are significant they are not as large as often perceived:

25 Jones Day (2012) Public Disclosure Requirements for Private Companies: U.S. vs. Europe

26 Article 19 (1999) The Public’s Right to Know Principles on Freedom of Information Legislation <https://www.article19.org/data/files/pdfs/standards/righttoknow.pdf>

27 Coustick-Deal, R. (2015). Responding to “Nothing to hide, Nothing to fear”. Open Rights Group. <https://www.openrightsgroup.org/blog/2015/responding-to-nothing-to-hide-nothing-to-fear>

28 Westin, A. (1967). Privacy and Freedom. Atheneum.

29 See for example European Commission (2016). Commission Staff Working Document Impact Assessment: assessing the potential for further transparency on income tax information, BIS (2015). Final Stage Impact Assessments to Part A of the Transparency and Trust Proposals (Companies Transparency), PWC (2014). General assessment of potential economic consequences of country-by-country reporting under CRD IV. Study prepared by PwC for European Commission DG Markt. Cobham, A. (2014) Benefits and Costs of the IFF Targets for the Post-2015 Development Agenda, Copenhagen Consensus.

- **Base erosion and profit shifting (BEPS)** by multinational businesses is estimated to result in revenue losses in the hundreds of billions globally. The OECD has given a core global estimate of \$240 billion.³⁰ The United Nations Conference on Trade and Development (UNCTAD) estimates that effective avoidance enabled by thin capitalization results in \$70–\$120 billion of annual tax revenue losses for developing countries.³¹ The International Monetary Fund (IMF) makes an indicative estimate that developing countries currently lose somewhere between \$100–\$300 billion of tax revenue.³²
- **Offshore tax evasion** – one estimate is that US\$7.6 trillion is held offshore globally, the majority by residents of rich countries, and that this results in tax losses in the region of \$190 billion a year. This estimate is highly uncertain and based on strong assumptions, that 80 percent of assets held in offshore accounts by individuals are unreported, and that these secret accounts are earning 8 percent interest.³³

These figures in the order of a few hundred billion are by no means insignificant, but they should not be interpreted as an estimate of the actual amount of money that could be collected in practice as a result of particular policies. Nor should they be seen as *huge* in relation existing public spending or projected needs. For example they are a relative drop in the ocean compared to existing public revenues which are in the region of \$7 trillion in developing and emerging economies, and \$18 trillion globally.³⁴

It is often stated that tackling issues around international tax or illicit flows could release revenues amounting to several times the education or healthcare budget of developing countries, or several times the international aid they receive ('3 times aid' or more recently '24 times aid'³⁵). However this is misleading as it is based on comparing estimates of sums that mainly relate to major emerging economies such as Russia and China with aid received by smaller and poorer countries. The tendency to exaggerate the scale of revenues at stake is not confined to NGOs or the popular media. For example to support agreement of EU Anti-Tax Avoidance Directive in 2016, the European Parliamentary Research Service produced infographics showing that annual revenue loss due to aggressive corporate tax avoidance in Europe was €160-190, however the study on which this was based actually gave a core estimate of €50-70 billion.³⁶ Similarly OECD research finds that profit shifting by multinational companies allows them to reduce their effective tax rate by an average of around 2 percentage points (and an additional 3 percentage points by exploiting mismatches between tax systems). But when the BEPS programme was launched the OECD used the a headline claim that "some multinationals use strategies that allow them to pay as little as 5% in corporate taxes when smaller businesses are paying up to 30%".³⁷

The largest numbers quoted in many reports (such as \$1 trillion annually from developing countries, and \$50 billion from Africa) relate to estimates of 'illicit financial flows' based on mismatches in trade data. However these are more suitable for attracting media and policy attention than for providing knowledge of the issues in practice.³⁸ Recent

30 OECD (2015) Measuring and Monitoring BEPS, Action 11 – 2015 Final Report.

31 UNCTAD (2015) International Tax and Investment Policy Coherence," Chap. 5 in Reforming International Investment Governance, World Investment Report.

32 Crivelli, E., de Mooij, R. and Keen, M. (2015) Base Erosion, Profit Shifting and Developing Countries (IMF Working Paper, Fiscal Affairs Department, International Monetary Fund.

33 Zucman, G. (2013) Taxing across Borders: Tracking Personal Wealth and Corporate Profits," Journal of Economic Perspectives 28, no. 4.

34 <http://data.worldbank.org/>

35 See Forstater, M. (2015) Three Times More Aid? <http://www.covi.org.uk/three-times-more-than-aid/>, COVI and Forstater, M (2017) Aid in Reverse: Fact or Fantasy. Centre for Global Development <http://www.cgdev.org/blog/aid-reverse-facts-or-fantasy>

36 Dover, R., Ferrett, B., Gravino, D, Jones, E. and Merler, S. (2015) Bringing transparency, coordination and convergence to corporate tax policies in the European Union Part I: Assessment of the magnitude of aggressive corporate tax planning. European Parliament Research Service. For a discussion of the presentation of the numbers see <https://hiyamaya.wordpress.com/2016/06/23/does-corporate-tax-avoidance-cost-europe-e160-190/>

37 Johansson, A. Bieltvedt Skeie, O. Sorbe, S. and Menon, C. (2017) Tax Planning by Multinational Firms: Firm level evidence from a cross country database. OECD Economics Department Working paper No 1355 and OECD (2013) OECD Urges Stronger Cooperation on Multinational Tax <http://www.oecd.org/tax/oecd-urges-stronger-international-co-operation-on-corporate-tax.htm>

38 Forstater, M. (2016). Illicit Flows and Trade Misinvoicing: Are we looking under the wrong lamppost? Bergen: Chr. Michelsen Institute (CMI Insight no. 5).

reviews of these methodologies find that they are based on imperfect methods with a great margin for error.³⁹

Perceptions that the numbers are larger than they are may lead to overconfidence about the ability of disclosures to reveal stark problems, rather than present needle-in-haystack challenges.

Box 2: Take Care: Why do we often think the revenues at stake are bigger than they are?

When estimates are presented, four common mistakes and misinterpretations tend to encourage inflated perceptions of scale:

- **Wrong countries** – Estimates of overall revenue losses attributed to developing countries relate mainly to major emerging economies such as Brazil, Mexico, China and South Africa. However the aggregated totals are often misinterpreted as if they can be ascribed to low-income countries (or are compared to aid volumes.)
- **Wrong numbers** – In some cases the wrong number is used altogether. Estimates of illicit financial flows (IFFs) ('trillions') issued by the NGO Global Financial Integrity are often misunderstood by others as an estimate of tax loss due to transfer pricing.
- **Wrong issue** – Often tax evasion and avoidance are conflated - for example the figure that \$1 trillion is lost through tax avoidance and evasion in Europe has been used to illustrate the scale of the impacts of complex corporate tax planning. However the report from which is drawn was mainly based on an estimate of domestic tax evasion (e.g. through undeclared cash-in-hand business)
- **Wrong time period** – Often estimates are aggregated over multi-year time periods to produce large numbers, which are harder to contextualize than annual figures. In some cases these multi-year estimates are then compared to annual health budgets or teachers salaries etc.. creating inflated perceptions of scale.

Forstater, M. (2015) Can Stopping 'Tax Dodging' by Multinational Enterprises Close the Gap in Development Finance? Policy Paper 069, Center for Global Development.

2.5 Transparency and accountability: not so easy

While transparency can be motivated by the plausible general case that 'more information enables people to make better decisions', this does not necessarily mean that mandated disclosures will work in practice. Omri Ben-Shahar of the University of Chicago Law School and Carl E. Schneider of the University of Michigan argue convincingly that mandated disclosures in areas such as risk warnings and terms and conditions have been worse than useless, producing reams of boilerplate information, and creating the appearance of having addressed real problems.⁴⁰ Rosie McGee and John Gaventa in a review of evidence commissioned by the UK government in 2010 argued that the evidence for impact of transparency and accountability initiatives in areas such as public services and budgets is sparse.⁴¹

The extractive industries are an area where it has long been recognised that there is a strong case for transparency to enhance governance and accountability, and to improve both the investment environment and the impact of the industry the welfare of society. However a key lesson from over 15 years of focused work has been that generating impacts from transparency is difficult. The Extractive Industry Transparency Initiative (EITI) is one of the oldest transparency and accountability initiatives (see box 3) and its experience highlights that transparency is not an end in itself. Outgoing chair Claire Short argues that a successful EITI must not be measured by the number and length of reports, but by whether the process has strengthened government and company transparency and accountability.⁴²

39 Nitsch, V. (2016). Trillion Dollar Estimate: Illicit Financial Flows from Developing Countries. In: Darmstadt Discussion Papers in Economics, 227 and Johannesen, N. & Pirttilä, J. (2016). Capital flight and development: An overview of concepts, methods, and data sources. 2016/95, UNU-WIDER.

40 Ben-Shahar, O. and Schneider, C. (2014) More Than You Wanted to Know: The Failure of Mandated Disclosure. Princeton University Press.

41 McGee, R. and Gaventa, J. (2011). Shifting Power? Assessing the Impact of Transparency and Accountability Initiatives IDS Working Paper. Volume 2011 No 383. Institute for Development Studies. University of Sussex.

42 Short, C. Challenge one: Integrating the EITI into government systems (2016) <https://eiti.org/blog/challenge-one-integrating-eiti-into-government-systems>

Box 3: EITI: Learning from experience*

Under the EITI, countries mandate that extractive industry companies disclose what they pay to the government in tax, royalties and signature bonuses. The governments then disclose what they receive. The figures are broken down by company, project and revenue stream and reconciled in an independent report.

51 countries are currently members, of which 31 have achieved compliance. 45 countries have published EITI Reports and more than \$1.93 trillion in government revenues from the oil, gas and mining sectors, covering 281 fiscal years, have been disclosed. More than 300 people work in the 51 national secretariats and over 1,000 people serve on national multi-stakeholder groups and the International Board. More than 90 companies support the EITI as well as over 90 institutional investors with funds under management \$19 trillion. More than 400 NGOs are involved with the EITI and approximately \$50 million is spent globally every year to support EITI reporting. Recent evaluations of the EITI have found that the initiative has succeeded in terms of building up its membership and producing reports, and has had some success in engaging civil society groups, however "it seems to have failed to empower the public to hold the governments and companies into account."

Key problems include a lack of public interest in the information offered by EITI, a lack of strategy for holding the public sector accountable for the use of revenues, and decisions made by consensus, not sufficiently based on evidence. The EITI has become heavily involved in routine operations at country level becoming less of an 'initiative' and more of a top down 'organization' – with a danger that the focus is too much on supporting and building the infrastructure for EITI reports and less on developing government systems.

* Rich, E. and Moberg, J. (2015): Beyond Governments – Making collective governance work: Lessons from the Extractive Industries Transparency Initiative. Sheffield: Greenleaf Publishing Limited., Scan Team (2011) Evaluation ion of the Extractive Industries Transparency Initiative. Final Report, Rustad, S., Le Billon, P. and Lujula, P. (2016): Has the Extractive Industries Transparency Initiative been a success? Identifying and evaluating EITI goals'. Working Paper, GIZ (2016) Assessing the Effectiveness and Impact of the Extractive Industries Transparency Initiative

2.6 Considering effectiveness, costs and harms

That the numbers are not as large as they are sometimes perceived to be, and that translating transparency into accountability is hard, are not a reason not to act, but these cautions suggest that we should not be overoptimistic that broad transparency measures would be an economic gamechanger. Many transparency initiatives are new and untested, and therefore the costs and benefits are hard to quantify. Nevertheless, the strategic view of transparency as a means to an end suggests that we should consider how best to achieve a particular objective, and look at all the options in terms of effectiveness, costs and harms.⁴³ The following chapters uses this framework to look at the objectives and options in two areas of financial transparency: beneficial ownership and country-by-country reporting.

Figure 3: Transparency costs and benefits

Benefits: effectiveness at achieving objective	Costs/harms
<ol style="list-style-type: none"> 1. Deterring/ exposing individual wrong-doers 2. Enabling citizens to understand and hold governments to account 3. Facilitating commercial relations 4. Building trust in governance 5. Providing data to support research, learning and innovation 6. Open data formats reduce cost of accessing, sharing and using information. 	<ol style="list-style-type: none"> 1. Direct costs and administrative burden of collection 2. Cost of publication and dissemination 3. Loss of specific privacy and confidentiality 4. Perverse impacts of information disclosure on users – providing false assurance or exaggerating concerns. 5. Perverse impacts on actors whose behaviour is disclosed: openness can inhibit honesty and experimentation, and drive further secrecy 6. Distraction of efforts from other means to meet objectives.

Developed by author

43 For a recent discussion of the potential benefits, costs and harms of transparency see also Taylor, R. and Kesley, T. (2016). Transparency and the Open Society. Policy Press.

3 BENEFICIAL OWNERSHIP TRANSPARENCY

Beneficial ownership: issues and options

'Shell companies' are those that do not undertake activities themselves, but are containers for owning assets. The ultimate beneficiaries are not necessarily the same as the legal owner, which can be another company, a lawyer, or an associate. While all companies are recorded on an official government registry, often this only includes a contact person, not details of the legal or beneficial owner. The majority of shell companies (including those with nominee owners) are used for ordinary, legal purposes, but they can also be used as 'getaway vehicles' for crime.* Cases of serious transnational financial crime including grand corruption, tax evasion, sanctions-busting, terrorist finance and money laundering tend to involve companies and trusts that cannot be traced back to their real owners.†

The FATF recommendation is that "countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities."[‡] There are several different approaches practiced and proposed to meet this:[§]

- **Information held by CSPs:** The most common approach has been for jurisdictions to impose a duty on corporate service providers (CSPs) that register companies to collect and verify documents establishing the true identity of beneficial owners, and to require them to make this information available to law enforcement, courts and regulators.
- **Central registries:** Another approach is to collect this information centrally. In general there is no verification. The EU instituted a new standard in 2015 requiring member countries to set up central registers with information available to law enforcement, tax authorities and regulators, as well as those that can demonstrate a 'legitimate interest'.
- **Closed central registries with automatic exchange of information:** The UK, Germany, France, Italy and Spain have agreed develop a system to exchange data between government authorities, and are pushing for this system to be implemented globally.
- **Public central registries:** Public registries are increasingly popular. The UK, Ukraine Netherlands, Australia, South Africa and Nigeria have developed or are committed to developing this.|| Most recently the European Parliament has also voted in support of this measure.¶ As with closed registries there is no verification however the hope is that as well as the deterrent of criminal penalties, it will be harder for people to make dishonest declarations, as the registry will be open to scrutiny by journalists, NGOs and other parties.

* ICIJ (2013) Inside the Global Offshore Money Maze. ICIJ.

† Van der Does de Willebois, E., Halter, E., Harrison, R., Park, J.W. and Sharman, J. (2011) The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It. World Bank.

‡ FATF Guidance (2014) Transparency and beneficial ownership

§ Sharman, J. (2016). Solving the Beneficial Ownership Conundrum: Central Registries and Licenced Intermediaries. Jersey Finance

|| Davies, R. and Gower, R (2016) Letting the Public In Opportunities and Standards for Open Data on Beneficial Ownership, Country-by-Country Reporting and Automatic Exchange of Financial Information. Financial Transparency Coalition.

¶ European Parliament News (2017) Citizens should get access to data on firm owners to fight money laundering <http://www.europarl.europa.eu/news/en/news-room/20170227IPR64164/citizens-should-get-access-to-data-on-firm-owners-to-fight-money-laundering>

Within the overall objective of tackling financial crime, fraud, corruption, tax evasion, sanctions-busting, terrorist finance and money laundering there are two different uses for beneficial ownership information:

1. **Preventing impunity – after the fact:** enabling those responsible for corruption and crime to be tracked down, exposed and brought to justice and also allowing contractual and civil liabilities to be pursued.
2. **Reducing risk – in advance:** making it easier for businesses and public entities to know who they are doing business with, and avoid being subject to fraud, collusion embezzlement or implicated in money laundering.

These two uses are complementary – enforcing the law and enabling civil and criminal liabilities to be recovered after the fact not only delivers justice but also reduces the attractiveness of crime and sharp practice as a risk-return prospect. Making it harder for those intent on committing crimes to pose behind innocent looking fronts in the first place makes fraud, embezzlement and other crimes harder to commit, and reduces the temptation for opportunistic evasion of taxes and other responsibilities.

The different uses rely on access to the same information (on legal, and ultimate beneficial ownership). However the scale and logistics of who needs to know are quite different, and neither case depends necessarily on public access.

Use case	Who needs to know?	About how many companies?	On what trigger?	Information obtained on what basis
Preventing impunity	Relatively small numbers (law enforcement, civil litigants)	Relatively small numbers of companies	Suspicion of wrong doing	Must not rely on cooperation of beneficial owner, or alert them of investigation
Reducing risk, promoting good behaviour	Relatively large numbers (any company or public bodies doing business)	Relatively large numbers of companies (all prospective business partners)	Customer, vendor, creditor due diligence and onboarding.	Can depend on cooperation of beneficial owner: e.g. giving permission for a bank reference

Figure 4: Practical requirements for beneficial ownership data

There can also be specific cases for public beneficial ownership in areas such as the extractive industry, public contracts and fishing licenses and vessels, where there are particular risks of authorities awarding licenses based on political connections and where participation of public officials or politically exposed persons in projects can create conflicts of interest and facilitate the diversion of public revenues through corruption.⁴⁴

Figure 5: Beneficial ownership options

There are several options for enabling access to beneficial ownership information, which can be combined with different approaches to verification of the information:

Who is required to hold the information?	Verification	Example
Regulated CSPs	Weakly enforced/ loopholes	British Virgin Islands (BVI) (previously)
	Strongly enforced	BVI (in development)
Closed central register	Self reported	EU
	Administrative spot checks	
	+ CSP regulation	Jersey
Public central register	Self reported	UK
	Administrative spot checks	Proposed by Financial Transparency Coalition
	+ CSP regulation	

3.1 Effectiveness

The two key measures of effectiveness of beneficial ownership transparency (in line with the FATF recommendation) are *reliability* of the information, and *timely access* to it.

CSP regulation: effective if enforced. The World Bank report ‘Puppet Masters: How the Corrupt Use Legal Structures to Hide their Stolen Assets and What to do About It’ is one of the most in-depth studies of the issues of beneficial ownership. It drew on evidence from cases of grand corruption, interviews with regulators and law enforcement officials, and a ‘mystery shopping’ exercises seeking to set up anonymous shell companies in different jurisdictions.⁴⁵ The Puppet Masters report concluded that requiring corporate service providers to collect and verify beneficial ownership information is much more effective than relying on self reporting by beneficial owners to a central register. Central registers it found were ‘better than nothing’, but as they are generally passive archives they could not be relied on to secure reliable information.

⁴⁴ Natural Resources Working Group (2016) Disclosing beneficial ownership information in the natural resource sector. Issue Brief.

⁴⁵ Van der Does de Willebois, E., Halter, E., Harrison, R., Park, J.W. and Sharman, J. (2011) The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It. World Bank.

However, while CSP and bank regulation are the predominant current mechanisms for gathering beneficial ownership information, it is clear that there are weaknesses and loopholes in implementation. A recent FATF report highlights problems with weak regulation of service providers, lack of sanctions for failure to maintain accurate records and obstacles to sharing data when it is needed.⁴⁶ In the UK for example it is an offence to knowingly or recklessly provide false or misleading information to Companies House, however according to Transparency International no company service provider has ever been sanctioned for non-compliance with their due diligence requirements.⁴⁷ In many countries the risk-based approach that requires corporate service providers to apply enhanced customer due diligence is simply not being implemented. The UK's Financial Services Authority published a report on banks' management of high-risk money-laundering situations. They found that a third of banks failed to take adequate measures to understand and verify their customers' ownership and control structure.⁴⁸

Contrary to popular belief, offshore financial centres tend to have stronger systems of CSP regulation than major economies. However the Panama Papers exposed a key weakness; in some jurisdictions an 'eligible introducers' exemption allows on-shore banks or law firms to vouch for the identity of someone registering a company without the offshore CSP having to carry out their own checks or hold the information themselves.⁴⁹ The idea is that the 'eligible introducer' is better placed to collect and verify 'know your customer' documentation from their local customers than the offshore service provider, and it is more efficient to do this once. However this system can break down if the CSP does not collect the information at the time of registration, and the eligible introducer later declines to produce the information or says that they do not have it.⁵⁰ Jurisdictions may also drag out the process of mutual legal assistance, delaying responding to requests for information.⁵¹ The British Virgin Islands has recently taken action to close the 'eligible introducer' loophole, requiring CSPs to hold information on all beneficial owners locally.

Jason Sharman (who led the World Bank 'mystery shopper' studies) argues that strengthening regulation of CSPs, through a regime of audits backed with sanctions would be more effective than establishing central registers which rely on the criminal and corrupt to self-report their holdings.⁵²

Central registers: make access easier, but don't address verification. Closed central registers provide a central means of access to beneficial ownership information. This can make it easier for law enforcement to access information quickly and also opens the potential for automatic exchange of information.⁵³ However they generally lack any means of verification. Jersey is one exception combining strong CSP regulation with a central register. The BVI is also developing a central register alongside its CSP regulation.

Open public registers do not solve the critical problem of verification, but offer broader universal *access* to information. Advocates for this system argue that this reduces the barriers for authorities from other countries to access the information as well as allowing citizens, journalists and civil society to hold company owners to account.⁵⁴ A further argument for open registers is that it would allow easier access by businesses undertaking due diligence checks on new potential customers, creditors, partners etc.

46 FATF (2016) FATF Report to the G20 on Beneficial Ownership

47 Transparency International –UK (2013) Transparency & Trust: Enhancing the Transparency of UK Company Ownership & Increasing Trust in UK Business. Submission to BIS.

48 UK Financial Services Authority (2011) Banks' management of high money laundering risk situations www.fsa.gov.uk/pubs/other/aml_final_report.pdf

49 Messick, R. (2016) Not the "Panama Papers" But the "BVI Papers" or Better Still the "EI" Papers. April 13 2016. Global Anti-Corruption Blog. <https://globalanticorruptionblog.com/2016/04/13/not-the-panama-papers-but-the-bvi-papers-or-better-still-the-ei-papers/>

50 Kenney, M. (2016) Lets Have an Honest Discussion about BVI. FCPABlog <http://www.fcpablog.com/blog/2016/12/1/martin-kenney-lets-have-an-honest-discussion-about-the-bvi.html>

51 Chene, M. (2008) Mutual Legal Assistance Treaties and Money Laundering. U4 Expert Answer (July 29), U4 Anti-Corruption Resource Center, Chr. Michelsen Institute.

52 Sharman, J. (2016). Solving the Beneficial Ownership Conundrum: Central Registries and Licenced Intermediaries. Jersey Finance.

53 Tax Justice Network (2016) Automatic Information Exchange is not the answer! <http://www.taxjustice.net/2016/05/28/automatic-information-exchange-is-not-the-answer/>

54 <https://financialtransparency.org/issues/beneficial-ownership/>

Great hope has been placed on the ‘many eyes’ principle that open databases will be more accurate because of the role of the public, journalists and NGOs in data verification. Transparency International argues that “combined with robust Asset Declarations and a thorough database of Politically Exposed Persons, civic society can match up the information and track irregularities – providing law enforcement with a start point for investigations.” However matching databases is a trivial task. It is the follow-up investigations that require significant resource.⁵⁵ Similarly for bank know your customer (KYC) and other due diligence, consulting an unverified public register would not be able to take the place of other checks.

Early experience of how ‘many eyes’ might be applied to public registers is being developed from UK’s first release of beneficial ownership information. Global Witness and other NGOs brought together thirty volunteers over a weekend to look at the data. Their experience highlights the hopes and practical limits of open registers. They compared the UK register with other datasets such as the US sanctions list and lists of politically exposed people – but recognised that they had no means to check whether their ‘hits’ reflected people sharing the same name and birthdate, nor whether people had lied to the register. They highlighted issues such as that 3 000 companies listed their beneficial owner as a company with an offshore address in jurisdictions such as Jersey, BVI and the Isle of Man. However without the power to demand further information from these companies all they were able to do was pass the matter back to Companies House for their attention.⁵⁶ Hera Hussain at Open Corporates notes that using the database alone to investigate fraud is like searching for a needle in a haystack, with many false positives amongst the potential leads.⁵⁷ It is certainly worth these organisations continuing to test and investigate what use can be made of the UK’s public beneficial ownership register. However it is hard to see why this is preferable to a regulated system. Verifying beneficial ownership information is a routine administrative process, which is important but boring, and which relies on triangulating with other information which may not be in the public domain. In the vast majority of cases there is no particular scandal to motivate investigative journalists, NGOs or other volunteers to comb through the haystack, and they lack information and powers to do it efficiently.

3.2 Costs and harms

Open self-declared public registers are relatively cheap to operate, particularly if the country already has an open corporate register, since it essentially involves adding a few extra fields to an existing form. For example the impact assessment of the UK’s open public register found that “*assuming beneficial ownership information is submitted at incorporation and in the context of the annual return there will be very little additional cost in terms of staff resources as 98% of incorporations and returns are handled electronically.*”⁵⁸ However, as outlined above it is also not clear that asking criminals and corrupt individuals to self-register through an unverified system would be effective. Launching a cheap but ineffective system with much fanfare (as the UK did with its beneficial ownership register) may take pressure away from resourcing the capacity needed to police a more robust system.

Closed central registers are more expensive than open ones since they require systems to ensure confidentiality of the information while allowing access by competent authorities.

The cost of verification is not trivial, and a critical issue is that the benefits may be accrued outside of the jurisdiction. Checking identity can be an expensive process; whether carried out by a public sector entity or by private businesses. There is a tension between keeping the costs, delays and annoyance for legitimate business owners reasonable, while at the same time trying to make it more difficult for those determined to use shell companies to hide their identities. This is exacerbated by the problem of split incentives between the costs

55 Transparency International –UK (2013) Transparency & Trust: Enhancing the Transparency of UK Company Ownership & Increasing Trust in UK Business. Submission to BIS.

56 Palmer, R. and Leon, S. (2016). What Does the UK Beneficial Ownership Data Show Us? Blog / 22 Nov 2016 https://www.globalwitness.org/en-gb/blog/what-does-uk-beneficial-ownership-data-show-us/?gclid=CK_Jo6HY4tECFQsWowod1o0IMg

57 Hussain, H. (2016) Can the UK’s beneficial ownership data be used to investigate corruption & money laundering? <https://medium.com/opencorporates/can-the-uks-beneficial-ownership-data-be-used-to-investigate-corruption-money-laundering-9227f6d5f69a#sxnv6z6sv>

58 BIS (2013). Consultation stage Impact Assessments to Part A of the Transparency and Trust proposals (December 2013)

incurred by one jurisdiction, and the benefits of enhanced law enforcement in another. This imbalance is particularly marked for offshore jurisdictions, since they are in the business of providing corporate and financial services for activities that take place elsewhere, and they are in competition with each other for this business.

A system of CSP regulation passes most of this cost to service providers, and on to their customers, as well as to banks through anti-money laundering regulations. It requires a publicly funded system of audits and inspection to ensure that CSPs carry out their role adequately, however fines for non-compliance would also offset this. Such a system requires resourcing, but the costs do not appear exorbitant since small developing countries such as the Seychelles are able to implement it.⁵⁹

Administrative verification and ‘spot checks’ on a self-reported register are likely to be less effective and more expensive. A verification system which relies on checking by a public agency keeps all of the costs and risks on the public purse – they can be recovered to some extent through corporate registration fees – but an administrative system is less flexible than a risk-based system– the fee levels must be standardized, whereas CSPs can charge for their time and risk where a particular case requires more detailed due diligence.

The Financial Transparency Coalition argues for public central registers and against putting the onus of verification on “profit-seeking middlemen.”⁶⁰ They believe that public registers combined with government spot checks and ‘proportional and sufficient penalties’ on those found to have misreported their ownership could be more effective. However is not clear why this would be the case. The majority of company owners are basically law-abiding, with a minority being opportunistic tax evaders, and a smaller minority being motivated criminals, kleptocrats or terrorists. Misdeclarations are likely to reflect many more business owners not filling in the forms correctly than criminals purposely giving false information (and those that have the most to hide will make themselves hardest to detect). Given this balance of probabilities due-diligence undertaken by a professional service provider is more likely to yield ‘hits’ in terms of identifying dodgy characters and turning down their business, than random spot checks of a self-declared register. The profit motive of CSPs provides a targeted means of leverage and scrutiny for regulators, as they can impose heavy fines and the threat of losing their license. On the other hand the level of fines that might be proportional and sufficient to incentivize a law abiding business owner to take care to fill in the forms correctly would not make a difference to a kleptocrat or crime boss purposefully lying on the forms, while massive penalties for basic administrative errors would be unjust.

There is also a question about privacy. While there is a clear principle that people should be able to know whom they are doing business with, this is not the same as being able to know everybody’s business. In the US for example private companies are under no obligation to make their accounts or other financial information publicly available. The theory here is that potential shareholders, creditors, and business partners of a private company will require the information they need as a condition to their investment or loan.⁶¹

Apart from owner-occupied properties, most assets in modern economies tend to be owned through corporate structures, and many of these are holding companies rather than trading entities. A universal register of beneficial ownership of companies would be a register of who-owns-everything. Reverse searchability and data processing power means it could easily be converted into a register of everything-that-is-owned by each individual (at least in relation to entrepreneurs and other high-net worth individuals, that tend to use corporate structures). Given that the vast majority of these individuals are not kleptocrats or criminals, but that they have reasonable a preference for privacy in their personal affairs, this needs to be recognized as a harm. Privacy concerns may be overruled by the public interest, in allowing tax authorities and law enforcement access information to the information, but it is not clear that there is a proportionate justification for everyone’s information to be made public.

59 Sharman, J. (2013) Preventing the misuse of shell companies by regulating corporate service providers. CMI Brief

60 Roovers, K. & Makkonen, H. (2016) Does Jersey’s business incorporation model make public scrutiny obsolete? Financial Transparency Coalition. <https://financialtransparency.org/jerseys-business-incorporation-model-make-public-scrutiny-obsolete/>

61 Jones Day (2012) Public Disclosure Requirements for Private Companies: U.S. vs. Europe

Loss of privacy and confidentiality is not only a harm felt by the individuals. Business confidentiality allows for firms to invest in new ventures and knowledge creation without any gains immediately being eroded by competitors. This might include for example early knowledge that a company is setting up a subsidiary in a particular country, or has acquired another company for its technology. While there are clear areas where beneficial ownership should be known (such as when a company is bidding for a public contract or concession), this does not necessarily mean that the beneficial owners of every company need to be in the public domain

Finally is the potential harm of **creating a false sense of security**, and weakening other areas of due diligence. Access to unreliable information is worse than useless. One argument of open registers is that as a ‘one stop shop’ allow both law enforcement, and also businesses undertaking due diligence on potential partners, creditors, customers etc. easy access to information. However both of these use cases depend on the reliability of the information. If banks and other businesses rely on unverified information for their ‘Know Your Customer’ processes, this will make this due diligence weaker rather than stronger.

Figure 6: Summary of effectiveness vs costs/ harms

System		Effectiveness			Cost/harms		
Who holds information?	Verification	Reliability of information	Access by competent authorities	Access for KYC	Cost	Reasonable Privacy	Weakens other CDD
CSP Regulation	Weakly enforced/ loopholes				Low		
	Strongly enforced			Via banks CDD	Medium		
Closed central register	Self reported			Via banks CDD	Low		!!!
	Administrative spot checks			Via banks CDD	High		!!
	CSP regulation			Via banks CDD	High		
Public central register	Self reported				Low	!!!	!!!
	Administrative spot checks				Medium	!!!	!!
	CSP regulation				Medium	!!!	

It seems likely that only systems which include strong CSP regulation meet the critical requirement of providing reliable information. This can be combined with closed public registers as in Jersey (and more recently being developed in the BVI), however this is a higher cost system and therefore would be disadvantageous to small developing country states that operate international financial centres.

While combining CSP regulation and bank due diligence to meet the needs of different information users perhaps does not seem as elegant as a single one-stop shop central database of beneficial ownership information, it has the advantage of aligning the costs of regulation with the location of law enforcement – companies may be registered anywhere, including small states, and all should meet the basic requirements of traceability, but bank accounts tend to be held in major economic centres, where legal investigations are also initiated. Similarly transparency of beneficial owners of companies tendering for public contracts or concessions can be required through the laws and contract conditions of those countries, rather than relying on regulations elsewhere.

CSP regulation (for reliability) could, in theory, be combined with open public registers (maximizing access), however if reasonable privacy concerns are taken seriously, then it is not clear that this is the ‘best of all worlds’ as it trades off a loss of privacy against no clear case of greater effectiveness. Furthermore it again reduces the incentives for jurisdictions to provide public resources to strengthen the effectiveness of CSP regulation, since they would then have to give away the information for free, rather than as part of an arrangement of mutual legal assistance with other jurisdictions. Jurisdictions which specialize in setting up offshore corporations have a valid interests in maintaining attractive privacy rules whilst demonstrating compliance with international standards and cooperation with legal investigations.⁶²

3.3 Other complementary approaches

Ensuring that CSP regulation and mutual legal assistance are effective appears to be the most urgent and critical step in preventing anonymous companies being used as getaway vehicles for crime, whether countries choose to adopt central, or indeed public, registers or not. This suggests a need for **practical tests and ratings** which assess the effectiveness of these systems. This could include ‘mystery shopper’ audit studies, field studies of how easy it is for competent authorities to trace beneficial ownership, ratings on how quickly countries respond to requests of mutual legal assistance. Different countries are taking different approaches and comparative studies can reveal what is working in practice, rather than assessing them against theoretical ideals.⁶³ FATF recommendations include that countries undertake national risk assessments. Transparency International recommends that these should be undertaken in consultation with key stakeholders and published online.⁶⁴

Targeted requirements for beneficial ownership declarations do not raise the same privacy issues as universal registers. Requirements for public beneficial ownership in key areas such as companies bidding for public contracts and concessions, and for owners of ships and fisheries permits can be undertaken without requiring that all companies make their beneficial ownership information public. This is supported by open contracting and extractive industry transparency initiatives. Similarly requirements for politically exposed persons (PEPs) to make financial disclosures should be strengthened to require them to declare assets owned through legal entities, including when they are held in the name of a nominee.⁶⁵

Whistleblowing regulations are a key complement to administrative measures, they are crucial in seeking to protect the interests of society by helping to ensure that information about wrongdoing or serious risk gets to the right people at the right time. They must effectively balance three main sets of rights: the public’s right to information and to know when their interests are at risk; the right of whistleblowers to freedom of expression and fair treatment; and the right of organisations to manage their operation and their reputation.⁶⁶

Finally advances are needed to make it easier for people and companies to authenticate their **legal identity** and for others to make faster, less costly and more reliable assessments of who they are doing business with. According to the World Bank 1 in 5 individuals (mainly in Africa and Asia) are unable to prove their identity, and therefore can struggle to access financial services, social benefits, healthcare and political rights. Without strong identification systems countries struggle to deliver these services. Technological solutions such as digital and biometric identification offer the opportunity to leapfrog

62 See Botho Emmen, M. (2015). When Transparency Isn’t the Answer: Beneficial Ownership in High-End Real Estate. March 23 2015. Global Anti Corruption Blog <https://globalanticorruptionblog.com/2015/03/23/when-transparency-isnt-the-answer-beneficial-ownership-in-high-end-real-estate/> and AIMA (2016). Transparent, Sophisticated, Tax Neutral: The Truth About offshore funds

63 Sharman, J. (2012). Chasing kleptocrats’ loot: Narrowing the effectiveness gap. U4 Issue, August 2012 No 4. Anti-corruption Resource Centre.

64 Goodrich, S. (2016) Just on Paper? Beneficial Ownership Legal Frameworks in BVI, Cayman & Montserrat. Transparency International?

65 Rossi, I. and Pop, L. (2015) Keeping the truth (and luxury New York apartments) hidden, while not lying. March 16 2015. Stolen Asset Recovery Initiative. <https://star.worldbank.org/star/content/keeping-truth-and-luxury-new-york-apartments-hidden-while-not-lying>

66 See for example Open Government Guide: Whistleblower Protection <http://www.opengovguide.com/topics/whistleblower-protection/>

traditional paper-based approaches.⁶⁷ Global Legal Identifiers for companies are a critical part of this emerging trust architecture and are being developed to enable firms to better understand their credit and market risk exposures.⁶⁸ A shift to readily identifiable and authenticable individual and corporate identities would not only make existing due diligence requirements easier to fulfil and harder to evade, they would also unlock the potential to make the financial system more efficient, effective and resilient through seamless, real-time payments, distributed commerce, more sophisticated client targeting and more accurate credit scoring.⁶⁹ However, privacy protections also need to be built into the development of these systems.⁷⁰

67 World Bank (2016) Identification for Development Strategic Framework <http://pubdocs.worldbank.org/en/21571460567481655/April-2016-ID4D-Strategic-RoadmapID4D.pdf>

68 In 2014 the Financial Stability Board established the Global Legal Identifier Foundation to take this work forward. <https://www.gleif.org/en/>

69 Carney, M. (2017). The Promise of FinTech – Something New Under the Sun? Speech at Deutsche Bundesbank G20 conference on “Digitising finance, financial inclusion and financial literacy”, Wiesbaden <http://www.bankofengland.co.uk/publications/Documents/speeches/2017/speech956.pdf>

70 Nyst, C., Pannifer, S., Whitley, W. and Makin P. (2016) Digital Identity: Issue Analysis. Report by Consult Hyperion for Omidyar Foundation. http://www.chyp.com/wp-content/uploads/2016/07/PRJ.1578-Digital-Identity-Issue-Analysis-Report-v1_6-1.pdf

4 PUBLIC COUNTRY-BY-COUNTRY REPORTING

Country-by-country reporting: issues and options

The 'publish what you pay' movement has long argued for a form of country-by-country reporting of revenues by extractive industry companies in order to hold governments to account for their use of natural resource revenues and to tackle corruption, fraud and poor governance.*

More broadly the tax justice movement calls for general publication of country-by-country reports (giving headline information about the activities, earnings and tax bills of multinational corporations, in each jurisdiction where they do business).† This has recently been adopted in a more limited form as a risk assessment tool by the OECD. This chapter relates to the general form of CBCR, rather than the specific extractive industry area.

Transparency options include:

- **Headline country-by-country reporting home tax authority, shared with others** – This is the approach that has been agreed by the G20/OECD as part of the Base Erosion and Profit Shifting (BEPS) programme. Companies are required to submit CBCR reports to the tax authority in their home jurisdiction, this will then be shared it with other jurisdictions through mutual exchange of information agreements.
- **Direct filing of country-by-country reporting to all tax authorities** – Another proposal for country-by-country reporting to tax authorities would be agree that make this information a direct filing requirement in each country (as part of the 'master file' requirement for BEPS transfer pricing documentation).
- **Public headline country-by-country reporting.** Many civil society organizations, and some investors call for governments to mandate that companies publish country-by-country reports. These include include Tax Justice Network, Transparency International, Financial Transparency Coalition, Eurodad, Christian Aid and Oxfam International, as well as the European Commission.
- **Full country by country reporting** – The Tax Justice Network (TJN)'s full proposal for CBCR is that multinational companies should be required to publish "a profit and loss account and limited balance sheet and cash flow information for every jurisdiction in which they trade as part of their annual financial statements".

An additional option is for tax authorities to agree to publish aggregated or anonymised data to allow researchers to explore features of tax policy implementation without access to the underlying corporate information.

* Parham, H., and van Oranje, M. (2009) Publishing What We Learned. Publish What You Pay. <http://www.publishwhatyoupay.org/en/resources/publishing-what-we-learned>.

† See for example Murphy, R. (2012) Country by Country Reporting: Accounting for globalisation locally. Tax Justice Network and Murphy, R. (2016) The Case for Making Country-by-Country Reporting Public. Trade Union Advisory Committee to the OECD.

The European Commission in its impact assessment survey on CBCR found wide disagreement between civil society organisations and businesses not only on whether CBCR should be public, but what the underlying objectives of the policy should be. Businesses tend to have greater support for CBCR to tax authorities, which is envisaged as a risk assessment tool, with the aim of supporting enforcement of existing tax rules. Those advocating for public country by country reporting believe that it can support a different aim; that of assessing companies against a broader principle of 'tax fairness', and to support public debate on potential changes to the current tax rules by highlighting 'legal but questionable tax practices'.

The 90 + countries involved in G20/OECD BEPS process have agreed to require country-by-country reports from large multinationals on a confidential basis – with only tax authorities having access to the data (and then sharing it with others). However many organisations campaigning on financial transparency are calling for the information to be made public.⁷¹

71 Financial Transparency Coalition (2016) Why Public Country-by-Country Reporting for Large Multinationals is a Must. http://financialtransparency.org/wp-content/uploads/2016/02/Joint_Civil_Society_QA_pCBCR.pdf

There are two broad arguments for public transparency of the information⁷²:

1. **Publication is the simplest way for tax authorities to access the information** – The BEPS process for country-by-country reporting provides information to assist tax authorities to administer existing laws. It is argued that it is too difficult for developing country tax authorities to access this information through exchange of information; therefore it should be made public.⁷³
2. **The public as citizens (and media and NGOs) need information to enable informed debate and democratic accountability of the tax system**, ultimately improving effectiveness and trust in the tax system. 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.”⁷⁴

The two objectives are complementary – tax authorities *should* have enough information to apply the tax rules, and public and makers policy *should* have enough information to subject tax policy and implementation to democratic scrutiny. However it is self-evident that the same dataset can do both jobs.

Figure 7: Potential users and objectives of public country by country reporting data

User	Aim	What do they need to know	What will they judge it against	What would they do with the information?
Tax authorities in developing countries	Enforce compliance	CBC data for individual MNCs in their jurisdiction	Existing tax laws	Risk assessment to direct audits of individual companies
The public, policy makers	Democratic accountability on tax policy	Not clear what information about individual companies	Own criteria of effectiveness, efficiency, equity	Support calls for tax reforms, Judge performance of authorities
Investors, consumers	Encourage corporate responsibility, understand risk	Not clear what information about individual companies.	Criteria of responsible tax practice (to date undeveloped)	Make investment, purchasing choices

4.1 Effectiveness

Information for tax authorities in developing countries

The headline indicators provided by the table of country- by-country data are intended as a risk assessment tool for tax administrations to identify where companies are booking profits in places with no economic substance. As Pascal St Amans, Director of the Centre for Tax Policy and Administration at the OECD argues “tax administrations will be able to identify very clearly, in a single document, whether or not they “smell a rat,” such as where, for example, you have all your profits in a zero tax jurisdiction where you have no sales, no employees and no assets”.⁷⁵ In practice, it is not yet clear how much impact

72 NB: This analysis relates to country-by-country reporting as a general requirement for multinational corporations. There can be other specific objectives for country-by-country or project-by-project reporting such as in relation to the extractive industries. These are not addressed here.
 73 Knobel, A. and Cobham, A. (2016) Country-by-Country Reporting: How Restricted Access Exacerbates Global Inequalities in Taxing Rights, Tax Justice Network.
 74 Council of Europe (2016) Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches (CBCR) - State of play
 75 St Amans, P. (2012) “Introducing BEPs” EY – Tax Insights for business leaders No. 12 [http://www.ey.com/Publication/vwLUAssets/EY-avocats-Pascal-Saint-Amans-ocde/\\$FILE/EY-avocats-Pascal-Saint-Amans-ocde.pdf](http://www.ey.com/Publication/vwLUAssets/EY-avocats-Pascal-Saint-Amans-ocde/$FILE/EY-avocats-Pascal-Saint-Amans-ocde.pdf)

CBCR reports will have, and tax administrations are not yet clear how they will use them. For example HMRC estimated that CBCR would result in an additional £5–10 million of revenue a year.⁷⁶ This is only around 0.01% of the country's corporate tax take – suggesting minimal impact (although it could turn out that these estimates were overly pessimistic). Developing countries with weaker tax capacity tend to be more vulnerable to multinational tax avoidance.⁷⁷ Therefore they might be a greater relative potential to gain from using this information. But tax authorities may also have other priorities than being the first to use this untested new tool, as Professor Jeffrey Owens argues; “In a typical developing country, the first priority is to get your tax administration working. Because without that, you can have whatever international arrangements you want, but you're not going to be able to do transfer pricing properly; you're not going to be able to exchange and use information.”⁷⁸

In relation to providing information for tax authorities in developing countries there is concern that they will not be able to get access through the exchange of information mechanism initially agreed. Under the current automatic exchange of information mechanisms, the Parent company has to provide the CBCR to a tax authority in their home jurisdiction, and all subsidiaries then notify their own authorities on which tax authority they need to approach for the information. This is an unwieldy process which will leave some developing country authorities unable to access the information at all, as it requires mutual agreement between jurisdictions under a ‘dating system’ similar to the CRS for banking information. The limited AEOI mechanism initially developed reflected concerns about confidentiality which were a dealbreaker for major countries such as the US and China.⁷⁹

Access could be improved by broadening access to all developing countries that meet the requirements for securing confidentiality. Requiring direct filing to each jurisdiction would reduce the barriers to access further, and would be an improvement in terms of ease, as it could be achieved simply by including the CBC report within the ‘local file’ requirements of the BEPS transfer pricing documentation rules.

However in each case broadening access increases the risk that information submitted under confidentiality will not be kept secure. There are also worries that countries may seek to use the information to demand taxes on a formulary basis. The OECD BEPs process for CBC specifically allows for jurisdictions to stop sharing information in this case.

Open publication would provide the broadest and simplest mechanism for developing country tax authorities to gain access to CBC information, however it would mean putting the information into the public domain – which is not the objective in this case. The Tax Justice Network argue that “Given the obvious benefit of online publication for MNEs, their opposition could only indicate that opacity serves them best, indicating either illegal, or at the very least, illegitimate conduct”⁸⁰. However this nothing-to-hide-nothing-to-fear argument is weak – we would expect taxpayer information submitted under confidentiality to remain confidential and only to be shared with other authorities that can also secure confidentiality.⁸¹ Given that countries will increasingly be sharing large quantities of sensitive banking information on individual tax payers, building up confidence in these systems is not something that can, or needs to be short-cut through a rush to publication, but will require the development of mutual experience of information exchange.

76 HMRC (2016) Country By Country Reporting Update <https://www.gov.uk/government/publications/country-by-country-reporting-updated/country-by-country-reporting-updated#detailed-proposal>

77 Johannesen, N., Tørsløv, T. and Wier, L. (2016) Are less developed countries more exposed to multinational tax avoidance? Method and evidence from micro-data. WIDER Working Paper 2016/10

78 Owens, J. and Lennard, M. (2014) Conversations with Jeffrey Owens and Michael Lennard, Tax Notes Int'l, February 3, 2014.

79 Bob Stack, then deputy assistant secretary at the U.S. Treasury, said that the US would not share country-by-country report (CbCR) information with foreign authorities who choose to make the reports public – see *Stack says US will withdraw CbC information if made public*, International Tax Review, at 13 (April 2016), <http://www.internationaltaxreview.com/Article/3541626/Stack-says-US-will-withdraw-CbC-information-if-made-public.html>.

80 Knobel, A. and Cobham, A. (2016) Country-by-Country Reporting: How Restricted Access Exacerbates Global Inequalities in Taxing Rights, Tax Justice Network.

81 Cockfield, A. (2016) How Countries Should Share Tax Information. Queens University Research Paper 080.

Approach		Effectiveness	Cost/harm			
		Access by all developing country authorities	Ease for companies	Ease for home jurisdiction	Ease for developing country jurisdiction	Concern about confidentiality, misuse
Shared between jurisdictions	Limited					
	Broad					!
Direct filing to each country						!
Published						!!!

Figure 8: Options for providing CBC reports to developing country governments

In practice some countries with economic muscle are running ahead of the exchange approach. Australia requires all companies operating in Australia that are part of a global group with annual global income of AUD \$1 billion to submit a country-by-country report. China and Germany also require direct filing if not obtained automatically from the other country.⁸² Once companies and countries become more confident with the process, and if the information proves useful, it is likely that more countries will push to be included in the exchange mechanism, or for CBC to be included within the routine local filings on transfer pricing.

Informing the public debate

The other argument for publication is that country-by-country reporting should be public by design, not just for convenience. As the Tax Justice Network argues “This would allow NGOs and journalists to expose[...] any major misalignment between the distribution of profit and the location of real economic activity.” Similarly the European Commission that public CbC would (1) incentivize companies to align more closely where they pay taxes with where profit-generating activities occur and (2) facilitate an informed democratic debate on corporate tax policy.⁸³ This argument is often seen as an extension of existing practices of transparency on issues such as carbon emissions and modern slavery. Montano Cabezas argues companies should disclose their tax returns for each jurisdiction in which they operate, in order to give market participants a tool to better understand a company’s comprehensive economic contribution to society.⁸⁴

Professor Alison Christians of McGill Faculty of Law argues that to trying to use morality to delineate areas of ‘legal but objectionable tax avoidance’ is counterproductive to the pursuit of coherent tax policy. Nevertheless she argues that public disclosure of tax-related data is critical for forcing governments to distinguish between legal and illegal behaviour within a regime that is capable of sustained public observation.⁸⁵

However many tax professionals, while recognising the need for a clear articulation of the difference between tax avoidance and tax evasion fear that publishing country-by-country reports would lead to a cacophony of accusations, misunderstandings and rebuttals, fuelling further public mistrust.⁸⁶ In particular there is a concern that additional disclosure would not take the public debate any further beyond the current situation where companies facing public censure respond that they pay taxes in full compliance with the law.⁸⁷

A cross-sector group convened by the Oxford Centre for Business Taxation on ‘Transparency in reporting financial data by multinational corporations’ was unable reach consensus on the aims of public country-by-country reporting. It notes the difficulty of defining the notion of the “proper” amount of tax due through processes of public debate

82 Knobel, A. and Cobham, A. (2016) Country-by-Country Reporting: How Restricted Access Exacerbates Global Inequalities in Taxing Rights, Tax Justice Network.

83 European commission (2016) Impact Assessment: assessing the potential for further transparency on income tax information <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52016SC0117>

84 Cabezas, M. (2014). Tax Transparency and the Marketplace: A Pathway to State Sustainability. McGill International Journal of Sustainable Development Law and Policy. Volume 10 Issue 2.

85 Christians, A. (2014) Avoidance, Evasion, and Taxpayer Morality. Washington University Journal of Law & Policy Volume 44.

86 Goodall, A. (2017) Public CbC reporting will do little for public confidence, UK tax professionals say <https://andrewgoodall.co.uk/2017/01/06/public-cbc-reporting-will-do-little-public-confidence-uk-tax-professionals-say/>

87 For example see “Apple’s Response on Its Tax Practices”, The New York Times (28 April 2012)

due to the complexity of tax law, the allowances and reliefs available and timing issues, and the risk of misinterpretation. Moreover, it highlights that there can be genuine additional difficulties in identifying the correct amount of tax due, even for tax authorities despite the very considerable powers and large amounts of information they have; different tax authorities may disagree on the conclusions to be drawn from the same facts.⁸⁸

Lowell Yoder, David Noren and Elizabeth Chao in a recent *Colombia Tax Law Journal* article argue that public CBCR will not achieve its aim of influencing corporate structure, since the many new rules introduced as part of the BEPS project are already causing MNEs to reevaluate their structures and make adjustments. They argue that MNEs are unlikely to revisit these structures yet again and intentionally choose to increase their tax liabilities further as a result of these public reports.⁸⁹

The debate about whether and how public CBC data could be used does not have to remain purely hypothetical (see box 4). Companies in the financial sector are already required to report key information on a country-by-country basis. For multinationals that mainly operate in Europe much of the information is also already in the public domain, albeit scattered amongst the accounts filed by subsidiaries in different jurisdictions.

Box 4: CBC analyses – how is the data being used?

Reports and analysis are already being undertaken using the type of information that would be included in public CBC reports. For example the Greens/EFA group in the European Parliament last year published a review of country-by-country reporting by banks which compared the reported profits with an alternative profit allocation using various formulas involving turnover and number of employees.* Similarly a group of French NGOs similarly have published reports based on CBC reporting by French banks.†

The French report demonstrates the general methodology, and the difficulty of drawing conclusions from headline indicators of profits, turnover, employee numbers and tax. It finds that French banks declare 1/3 of their profits in low tax jurisdictions notably Luxembourg, Belgium, Ireland, the Netherlands, Hong Kong and Singapore, but that this only represents a quarter of their activities and 1/6 of their staff, and that the banks are 60% more profitable in these jurisdictions than in other countries. It interprets this as a “disconnection between reported profits and actual business activity”. However they note that the lower tax jurisdictions host fewer retail banks and specialise in ‘highly financialised and more profitable activities’ such as corporate and investment banking. In other words it is not that there is a clear disconnect between reported profits and actual business activity, but that business activity was not homogenous across different jurisdictions. It is not unexpected that investment banking would involve relatively smaller headcounts of staff to turnover than high street banks, and that they would make higher rates of profit. Although the report begins by arguing that country-by-country reporting makes “it possible to determine whether or not the tax paid genuinely represents a fair amount of what companies ought to be paying in each country” it does not in fact come to such a determination, but simply points at the different profit rates in relation to staffing and turnover in each country. The report ends with recommendations that are mainly about extending and expanding reporting requirements, rather than acting on specific findings.

A recent report by the Greens/EFA group in the European parliament on the Spanish clothing company Inditex case also highlights challenge of interpreting CBC reports.‡ It compiled a version of country-by-country data for the fashion company Inditex, drawing on over 60 corporate filings from around Europe. It argues that the company has saved at least €585 million in taxes during the period 2011–2014, by using ‘aggressive corporate tax avoidance’ techniques. However the situations that the report describes do not fit within the everyday meaning of ‘aggressive avoidance’ (such as being artificial and purely tax motivated) but rather reflect the fact that genuine commercial functions such as store fit-out, sourcing and e-commerce are centralised across the group and carried out in the Netherlands, Ireland and Switzerland.§

* Murphy, R. (2015) *European Banks’ Country-by-Country Reporting A review of CRD IV data*. Greens/EFA MEPs in the European Parliament http://mollymep.org.uk/wp-content/uploads/CBCR_Full-report-PDF-July-2015.pdf

† Aubry, M., Dauphin, T and Watrinet, L. (2016) *French Banks Activities in Tax Havens*. CCFD Terre Solidaire/ Oxfam France/ Secours Catholique/La Plate-Forme Paradis Fiscaux et Judiciaires.

‡ Tataret, M (2016) *Tax shopping: Exploring Zara’s tax business*, Greens/EFA Group in the European Parliament <http://www.greens-efa.eu/tax-shopping-16316.html>

§ Forstater, M. (2017) *Inditex, the Limits of CbC Data, and the Meaning of ‘Aggressive Avoidance’*, *Tax Analysts* Feb 6 2017.

Public CBC reports seem to encourage a naïve analysis of profit shifting which assumes that the ‘actual business activity’ of multinational corporations is (or should be) undifferentiated across jurisdictions – rendering any high value shared services or other

88 Oxford University Centre for Business Taxation (2011) *Transparency in reporting financial data by multinational corporations Report of a group chaired by Michael Devereux*.

89 Yoder, L., Noren, D and Chao, E. *Public Cbc Reporting Will Not Achieve Its Goals*, 8 *Colum. J. Tax L. Tax Matters* 11

areas of higher profit that use relatively fewer staff and tangible assets as ‘misalignment’. The OECD specifically warns that the CBC data should not be used by tax authorities to raise assessments based on this kind of formulary apportionment – however this is precisely the kind of analysis that is likely to be used in public analysis of CBC reports, and has been recommended by the European Commission.⁹⁰

4.2 Costs and harms

Public CBC reporting has low direct costs. Now that companies are compiling CBC reports for tax authorities, making them public would involve minimal additional cost (indeed, as the Tax Justice Network argues it would save some money and time in not having to file information to separate authorities).

However this is a weak argument on its own for reducing confidentiality. While companies do not have the privacy rights of individuals, the ability to maintain confidentiality is generally respected as critical to a sound business environment. Revealing assets, headcount, sales and profits in every location could mean multinational companies revealing commercially sensitive information about new developments.⁹¹

Tax morale and trust. The use of for country-by-country reports to assess ‘misalignment’ by comparison with a formulary approach demonstrated in the early analyses sets them on a crash course with the findings of tax authorities. Governmental tax authorities will already have all of the CbC information, as well as much more information, filed directly with them by the companies, and are tasked with enforcing compliance with applicable tax laws. CBC analyses which suggest, that these tax bills are not ‘right’ on the basis of some alternative formulary approach will not only expose companies to unmanageable harm to their reputations, but will also undermine confidence that tax authorities are doing their job, which could undermine ‘tax morale’ and voluntary compliance through the perception that large taxpayers are not respecting the rules .

4.3 If not CBC then what?

While public CBC reports may not be the right solution for informing public debate, this does not mean that the issue can be ignored. Citizens and parliamentarians *should* be able to assess government tax policy and hold revenue agencies accountable for their performance. There is also demand for companies to explain their approach to tax.

One approach is to demand even more information about individual tax payers. The UK Public Accounts Committee, for example, whose remit is to assess the efficiency and effectiveness of public spending (i.e. the performance of HMRC as an agency) has over several years taken it upon itself to inquire into the tax affairs of individual large companies, becoming frustrated in the process. In 2016 following its inquiry into a settlement with Google it concluded that “the lack of transparency about tax settlements makes it impossible to judge whether HMRC has settled this case for the right amount of tax.” It recommended that HMRC should consider changing the rules that protect corporate taxpayer confidentiality to “make the tax affairs of multinational companies open to public scrutiny to provide the means for Parliament and interested parties to judge whether tax settlements reached are reasonable.”⁹²

However there is no principle that the public or politicians *should* be able to judge whether individual tax settlements are right, anymore than we would expect them to scrutinise and second guess whether doctors are prescribing the right medicine to individual patients, or teachers are giving the right marks to individual students. Politicians and public oversight bodies must in ensure that institutions such as tax authorities, health authorities and exam boards operate robustly, but they should not be involved in the tax affairs of individual taxpayers.

90 European Commission (2016). Commission Staff Working Document Impact Assessment: assessing the potential for further transparency on income tax information

91 D’avino, R. (2017) Balancing The Public’s Right To Know And Corporate Privacy Rights — Safeguarding Competition In The Era Of Country-By-Country Reporting: A Response To Reuven S. Avi-Yonah, 8 Colum. J. Tax L. Tax Matters 5

92 PAC (2016) 25th Session: Corporate tax Settlements <https://www.publications.parliament.uk/pa/cm201516/cmselect/cmpubacc/788/78805.htm>

Public assurance and oversight. If the public does not trust that revenue authorities resolves disputes in a fair and even-handed way according to the law, then what is needed is a means to provide this assurance. One effort towards addressing this in UK has been the establishment of the role of Tax Assurance Commissioner. This was set up in 2012 following controversy over alleged ‘sweetheart deals’ which were later found to be reasonable. However the Commissioner has so far been unable to assuage public, media and politician concern. Judith Freedman of the Oxford Centre for Business Taxation highlights that one problem is that the role of the Tax Assurance Commissioner is not widely understood, and as an employee of HMRC is not seen as independent. She suggests that the role should be undertaken by a genuinely independent body such as an expert unit of the National Audit Office tasked with providing external scrutiny of a sample of settlements on a regular, routine basis.⁹³

Corporate reporting and civil society engagement on tax strategies and dilemmas. Many large companies already publish something beyond statutory reporting requirements on their approach to tax, as part of their annual report, corporate responsibility or sustainability report, or in a free-standing statement. For example in the UK nearly two thirds of the FTSE 100 already publish something on their tax strategy, and this is being made a mandatory requirement. Investor interest in corporate tax practices is on the rise; for example, with major institutional investors such as Alliance Trust and Legal & General Investment Management, as well as ethical investors such as Domini Social and RobecoSAM, coming together as part of the ‘Principles for responsible investment’ initiative to explore how to better understand tax risk and responsibility. Requiring businesses to articulate what they mean by responsible tax practice may be a step towards a better understanding of the issues and dilemmas and as disclosures on tax strategy and practice become the norm, the state of the art of assessing them must also mature.

Collaborative development of standards and guidance on responsible tax practice. The difficulty of judging companies on their approach to tax, is that there is little clarity about what a responsible approach to tax looks like in practice. The FTSE4Good Index and the Dow Jones Sustainability Index for example assess whether companies make declarations on complying with the ‘spirit of the law’, paying taxes where value is created, tax avoidance, transfer pricing and ‘tax havens’, but the analysts do not seek to assess the content of these statements, merely their existence. Christian Aid has recently declared a campaign victory after the UK government adopted a policy requiring that local councils exclude from public contracts companies engaged in “aggressive tax avoidance”⁹⁴ However the standards used to judge this are the General Anti-Abuse Rule (GAAR) and Disclosure of Tax Avoidance Scheme rules (DOTAS)⁹⁵. These rules offer a much narrower conception of “aggressive avoidance” than those usually implicitly considered by NGOs and the media (for example Google, Starbucks, Inditex, SABMiller and all the other high profile cases are likely to be compliant). The NGOs Christian Aid, Oxfam and ActionAid have issued their own recommendations, in the discussion paper Getting to Good, which they offer in the spirit of supporting constructive dialogue.⁹⁶

93 Freedman, J. (2016). The Role of the Tax Assurance Commissioner in Reviewing Tax Settlements. 03 May 2016. Oxford Centre for Business Taxation. <https://www.law.ox.ac.uk/business-law-blog/blog/2016/05/role-tax-assurance-commissioner-reviewing-tax-settlements>

94 Christian Aid (2017) Sourced campaign: our work is done, Jan 27 2017. <https://medium.com/christian-aid-campaigns/sourced-campaign-our-work-is-done-91f0be03876#.trel69ftf>

95 Crown Commercial Service (2016). Procurement Policy Note: Standard Selection Questionnaire (SQ) Action Note 8/16 9th September 2016

96 Christian Aid/Action Aid/Oxfam (2016). Getting To Good: Towards Responsible Corporate Tax Behaviour. <http://www.christianaid.org.uk/images/Getting-to-good-corporate-tax-November2015.pdf>

5 CONCLUSION

For complex problems to gain political and public momentum, it is helpful to be able to point to simple, clear solutions. For the issues of illicit financial flows and profit shifting by multinational corporations, public registers of beneficial ownership and country-by-country reporting have played this role. However the effectiveness of these iconic policies is not guaranteed. Every new policy solution has to start somewhere and it would be unreasonable to require that nothing be done without a pre-existing track record. But considering transparency as a means to an end brings into sharper focus the substantive question of what that the objective is:

- **In the case of beneficial ownership transparency**, the objective is to make it harder for the criminal and corrupt to hide in obscurity and easier for everyone to manage counterparty risks. Universal central public registers of beneficial ownership are neither the only nor the best solution. There is good evidence that regulating company service providers is a more effective means of preventing people hiding in the shadows, while enhanced digital identity systems could allow people and companies to identify and authenticate themselves as needed, without creating a register of what everybody owns.
- **In the case of public country-by-country reporting**, there are disagreements over what the objective might be, but one area of consensus is the need to enable public and political scrutiny of the tax system and its implementation, both to provide assurance and build trust in the system and to support informed debate on reforms. It is not clear that the CBC template provides information that is either necessary or adequate for this purpose, but there is urgent need for dialogue and experimentation between policy makers, revenue authorities, businesses, civil society and others to work out what would be more useful.

Civil society and the media play a key role in contesting corruption, highlighting injustice, scrutinizing the powerful and demanding policy reforms.⁹⁷ Freedom of the media and the internet, freedom of speech and access to information are critical and should be strongly defended, but the court of public opinion cannot replace the rule of law.

Mass mandated disclosures are unlikely to release the vast sums of hidden money, that are sometimes promised. There is a danger that transparency becomes a hamster wheel; you can always ask for more detailed and widespread disclosures without necessarily getting any closer to the goal of more responsive public institutions, more effective markets and a stronger social contract between governments and their people.

Progress in developing effective policies ultimately depends on trying, failing, learning, and adapting. Otherwise policy makers can be driven to pass laws and declare policies which are follow the logic of 'form' rather than 'function' in order to impress outsiders, or avoid their ire or punishment. Different countries are now trialing and testing approaches to collecting and sharing additional financial information. The next phase requires learning-from-doing and capturing and sharing knowledge about what works. The goal should be not 'transparency' for its own sake but creating stable and business-friendly investment environments, enhancing the accountability of government, and strengthening revenue collection and public budget management.⁹⁸

⁹⁷ Mungiu-Pippidi, A.(2015) *The Quest for Good Governance: How Societies Develop Control of Corruption*, Cambridge University Press

⁹⁸ UNCTAD (2015) *World Investment Report: An Investment Perspective in International Taxation*.

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Public financial transparency is increasingly advocated as a solution to concerns over *legal* tax planning by multinational corporations, and *illegal* tax evasion, fraud and money laundering. In particular there are calls for mandatory publication of beneficial ownership (the ultimate owners of companies and trusts), and country-by-country reports by multinational corporations (detailing revenues, assets, employment, profits and taxes paid in each jurisdiction). Other proposals include publication of tax rulings and profit and loss accounts for all companies. The broad case is made that the problems are huge, and that public transparency is the only solution. However, the author of this Insight argues that caution is warranted since the scale of revenues at stake are in fact smaller than is often perceived, while experience suggests that data transparency is not a simple route to accountability.

For complex problems to gain political and public momentum, it is helpful to be able to point to simple, clear solutions. Public registers of beneficial ownership and country-by-country reporting have played this role for the issues of illicit financial flows and profit shifting. But, there is a danger both for governments and civil society that iconic transparency measures provide ‘form’ rather than the ‘function’ in seeking to solve these problems. Ultimately, the aim should be to iterate towards mechanisms that enable more responsive public institutions, trusted legal systems, more effective markets and a stronger social contract between governments and their people.

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