Alianza por la Responsabilidad Fiscal

Corporate Tax Responsibility Thermometer

1. Rational of the proposal

Context

In recent years, the taxation of large companies has been in the spotlight of public opinion. Recent media scandals have contributed to this, such as the Panama Papers and, above all, the Luxleaks, but it also comes from a wider reflection at the global level. The launch of the OECD BEPS process undoubtedly stands out as a proposal for the reform of the global tax system since the diagnosis that the current one poses many gaps for a fair effective taxation by large companies with transnational presence. For its part, the EU is strengthening the implementation of different legislative initiatives that seek companies to contribute fiscally what they should and where they should. One of the key initiatives in this regard, both in the BEPS process and in the EU, is the country-by-country reporting (CBCR), as an essential transparency measure that provides key information to understand relevant tax practices of companies with presence in several countries.

In Spain, CBCR consolidates as a fundamental tool for companies to report on their fiscal behavior through different legal requirements. Since 2015, larger companies have to include a report according to this model for the Tax Agency, and since that same year, financial entities have to present it publicly. In addition, the recent Non-Financial Information Law requires large companies to publish a reduced format of the country-by-country report from this year.

Parallel to the regulatory developments, from a vision of corporate voluntariness linked to a genuine approach to corporate social responsibility, large companies face the challenge and the opportunity to show and demonstrate the extent to which they incorporate responsible taxation frameworks affecting to tax policies and practices and the way of accountability of their effective tax contribution in those countries where they have economic activity.

In this context, different proposals for corporate tax transparency have appeared in recent years. These include the total tax contribution reports that many companies publish, but also the CSR Europe Blueprint initiative regarding corporate tax transparency and responsibility, and the process lead by GRI to include among its standards those reporting about tax issues.

However, beyond these initiatives, it is pertinent to build a tool to assess the tax behavior and practices of companies in the countries in which it operates, so that it can measure its degree of tax responsibility based on a methodology that allows analyzing information of tax relevance of the companies.

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To this end, a mixed composed working group, under the name of Alliance for Tax Responsibility, proposes a tool called Tax Responsibility Thermometer. Focused on the casuistry of large companies with a transnational presence that allows them to access opportunities for international tax planning, this tool aims to measure the effective articulation of tax responsibility approaches in the different tax relevant actions of companies.

Alliance for Tax Responsibility

The alliance is the name under which the organizations that have participated in the working group that has developed the tool are grouped and combines a mixed profile of organizations from the academic world, the private sector, the administration and civil society. Thus, the following organizations are members of the alliance:

- ESADE, School of Law
- IHE, Association of State Treasury Inspectors
- Oxfam Intermón
- Sustentia, consultancy in private sector and Human Rights

Objective of the working group

Increase the tax responsibility of large companies to achieve a fair taxation, through the development of a methodology of work focused on that objective. The ultimate goal must be a verifiable fair tax contribution of large companies and a substantial reduction in corporate tax evasion and avoidance levels.

Complementary objective

Prepare a proposal for measuring the tax responsibility of companies with an international presence, as a measure of the companies' commitment to it, based on the analysis of their tax practices.

The proposal does not intend to cover the different idiosyncrasies that may exist by sector, type of company or business model, but it establishes a general methodological proposal as a first approach that can be refined in future developments.

Description of the process of building the tool

Since the second half of 2016, the working group has worked in different face-to-face work meetings. The process has started from a reflection to delimit the objective of the process and the approaches on which to base. The result of this is the definition of an objective of the process, a proposal for defining corporate tax responsibility and elaborating the criteria to consider a territory as a tax haven.

The purpose of the proposal is not assessing the level of tax transparency of companies, but rather how their tax practices define their commitment with tax responsibility frameworks. According to this premise, and taking into account the consideration contained in the definition of tax responsibility included below that the taxation must be aligned with the real economic activity of the company, the working group identified the country-by-country reporting model as the main source of information revealing tax practices of companies.

Based on this reporting model, different ratios have been built by linking different data categories. These ratios are intended to provide relevant information on company behaviors, distinguishing between how they operate and behave in tax havens and in the rest of the countries, in such a way that they bring relevant conclusions to assess the tax practices of companies. For this analysis, three dimensions have been considered essential for measuring corporate tax responsibility: tax contribution and geographical distribution, location of benefits and economic substance, as well as a fourth qualitative of transparency. In this way, the results of these ratios allow detecting deviations or inconsistencies that provide valuable information on each of these dimensions.

However, the working group recognizes that neither the data contained in the country-by-country reporting nor the general picture that can be extracted from the report are self-explanatory by themselves, and it is necessary to complement the information with a narrative part that specifies what exact information it is included in each piece of information.

For that same reason, the own tool of the Thermometer of Tax Responsibility has to complement the quantitative part expressed in the numerical results thrown by the ratios with a qualitative one that consists of providing clarifications that allow to clarify, contextualize and explain these results. In this way, the tool has a clear vocation to get companies to provide relevant explanations about their tax practices and behaviors.

Dialogue with companies and other actors

The process of construction of the Tax Responsibility Thermometer includes the holding of round tables at the beginning and in the final phase with companies and other relevant actors.

The first round table was held in February 2017 and was attended by representatives of different companies of the Ibex-35, as well as legal advisors, academia and civil society organizations. The round table served to present both the process and the working group that is developing it and to discuss the initial baselines of the proposal.

In July 2018, another session with companies took place in which the tool proposal reached by the working group was contrasted with them. In it, the relevance of the model was debated and the contributions and impressions of the companies were collected to make up the final version of the tool.

Finally, and as a culmination of the process, in April 2019 the final proposal of the Fiscal Responsibility Thermometer will be publicly presented to a mixed audience of investors, Administration, media, civil society and the companies themselves.

2. Basic approaches of the model

Definition of tax responsibility

The working group starts from a definition proposal considered as a journey in which it is necessary to go through different stages. Thus, the concise definition proposed is the following:

"A tax responsible company is one that pays the fair share of taxes that correspond to it, where it operates and generates real value, without seeking stratagems or tricks to abuse the inconsistencies of the tax systems or use its ability to influence governments that should prevail the collective interest."

Principles of tax responsibility

A company that seeks to be tax responsible has to embark on a path towards responsibility that consists of the following milestones:

1. **Legality**: Legal compliance, in letter and in spirit, in all countries where it operates.

2. **Transparency**: Consumers, citizens and investors have a legitimate right to information and to the accountability of large companies on their effective tax contribution.

3. **Institutional commitment**: Companies must have a public tax responsibility policy, which includes the clear mandate not to create structures with the sole purpose of reducing its tax burden nor hiding information.

4. **Substance:** Companies must pay the taxes that correspond to it where the real economic activity is generated, without artificially diverting benefits towards tax havens.

5. **Influence:** Provide transparency and clarity about the lobbying activities carried out in all countries where they operate and not influence government decisions that may negatively affect the lives of people.

Focus on Corporate Income Tax

The working group is aware that the taxation of large companies comprises a wide variety of tax figures. Among them, there are some related to specific activities and specific sectors, but there is also a consideration of the social contributions and tax collection functions of third parties assumed by the companies as part of their tax effort. Without underestimating all this, the Thermometer focuses exclusively on the practices that pertain to Corporate Income Tax, since it is the one on which there is the greatest controversy and where the interest and concern about the taxation of large companies is focused. Regarding the rest of tax figures, the working group presupposes the tax responsibility of the companies.

Definition of tax haven

The working group believes it is convenient to handle a definition of a tax haven to be used in the process of developing the measurement tool. Therefore, the following definition used by different civil society organizations is proposed:

"Tax havens are territories that have intentionally adopted a legal framework that has the following characteristics:

- Low or no taxation
- Tax benefits for non-residents, without the need to justify a substantial and real economic activity
- Lack of cooperation with other tax administrations
- Opacity: legal frameworks that allow the non-disclosure of the corporate structure of legal entities or the ownership of assets or rights.

In this way, the working group goes beyond the official lists of tax havens, such as that of the European Commission and the content of Spanish legislation R.D. 1080/91 and subsequent amendments. Therefore, it takes a broader reference that also include territories subject to controversy in tax matters, are therefore listed in other agencies' lists or are being investigated by official institutions for reasons of unfair tax competition.

Therefore, for the application of the tool, it is pertinent to consider the countries included in this list as a tax haven due to a more demanding commitment on behalf of the companies.

However, in order to avoid confusion with references to other listings, especially those of an official nature, the tool will use the nomenclature Tax Controversial Territories for all these territories considered in this argumentation. Another reason for this is to be able to use a denomination with which the different actors can be satisfied and avoid discrepancies that may cause the non-use of the tool by companies.

3. Tax Responsibility Thermometer

Measurement model

The model consists of a battery of ratios included in three dimensions of analysis, with a fourth that provides additional information of a qualitative nature. The ratios included in the tool, in its vast majority, are built from the different categories of data included in the 231 country-by-country reporting model.

The working group considers that behind the data used to elaborate the tool may be different realities depending on the type of company or the sector of activity, or simply the lack of a clear delimitation by the rule that governs the CBCR of what is to be reported in each category of data can lead to diverse interpretations and a certain degree of ambiguity. Therefore, in addition to the battery of ratios distributed by dimension to analyze, the tool must be complemented by a narrative part where to clarify what type of reality is reflected in each category of data.

Results evaluation

The numerical result that each ratio throws will be valued according to a scale that interprets the results according to a traffic light system (green, yellow and red). Although this system assigns an evaluation qualifying each result, the logic of valuation tries that, in the cases in which the ratios reveal deviations with respect to an optimal valuation, the company complements this result with a narrative part that tries to contextualize, justify and explain that result.

The rating scale distinguishes three categories:

- Deep Green: "Adequate", it is not considered necessary to provide more information.

- Light Green: "Acceptable", the result is not considered as negative, but more information shall be convenient.

- Yellow: "Improvable", the result generates doubts, so it is necessary to explain these results to try to justify them and give an understanding of the underlying reality.

- Red: "Deficient", the result generates alarm, possible indication of censurable behavior, it is necessary to provide more information, the explanations have to be more detailed and complete.

Dimensions of analysis of tax responsibility

To measure the tax responsibility of companies, there are four dimensions of analysis:

- Tax contribution and geographical distribution

It gives a measure of the general level of taxation of the business group for its global activity, as well as the geographical location of income and benefits.

- Location of benefits

It tries to reveal the geographical alignment that occurs in the business group between the results obtained and the income generation. The distortions that may be detected may show practices of channeling benefits towards territories of lower taxation with the purpose of artificially minimizing the payment of taxes.

- Economic substance

It makes possible to understand if the presence of the company in certain territories, especially tax havens and tax controversial territories, is justified from an operational point of view according to the data on economic activity and structure.

- Transparency

It provides relevant data on taxation of more qualitative aspect. Specifically, the information included in this dimension reveals aspects related to the relationship of the business group with tax administrations.

Ratios by dimension

The ratios that allow analyzing each one of these dimensions are those detailed below, along with the scale for their assessment. The detail of the calculation of each of them is specified in the methodology annex.

Tax contribution and geographical distribution

1. **Global effective rate** (three years average)
2. **Global effective rate as percentage of average global nominal rate** (three years average)
3. **Turnover** in tax controversial territories over the total
4. **Profits** in tax controversial territories over the total

Location of benefits

5. **Profitability** in tax controversial territories compared to other countries
6. **Profitability per employee** in tax controversial territories compared to other countries
7. **Profitability of assets** in tax controversial territories compared to other countries

Economic substance

8. **Productivity per employee** in tax controversial territories compared to other countries
9. **Turnover on assets** in tax controversial territories compared to other countries
10. **Employees by branch** in other countries compared to tax controversial territories

Transparency

11. Tax litigations and sanctions
12. Rulings, patent box and preferential tax agreements

Assessment scales

The valuation of the results of each ratio is as follows:

Tax contribution and geographical distribution

1. **Global effective rate** (three years average)
   Adequate >20%
   Acceptable 15% - 20%
   Improvable 10% - 15%
   Deficient <10%

2. **Global effective rate as percentage of average global nominal rate** (three years average)
   Adequate >90%
   Acceptable 75% - 90%
   Improvable 50% - 75%
   Deficient <50%

3. **Turnover** in tax controversial territories over the total
   Adequate 0 – 10%
   Acceptable 10% - 20%
   Improvable 20% - 30%
   Deficient >30%

4. **Profits** in tax controversial territories over the total
   Adequate 0 – 10%
   Acceptable 10% - 20%
   Improvable 20% - 30%
   Deficient >30%

Location of benefits

5. **Profitability** in tax controversial territories compared to other countries
   Adequate < 1.5 times
   Acceptable 1.5 – 2 times
   Improvable 2 – 3 times
   Deficient > 3 times

6. **Profitability per employee** in tax controversial territories compared to other countries
   Adequate < 2 times
   Acceptable 2 – 2.5 times
   Improvable 2.5 – 3 times
   Deficient > 3 times

7. **Profitability of assets** in tax controversial territories compared to other countries
   Adequate < 1.5 times
   Acceptable 1.5 – 2 times

Improvable 2 – 3 times
Deficient > 3 times

Economic substance

8. **Productivity per employee** in tax controversial territories compared to other countries
   Adequate < 1.5 times
   Acceptable 1.5 – 2 times
   Improvable 2 – 3 times
   Deficient > 3 times

9. **Turnover on assets** in tax controversial territories compared to other countries
   Adequate < 1.5 times
   Acceptable 1.5 – 2 times
   Improvable 2 – 3 times
   Deficient > 3 times

10. **Employees by branch** in other countries compared to tax controversial territories
    Adequate < 2 times
    Acceptable 2 – 4 times
    Improvable 4 – 6 times
    Deficient > 6 times

Transparency

11. **Tax litigations and sanctions**
    detail quantity, reason and volume

12. **Rulings, patent box and preferential tax agreements**
    detail quantity, reason and volume

These last two do not yield a numerical result that could be assessed, so the detail of the information required has to be provided.

Use of the tool

Due to the information it provides, the tool can be used both internally by companies to carry out a tax self-diagnosis and externally for analysis by third parties. However, the main vocation of the **Tax Responsibility Thermometer** and the use for which the working group has built it is *to be used on a voluntary basis by those companies that want to give an unequivocal step to be committed to a demanding degree of tax transparency that serves as accountability by the company for its effective commitment to tax responsibility.* Much of the data used to calculate the ratios comes from the country-by-country reporting model, so the proposal includes making this report and the Thermometer jointly public in the annual accounts of the business group.

The present proposal assumes that many of the categories of data on which the ratios and indicators are constructed may contain a degree of ambiguity that makes the rigor of the conclusions and the possibility of establishing comparisons difficult, either because they are not properly defined or because according to the business activity they can reflect different realities. The results of the ratios can also show deviations that may have an operational justification according to the activity sector or the business model of each company. Therefore, the proposal of indicators is considered incomplete if it is limited only to the calculation and assessment of the ratios by dimension of analysis and must be complemented necessarily with a narrative part in which the company explains the reality underlying each presented data and contextualizes and justifies the results derived from the calculation of the ratios.

Corporate tax responsibility Thermometer

dimension	ratio	tax responsibility scale			
		adequate	acceptable	improvable	defficient
tax contribution & geographical distribution	**1. Global effective tax rate** (global, three years average)	> 20%	15% - 20%	10% - 15%	< 10%
	2. Global effective rate as percentage of nominal (three years average)	> 90%	75% - 90%	50% - 75%	< 50%
	3. Turnover (tax controversial territories / total)	0 - 10%	10% - 20%	20% - 30%	> 30%
	4. Profits (tax controversial territories / total)	0 - 10%	10% - 20%	20% - 30%	> 30%
location of profits	**5. Profitability** (tax controversial territories / other countries)	< 1,5x	1,5x - 2x	2x - 3x	> 3x
	6. Profitability per employee (tax controversial territories / other countries)	< 2x	2x - 2,5x	2,5x - 3x	> 3x
	7. Return on assets (tax controversial territories / other countries)	< 1,5x	1,5x - 2x	2x - 3x	> 3x
economic substance	**8. Productivity per employee** (tax controversial territories / other countries)	< 1,5x	1,5x - 2x	2x - 3x	> 3x
	9. Turnover on assets (tax controversial territories / other countries)	< 1,5x	1,5x - 2x	2x - 3x	> 3x
	10. Employees per subsidiary (other countries / tax controversial territories)	< 2x	2x - 4x	4x - 6x	>6x
qualitative indicators					
transparency	**11. Litigations and fiscal sanctions** (number, reason and amount)				
	12. Rulings, patent box and preferential tax agreements (number, reason and amount)				

ANNEX 1: Methodology

The reporting model of the Tax Responsibility Thermometer includes ten ratios divided into three dimensions of analysis, plus a fourth one of a qualitative nature that collects information on two other aspects.

The main source to build these ratios are the data included in the country-by-country reporting model 231, hereinafter CBCR. Almost all of them consist in the comparison of different magnitudes between categories of countries. To clearly delineate how each of the ratios is constructed and to what each category of data used for this purpose refers to, a methodological explanation is offered below that reviews each calculation and each term used in the tool:

Equivalence between CBCR and ratios terms

The battery of ratios of the model is built from the data of the CBCR, although the terminology differs in some cases, since the model uses terms that aim to better mark the reality that is expressed in them. This is mainly due to the fact that the model talks about "Turnover" to take the data of "Total income" of the CBCR and "Material assets" what the CBCR calls "Tangible assets other than treasury and instruments equivalent to treasury". In addition, the model also uses the "Number of affiliates" data that the CBCR does not provide directly. In this case, the subsidiaries that fall within the consolidation perimeter of the business group must be consigned.

Country categories

Three terms are used to make the comparison by country type in almost all ratios:

- Tax controversial territories: reflects the calculation of each concept for all countries and territories considered as tax controversial territories according to the definition contained in the base proposals of the model. There are specific cases in which certain territories are not a national territory, but part of one (e.g., the US state of Delaware). In those cases, a more exhaustive application of the tool would break down the data of that territory from the total country to which it belongs.

- Other countries: reflects the calculation of each concept for all countries that are not tax havens.

- Total: reflects the calculation of each concept for all countries.

Calculation of ratios by dimension

Dimension 1: tax contribution and geographical distribution

Ratio 1: Effective rate (total, three years average)
This indicator is built dividing the amount of corporation tax paid in all countries in the year of the reporting year and the two previous years by the sum of the pre-tax benefit in all countries in the year of the reporting year and the two previous exercises. All for

positive numbers. Data for years in which one of the variables or both, taxes paid or results are negative, will be excluded from the calculation.

In case the result is negative, it is recorded as *n. a.* or with a script and an explanation is included in the *Observations* field.

Ratio 2: Global effective rate as percentage of average global nominal rate (three years average)
The calculation of this indicator begins by multiplying the benefit obtained in each country by the nominal rate of that country, whose result gives taxes at nominal rate. Then the sum of taxes at nominal rate for all countries will be divided by the total of profits obtained in all the countries to reach the average nominal rate of each year. The final ratio is reached by dividing as percentage the sum of the nominal rates of the reporting year and the two previous ones between the sum of the effective rates of those three years.

In case the result is negative, it is recorded as n. a. or with a script and the explanation is included in the *Observations* field.

Ratio 3: Turnover (tax controversial territories / total)
It is calculated by dividing the sum of turnover in tax controversial territories by the total turnover.

Ratio 4: Profits (tax controversial territories / total)
It is calculated by dividing the sum of pre-tax results in tax controversial territories by the total of pre-tax results.

In case the result is negative, it is recorded as *n. a.* or with a script and the explanation is included in the *Observations* field.

Dimension 2: Location of benefits

Ratio 5: Profitability (tax controversial territories / other countries)
It is calculated by dividing the profitability in tax controversial territories by the profitability in the rest of the countries. Each of them is calculated by dividing the pre-tax results in each group of countries by their turnover.

In case the result is negative, it is recorded as *n. a.* or with a script and the explanation is included in the *Observations* field.

Ratio 6: Profitability per employee (tax controversial territories / other countries)
It is calculated by dividing the profitability per employee in tax controversial territories by the profitability in the rest of the countries. Each of them is calculated by dividing the pre-tax results by the total number of employees for each group of countries.

In case the result is negative, it is recorded as *n. a.* or with a script and the explanation is included in the *Observations* field.

Ratio 7: Return on assets (tax controversial territories / other countries)
It is calculated by dividing the profitability of assets in tax controversial territories by profitability in the rest of the countries. Each of these returns is calculated by dividing the results before taxes by the amount of tangible assets for each group of countries.

In case the result is negative, it is recorded as *n. a.* or with a script and the explanation is included in the *Observations* field.

Dimension 3: Economic substance

Ratio 8: Productivity per employee (tax controversial territories / other countries)
It is calculated by dividing the productivity per employee in tax controversial territories by the rest of the countries. Each of them productivities is calculated by dividing the turnover by the total number of employees for each group of countries.

Ratio 9: Turnover on assets (tax controversial territories / other countries)
It is calculated by dividing the invoicing of assets in tax controversial territories by the profitability in the rest of the countries. Turnover on assets in each group of countries is calculated by dividing the turnover by the total of tangible assets.

Ratio 10: Employees by branch (tax controversial territories / other countries)
In this case, the division is made in the opposite direction and is calculated by dividing the employees by branch in the rest of the countries by the employees by subsidiary in tax controversial territories. Employees per subsidiary are the total number of employees in each group of countries divided by the number of subsidiaries held there by the business group.

Dimension 4: Transparency

11. Litigations and fiscal sanctions
It should indicate the number of tax litigations that the business group has open and the sanctions in the last year, providing the detail of the amount and an explanation of the reason for each of them.

12. Rulings, patent box and preferential tax agreements
It should indicate the number of preferential tax agreements that the business group has obtained in the different countries in which it has a presence, as well as the amount affected in each case and an explanation of what each agreement consists of.

Rating Scale

The result of each ratio is assessed according to a scale with three levels, which establishes an adequate, improvable or deficient range of results. As already indicated, although each range has a semaphore color and a qualifier that denotes an assessment, what is intended is that the doubts that each result may offer are treated to clear up with an explanation that serves as a contextualization or justification, more detailed the further away the result of the appropriate level.

With this, the aim is emphasizing that the cut values of each range really do not have to be understood in a strict sense but as a reference to interpret the results. The determination of each cut value between ranges has been made based on a criterion that establishes a reasonable proportionality between the practices and business magnitudes that a business group obtains in tax havens with respect to the rest of the countries. For example, a profitability in tax havens above two times that obtained in non-tax havens is far from a proportionality considered adequate, as well as having four times fewer employees per subsidiary in tax havens than in the rest of the countries.

In the case of the effective rate ratio, any value above 23% is considered adequate, given that this value represents the approximate world average of the corporate tax rates of the countries.