THE PRINCIPLES FOR RESPONSIBLE INVESTMENT PODCAST TRANSCRIPT

THE PROPOSED GLOBAL TAX REFORMS – CAN THEY ELIMINATE PROFIT SHIFTING?

WITH VAISHNAVI RAVISHANKAR, SENIOR SPECIALIST, GOVERNANCE ALEX COBHAM, CEO, TAX JUSTICE NETWORK, RYAN GURULE, POLICY DIRECTOR, FACT COALITION

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Vaishnavi Ravishankar, PRI
Welcome to the PRI podcast. My name is Vaishnavi Ravishankar and I'm a Senior specialist in the governance team at the PRI where I lead the work on tax issues. Today, I'm delighted to be joined by a special guest, Alex Cobham and Ryan Gurule to share their insights on the much talked about tax reforms and broader policy developments on tax and potential implications for institutional investors.

Alex Cobham is an economist and the CEO of Tax Justice Network. He's an expert on issues such as illicit financial flows, effective taxation for development and inequality. He's also published books on these topics that uncounted an estimating illicit financial flows. It's a real pleasure to have you here, Alex, welcome.

Alex Cobham, Tax Justice Network
Thanks Vaishnavi, of it's great to be with you.

Vaishnavi Ravishankar, PRI
We also joined by Ryan Gurule, who is the Policy director at the FACT Coalition. Before joining FACT,

he was vice president, senior corporate counsel for a family of traditional and renewable energy logistics companies, and has previously practiced, tax and corporate law at international law firms. Ryan actively engages in tax policy work, acting as a consultant for the Center on Budget and Policy Priorities on corporate tax policy. It's great to have you here, Ryan, welcome.

Ryan Gurule, FACT Coalition
Thank you, it's a pleasure to be here.

Vaishnavi Ravishankar, PRI
Before we jump into the content, perhaps we could start with a brief background of the work you do on tax at your respective organisations. Alex, could I come to you first?

Alex Cobham, Tax Justice Network
Thanks. So the tax justice network was established in 2003, so for nearly 20 years now we've been, I guess, kind of at the think tank end of a growing global movement where we're doing research on the scale of international tax abuse and on a range of alternative policies in particular policies to allow countries to raise more revenue in progressive ways to ensure that we deliver on what we call the four hours of tax.

So revenue and redistribution to curtail inequalities but also re pricing to make sure that things like tobacco consumption or carbon emissions are, you know, effectively priced so the social costs are taken into account. And most importantly the 4th are representation, that tax systems function in a way that makes governance, governments more rather than less accountable to their citizens. So they're raising and spending those revenues in the way that people actually want.

I guess that brings us into a range of issues from how the international tax rules for multinational companies work through to the ways in which governments give tax incentives through to the types of individual income and wealth taxation schedules that countries have and how they interact with each other. Issues such as the financial secrecy, that tax havens provide that can undermine tax systems elsewhere. So if you like everything from the domestic through to the Philly International and the way that those policies are made is kind of within the tax justice network, field of operations I guess.

Vaishnavi Ravishankar, PRI
That's a great overview. Thank you Ryan, could I ask you to provide a brief background as well?

Ryan Gurule, FACT Coalition
Of course, thank you as the new policy director at the FACT Coalition. I'm bringing my prior industry experience into the coalition to help prioritise our work on creating fair attack systems domestically in via international agreement, such as that the OECD level is Alex touched on.
That can help ensure sustainable government funding for needed investments that help promote open societies via social services, addressing equity and combating climate change. The FACT Coalition is a nonpartisan alliance of over 100 non-profit groups at various levels of government.

And in fact, Coalition has a very strong bipartisan advocacy record in tackling global corruption, kleptocracy, and illicit financial flows. My role is to help tie this important work together with the work at the FACT coalition is already been historically doing in international tax reform. Given the inherent relationship between the two subject matters.

Vaishnavi Ravishankar, PRI
Great thank you. You mentioned that you're looking to create a fairer tax system with your work. Tax fairness has become quite a buzz word lately. Do you think there's a level of common understanding among stakeholders? So policymaker, civil society in dusters, etc on what it actually means?

Ryan Gurule, FACT Coalition
Well, I'm very excited to hear Alex’s response to this question as well. I hope it gets posed to both of us, but I would say that fairness is an inherently subjective word, of course. But the things could probably be objectively more fair by most any definition of fairness from a global tax perspective. There are a variety of different types of tax fairness that we might talk about. Different groups talk about tax fairness in different contexts and with different goals in mind. So domestically, sitting in the United States and for US challenges, tax often has the concepts of vertical tax equity, which is something that would be based on the idea of equity being rooted in the ability to pay tax sometimes. And most generally that supports progressive tax policy. It also has concepts like horizontal tax equity. Such as like situated taxpayer payers should pay the same.

But internationally there's also similar concepts that might come to mind as we consider funding huge global challenges, particularly taking into consideration the role that developed nations have played in climate change or historical trading colonial practices that have resulted in persistent inequities.

These categories of tax fairness often start with lofty goals like we should make the tax system fair for working families who bear a greater comparative burden in many systems, and those who earn income from capital or then big corporations. But then you often have money being a very strong political voice in politics and sometimes that might lead to big businesses saying that. Assist in that levees too much taxes unfair compared to other places where capital could be invested.

Again, because fairness is a subjective word, the motivations for those claiming to advocate for tax fairness was always going to be evaluated. But going back to my examples, it seems harder by any definition to argue that a current global system that perpetuates cycles of dynastic individual and national wealth in the face of staggering inequities and challenges like climate change, could not be made more fair by basically any definition.

Vaishnavi Ravishankar, PRI
That's really interesting. And Alex, what's your perspective on this?

Alex Cobham, Tax Justice Network
Oh look, I would very much agree with Ryan’s points you know, I think you can think about tax fairness or we prefer to say tax justice in a set of different areas. You know I think most easily people think about individuals and households that you know broadly. Everyone should pay tax according to

their ability, right? So we should have a sliding scale in general that ensures that higher income households and individuals are paying higher marginal rates.

Unfortunately, while we get that in general with income tax system, we actually don't have it in many countries in the overall tax system because we put a lot of emphasis on indirect taxation, particularly kind of sales, taxes and value added taxes. That means the lowest income households who spend necessarily the greater share of their income will tend to see the biggest share spent also on those regressive taxes. So overall we can end up with the lowest income households paying a higher share of their income.

In tax, even though there is this broad consensus that it should be the other way round. There's one issue to conjure with thinking about businesses. You're looking more kind of level playing field arguments, making sure that we don't have persistence of this situation where the biggest multinational companies actually end up being able to engineer the lowest effective tax rates and out competing unfairly. The smaller domestic businesses that can't play those same games, but are generally responsible for the biggest share of employment.

So they most important to us as societies and then as again as Ryan said, you know at the global level we have this issue of the inequalities in taxing rights that consistently we find lower income countries end up losing a bigger share of their current tax revenues to the international tax abuse of both individuals hiding their assets and income streams offshore and multinational companies through corporate tax abuse. So we have a situation where in each of those areas probably we have policy outcomes that are inconsistent with what would be the broad political consensus for fairness.
More positively perhaps to finish on this point that you could say, though, that we have seen a really significant shift in the prevalent narratives over the last couple of decades. And you know, my predecessor as the founding director of the Tax Justice Network. John Christensen, always was very clear about this.

We're in the business of getting policy changes to make things better, but that's a small piece really of the bigger shifts that we need to be making, which is about what he'd called changing the weather, changing the narratives on the basis of rich people, make policy decisions. If you win a little policy thing, it may hold for a while. The bigger thing is to shift people's view about what should be the outcome.

And in particular, you know the one that you can really see here is that's coming embedded in the last couple of decades. Is this idea that paying tax is a social act. It's about a contribution that we make as individuals to the society from which we gather all of the benefits of our existence, right? So that not paying tax or paying less tax than you really have to is not being smart. As you know, Donald Trump and others might put it. It's being antisocial explicitly against the society that you are part of.
And I think you know what we've seen is that narrative really get locked in now and that's what underpins this sense of tax, fairness, or tax justice that is increasingly widespread. The challenge, I think for us as campaigners now is to convert the support for that view in that narrative into the hard policy shifts that we need to make sure we have tech systems that actually deliver on that, that promise of fairness.

Vaishnavi Ravishankar, PRI
Talking about narrative shifts, we had a big announcement recently, that 130 countries had agreed to reform international corporate taxation. The deal is meant to prevent profit shifting by introducing a global minimum tax of at least 15% and re allocating taxing rights on multinational profits. We yet to see a detailed implementation plan, but at this stage Alex what do you think would be the implications of the proposed tax reforms of multinational companies and their investors?

Alex Cobham, Tax Justice Network
We were kind of, you know, a bit torn about this. On the one hand, the reforms are potentially historic. You know they are the biggest shift in international tax rules. Perhaps in a century you know, since the League of Nations were setting these rules back in the 1920s and 30s when multinational companies were basically things that operated from an imperial power in in a few colonies, right? A very different world from the complexity that we have now, but in some ways the same issues exist. How do you make sure that the taxable profits are distributed in a fairway?

What we've seen you know what, what our analysis and the data show are this kind of explosion of profit shifting since the 1990s. For US headquartered multinationals where we have the best data. Only 5% or so of their global profits were being shifted away from the place that they arose, that the location of the real economic activity in the early 1990s. That 5% explodes to 25-30 % perhaps even 40% today. As the complexity of multinational grows, but also as they become more and more committed to paying it little tax as possible, regardless of the social implications.
So we're at a point now. Where even the rich countries that have tolerated and in some cases encourage this behaviour for decades are now saying enough is enough. We need to fix the rules. So that's great news. And that's the first piece. So in 2019, when this round of reforms began, the idea that was that there would be 2 pieces to it.

Firstly, we'd fix the actual tax rules by going beyond the arms. Length principle is very old fashioned, idea that. The League of Nations basically put in place that really doesn't make sense anymore. The idea that you can tax or you can treat the transactions between different companies that are within a multinational group as if they were operating independently at arms length. As long as you get those prices right, then the profit will end up in the right places and you don't have to worry about anything else.

That just doesn't make sense for multinationals because they don't maximize profit within individual subsidiaries. They maximize profit at the global level, and that's where you need to be addressing the profits for tax purposes, and the question then is simply how you apportion that taxable profit between the different countries.

And so the idea in 2019 was that we would move away from the arms length principle and instead to a some type of apportionment where we take that that profit at the global level and distribute it between the countries where the real activity takes place. So that element is about making profit shifting much harder, and then the second element, what's called pillar two, is the global minimum tax to make profit shifting much less attractive by ensuring that whichever jurisdiction you declare your profits in, you have to pay some minimum rate that is much more than the zero rate of tax that lots of multinationals have been able to pay on lots of their profits for a couple of decades.

So if you delivered this thing in its entirety. Per that original ambition, it would be absolutely dramatic. You would really undo the global inequalities in taxing rights that lower income countries suffer. You know where they are losing a higher share of their current tax revenues than anyone else, but you would also generate revenues in high income countries where the absolute increase in revenues would be much bigger cause those are the countries that lose the largest amount in dollar terms.

So almost every jurisdiction would be a very significant winner from fixing this this problem. We estimate conservatively that the global revenue losses from tax abuse by multinationals are about $245 billion a year. That's the sort of amount you'd potentially recover from ending profit shifting.

If on top of that you made sure that the profits where they are taxed are paying a reasonable minimum rate, you're potentially talking about something more like $400-500 billion of additional revenues each year. This is dramatic, and that's in a sense where we thought we were landing. Where we've actually landed is still being sorted out, but he's a step away from that. So on pillar 1, instead of apportioning all of the profits of all multinationals according to where they real activity is. We are only looking at the very biggest multinationals and most profitable ones and a very small part of their profits actually being apportioned and only being apportioned according to where their sales take place, not where their employment is so it's dramatically smaller.

They were looking at additional revenues of perhaps $5-10 billion a year something but quite close to nothing so very small. The minimum tax, however, still retains the ambition, and that's where the Biden administration have really pushed. The rate is probably going to be 15%, but even so that's a much better for than the zero rates. That's been the minimum until now. If we get that in place, it will still be substantial and it will really reduce a lot of the incentive for profit shifting, so it's not going to be the end of the end of the road approach will talk about some of the issues that there are still in the distribution of benefits. But it would be still a big step forward. So I think there's quite a lot of optimism still about what can be landed there in October, and that this would potentially still be not the biggest historic step that we all hoped for, but a pretty big shift in the grand scheme of things in making the international tax rules work that much better for multinational companies.

Vaishnavi Ravishankar, PRI
Although this is historical agreement in in some ways Alex you've argued that the reforms are unlikely to be inclusive and potentially ineffective. Why is that?

Alex Cobham, Tax Justice Network
As I say that the ambition of pillar one is really gone. We're only talking about a very small bit of the profits of a very small number of multinationals being affected there. But pillar 2, the global minimum tax still has a real potential.

However, what the OECD proposals look like at the moment are about as unfair as you could possibly make them. So there's been this ongoing discussion about who will be allowed to top up the taxes where we have profits that aren't being taxed at the minimum rate. So consider as an example, a French multinational that has managed to shift $1 billion of profit out of its operations in Brazil and into Bermuda, where it would pay at the moment a zero rate of tax. Under the current proposals from the OECD, it's not Brazil who would get to top up that tax to 15% and therefore take $150 million of tax from the multinational. It actually France. So even though it's Brazil, that is losing all of the revenue on that profit. Shifting from real activity in Brazil into Bermuda. It's France that would take the benefit. Why? Because France is the headquarters country of the multinational that's doing the profit shifting. And under the OECD proposals, it's the headquarters country that gets the 1st right to top up that tax.

Now when I say it in terms of a specific case like that, it seems obvious that that's completely wrong. There's no, there's no sense in which front should be allowed to top up the tax that's not being paid by a multinational in Brazil, but that's the proposal of the OECD. That's why in our estimate, the G7 countries alone would take more than 60% of the additional revenues. Because of course they are the headquarters countries for the majority of the biggest and eight or 10,000 multinationals around the world that will be in scope for Pillar 2.

Vaishnavi Ravishankar, PRI
When talking about the proposed reforms, I think when issues that is the form of the agreement itself as we've been discussing the other question in everyone's mind, is US position in all of this, Ryan being in Washington, you are close to the action. Do you think the Biden government will be able to get these reforms through Congress in its current form? What are the main challenges you see?

Ryan Gurule, FACT Coalition
The reforms that the President is proposing is part of you as international tax reform very closely aligned with the OECD process? And of course, that's not an accident. And in fact, in many ways their help their meant to help bolster the OECD negotiation process. So Alex mentioned for example that the 15% rate looks like that will be, a rate that could be agreed upon for the Pillar 2 tax, but I would note that the US is very interested in still trying to increase back global minimum rate. And that's reflected in the US tax reform efforts. The attractive piece potentially about the pillar 2 components in the US is that they don't necessarily require the same level of congressional action in our system. Our political system that is for reform. The Pillar 2 taxes can be enacted or something very close to them in a way that only requires majority participation by our Senate. That could happen through the budget reconciliation process. That's happening essentially simultaneously with all of these OECD processes.

To answer your question there are there are political challenges there. There is an uphill battle here. I think that the US does view that it is being a leader in these negotiations through the Biden administration, through Secretary Yellen. And I don't think that the US necessarily views itself as being exclusively a winner in these negotiations. Although you know Alex makes some very good points about the way that the deal is being structured, but I do think that the deal is a priority for the White House. And I get it. I think the team that's currently assembled at the Treasury, which is a very impressive team. It is working really hard to see this through.

Vaishnavi Ravishankar, PRI

This has been a really fascinating conversation before we end what it is a one call for action for investors that you'd like to end this podcast with.

Alex Cobham, Tax Justice Network

The evidence is pretty clear. Investors don't make additional returns when companies managed to engineer lower effective tax rates. But investors do suffer higher risks when that happens. Now, what does that mean? You know, it means that either the C-Suite capture the benefits of the tax avoidance, or they reinvest badly or businesses that managed to engineer lower effective tax rates are businesses that then perform badly. One way or another investors stuff the risks and get no return for it.

Now we would say this is almost certainly because in order to engineer those lower effective tax rates, what you're doing is the management of companies is partaking in more risky, opaque behaviour. They have to hide what they're doing and that opens up all sorts of other risks.

That's why you know what we've seen and the fact coalition have been, you know, really great at building this in the US. We've seen it globally too with investor support for the global reporting initiative's country by country standard. That's to for companies to report this information publicly.

Investors are really getting engaged cause they know they're the ones who suffer first. When companies are behaving badly on tax. But it's also true that societies suffer too, for all the reasons that we've discussed. And, you know, that's why when we put forward the original draft accounting standard for country by country reporting back in 2003, it was about addressing tax. But delivering transparency that really matters. Transparency with power to benefit society. If you don't know where businesses are doing their business. How can you possibly know it's a good investment? How can you possibly know that they're meeting environmental or labour regulations? How can you know their behaving socially responsibly? How can the business itself know that it's putting its investment in the places that are that have the highest return? You know it's basic information that should be in the public domain in order for performance to be better so their investors have an opportunity now. We know that policy makers consistently take this side of multinationals and their BIG 4 tax advisors. If the only people on the other side are civil society saying do this thing better, you know it's easy to hear the voice of business and think it's against transparency and that's it.

When investors join with civil society in saying no, we are the market and we want that information in the public domain to then it becomes much easier for policy makers to mandate transparency. That's what we've seen in the EU, which is now moved to introduce at least some requirement for companies to publish their country by country reporting. We're seeing it in Congress. We may see Senate follow that up, or we may see the SUC move unilaterally. What we need is the factory panel recommendations at the UN to be fully adopted for companies in every country of the world to publish their country by country reporting.

Ryan Gurule, FACT Coalition

The only thing I can really additionally add to Alex's very comprehensive summary is, you know, I would encourage investors on a bigger macro scale to consider that their risk created by failing to support global tax reform that can help fund government revenues to provide needed social services to combat various and worsening in equities. And to fight climate change is actually the single biggest threat to their cost of capital, it is not the comparatively marginal cost of more fair tax systems.

Vaishnavi Ravishankar, PRI

Perfect thank you both again for joining this PRI podcast. If you found this interesting, do register for the session on tax fairness at the PRI Digital Conference which is taking place over 18th to 21st October. There's a link in the episode description for those who would like to register. Also tune in next week where the PRI's Sixtine Dubost will lead a discussion on ESG in credit risk and ratings. And if you've enjoyed this episode, please do subscribe and rate our podcast. Please do continue to keep safe and well. Thank you, goodbye.