The Taxcast, February 2024 Transcript: Taxing Multinationals, unitary-style

Naomi Fowler: Hello and welcome to the Taxcast, the Tax Justice Network podcast. We're all about fixing our economies so they work for all of us. I'm Naomi Fowler. Coming up later on this extended special edition of the Taxcast. While we wait for a global tax body at the United Nations, what are the ways forward for nations desperate to tax multinationals?

Sol Picciotto: It'll be some time before we have a global tax body. So that's why we say it's important for there to be a new initiative now to move forward for willing countries to do that. We'll talk unitary taxation later.

Naomi Fowler: But first, we've got the return of our commentary slot this month, and I'm going to talk to Zorka Milin of the Financial Accountability and Corporate Transparency Coalition in the United States. It's brilliant to have you with us. Can you tell us a bit about how you ended up working for Financial Accountability and Corporate Transparency? Let's start there.

Zorka Milin: Sure, thank you so much, I'm delighted to be here. My main professional background is in international tax law. So I worked in private practice with a couple of big law firms, I was based in New York. They were global law firms. And that was my first career. I enjoyed it. Now I know this is not everyone's cup of tea, but I just loved the intellectual challenge of figuring out the ins and outs of tax code and regulations. But then I just want to do something a bit more meaningful. So that's when I decided to make a switch and I wound up working for NGOs. And the turning point was a trip that I took to Sierra Leone, volunteering for this amazing, amazing local legal justice organization called Team Up for Justice. They have a network of community paralegals in rural areas where there's no other access to the, to the justice system.

And so I was sent to one of those remote areas. Ostensibly, it was to mentor and train these local paralegals and basic legal principles. That was, that was the idea, but it was such an eye opening experience and transform experience for me. As it happened I was posted in an area that was incredibly rich in diamonds and gold and, you know, all sorts of, you name it and the main thing that I experienced there was to see firsthand, to see the unbearable injustice of how foreign companies are behaving in a place like this just taking, taking, taking this immense natural resource wealth of out of this community that was incredibly impoverished community without sharing or, you know, paying much of anything in taxes that would help this community in the country as a whole, you know, the only impacts they were leaving behind pollution and devastation and seeing that really shook me to my core and it made me so angry that what I did is I ended up approaching Global Witness. I just wrote them out of the blue. I said, you know, I said, hi, I'm a tax lawyer, how can I help? And then from there, I wound up working at Global Witness for many years. And, you know, I'm so proud of my time at Global Witness, I mean, during those years we've campaigned for a number of different issues and we've won on things from, you know, transparency of initial ownership, transparency of natural resource payments, uh, and of course, not to mention there were countless corruption scandals that we exposed over those years. But one thing I didn't get to do there was to work on tax issues directly and I really missed that. So now I'm very happy to be in a role that combines working on tax justice along with anti corruption and transparency, which I think are very closely connected with the FACT Coalition. So that's my story. So here I am!

Naomi Fowler: Amazing. I mean, that's what I love about so many of the people that I meet who work for financial transparency, you've had other lives completely and you've worked in the field. That's what makes you so effective as campaigners. And I remember meeting you in London, actually, many, many, many, many years ago when you were working for Global Witness. And now here we are on the Taxcast, which is, uh, brilliant.

So, uh, let's start with the first thing we were going to talk about, which is that the United States has a new beneficial ownership register. So, from January the 1st, 2024, the Treasury Department began accepting filings on the true beneficial owners of many U. S. companies under the Corporate Transparency Act, and it's been a long time coming, years of campaigning. The United States has lagged behind other countries for a long time on this. And what it means is that pre- existing business entities covered by this new measure basically have until January the 1st, 2025, to submit their ownership information. New entities must file within 90 days of formation. It's a massive victory in the fight against money laundering. So, how's that been in your experience of campaigning and what were the tactics that finally got it over the line?

Zorka Milin: Right. That's a huge win. And as you say, it certainly didn't happen overnight, it took years and years of very persistent campaigning. The earliest that I know of this issue, it goes way back to at least the 2008. There was kind of an early version of this legislation that was led by, uh, then Senator Carl Levin of Michigan. And he was an amazing Senator who led the Senate Permanent Committee on Investigations. They exposed all sorts of tax and corruption scandals back then. And, you know, it turned out that in each one of those scandals, anonymously owned companies played a very prominent role. So, so that was back in 2008, so it came before the Panama Papers and all those tax leaks and scandals. And then that legislation kept being reintroduced in every single session of Congress until finally, finally, it passed in 2020.

And I say that just to give you an idea that, you know, overall, it took more than a decade. And here we are now, it's finally being implemented. And also it took it took time. It also took a very broad umbrella of not just, you know, the usual anti corruption, tax transparency NGOs, but also you know, teaming up and kind of holding hands with advocates on other issues, advocates against human trafficking and, you know, unions and labor groups and faith groups and and so on, um, very broad coalition and and not just civil society but also folks who cared about national security. So the, the national security policy community, the law enforcement, because they were running into these, uh, companies and their investigations.

And maybe I would say one of the most critical was that we had some business allies. And, um, so in a way it was a kind of a strange coalition, leadership by civil society, first and foremost, and then combined and followed by support from other stakeholders and parts of the private sector in particular. So, and in this case, the private sector actors, it was the American banks that supported the measure really, that was, that was very important. And the reason they supported it was because knowing the beneficial owners of companies would help them in their own anti money laundering, due diligence obligations that they were, you know, they were legally required to do, to do these checks. So it was, it was also in their interest.

And, um, it really shouldn't be easier to set up a shell company than it is to get a library card from your local public library, and astonishingly, that was the case in many parts of the U. S. before this law was passed, because, you know, for the library card, when you go to the library, you actually have to show an ID but to set up a company, you didn't, but now you'll actually also have to do that if you're a beneficial owner of a company set up anywhere in the U S, so it's absolutely, it's a, it's a watershed moment, yes.

Naomi Fowler: Wow, it is indeed. And I mean, obviously no country has got a perfect beneficial ownership register of a kind that we'd all like to see, but, you know, big achievement though this is, that's happened in the States. Now there are some gaps, like with many different jurisdictions with their registers, um, that need closing. So I think, so there's three main things we focus on at the Tax Justice Network. So very often with registers, you're only obliged to be on a beneficial ownership register if you own or control 25 percent or more of a company. And we want to see the lowest thresholds possible. So if you own one share, we think you should qualify to be registered. We want to see transparency and the broadest public access to the register, so open source, free, and we want to see as few exemptions as possible. And we'd like to see really all legal vehicles subject to ownership registration.

So with the U. S. Beneficial Ownership register, there are I think 22 exemptions to those who must register, which sounds like a lot, right? So what improvements would you like to see there?

Zorka Milin: Oh, for sure. Yes, I think there are areas for improvement. In addition to everything you mentioned, I'll say one area in particular that we will be watching closely is the issue of access, so because this registry is not public, unfortunately, you know, that's the gold standard. We would like it to be public, but it's not, it's not public under the law. We still want to make sure that this data doesn't just sit there, but, you know, to make sure that it's as useful as possible to investigators and, you know, to to other users and, uh, this issue of kind of who has access to the registry and how that works, what are the procedures for that, that that's still being sorted out so, uh, so we're watching that and we're not the only ones watching that. Our banker friends, as I mentioned earlier, they also care a great deal about, uh, being able to access this information for their own purposes so, so that, so that's important.

And then my number two issue is verification. That's a, that's a challenge not only for the US, but I think really for beneficial ownership registers everywhere, uh, to make sure that this data is actually, you know, it's accurate, but, you know, there's still this bigger issue that we cannot have a kind of, you know, no questions asked approach, just, just, you know, put anything you like, uh, there needs to be some way to verify this information because otherwise it defeats the whole purpose of, of these measures. So, so I think that's an important, very important issue.

Naomi Fowler: Yeah, we, we're going to talk also, we have a tale of two crimes that happened in the same week, really. So we've got two very different cases we want to discuss. One, a whistleblower who's a former IRS tax man in the United States, and the other, uh, tax lawyer in Germany. Um, obviously, you know, you can't compare two completely different legal systems. These are two different crimes they've both been convicted of, but one was a crime at least of conscience and the other definitely just a crime of basically self interest and full on fraud.

But anyway, if we look at the first one, the whistleblower and former IRS tax man, who's called Charles Littlejohn, was sentenced In the states to five years in jail, plus three years under supervised release. And what he did was that he leaked details of Trump's tax returns and the returns of some very wealthy U. S. Americans as well, including Jeff Bezos and Elon Musk. And, you know, let's be clear, his actions caused no loss to the US taxpayers, but I know what he helped to do was inform the public of the huge gap between what we ordinary people pay in taxes and what the very wealthy and powerful tend to pay. So, you know, whatever the rights and wrongs legally, he pleaded guilty to one count of disclosing tax return information. He did express remorse, but he did act out of conscience. So that's five years for him.

The lawyer in Germany, on the other hand, you know, he was a Freshfields, Brookhouse, Derringer law firm partner. He got three and a half years in jail for committing tax fraud and that was part of a massive tax scandal going back years in Germany that caused a loss to taxpayers of, I think, between 374 to 390 million euros. Huge loss, um, very damaging to the rest of society. I mean, to be honest, I was kind of surprised that the lawyer got as much as three and a half years, because as we know, white collar crime is treated so differently when the accused is, you know, in a six thousand dollar suit! I mean, what do these two cases say to you?

Zorka Milin: You know, it's such stark contrast for how the world treats these two types of contacts. And it's striking too, because these two decisions, yes, they are you know, very different countries and different legal systems, but they happened to come down at exactly the same time, I think it was just a day apart. And, uh, both cases were punished. And yes, you're absolutely right that this is a very rare instance where we actually had a tax lawyer who ends up in jail, I mean, that, that really, that's not something that happens very often. And as a former tax lawyer, I will say I was absolutely gobsmacked that this was a very senior tax lawyer, and he was working in the prestigious international law firm, I mean, Freshfields is one of a handful of so called Magic Circle firms that are based in London. And so to see that someone like that was actually held accountable for once doesn't happen every day. And it happened in this case because what he did was just so egregious and way over the line of illegality. I mean, we're, we're not talking about, you know, there's um, some gray areas and people sometimes debate, you know, what's evasion, what's avoidance and so on, but this, this was, I mean, it was fraud and it was, it was also very consequential. As you say, hundreds of millions of tax revenues were lost and yet even with all of this, this tax lawyer was still punished less harshly than someone who exposed the results of, you know, kind of very creative tax shenanigans and showed the world just how little some of the wealthiest and most powerful people pay taxes.

You know, I mean, we have to say the criminal law. It is what it is. It's what the judge decides. And in the U. S., we also have sentencing rules that kind of determine what the sentence is. And by the way, here I'll say there are, there are some American politicians who feel that this whistleblower, he got off easy, that he should have been punished even more harshly, even though actually under the current rules, he got the longest possible sentence under the current law. So now they want to change the law to make it even more to make it, it would make it twice as long, so instead of five years, it would be 10.

So, um, but you know, let's, I, I think we should just take a step back and ask why, why are our laws, I mean the laws of so many countries around the world are so soft on wide collar criminals and, and yet so harsh on whistleblowers? Who, whose secrets is it that these laws are protecting and, and why? In this particular case, it was the tax secrets of people like Jeff Bezos and Elon Musk and Warren Buffett, I mean, these are some of the very richest people on the planet. And what we learned from the leak, this was published in a detailed investigation by ProPublica, it's fascinating reading. Uh, in some, in some tax years, these richest people on the planet, they paid nothing in taxes, literally zero, not a single penny. And that's you know, I think that's striking!

I mean, you can kind of be smart and say, well, we kind of knew that the tax system is rigged and it's stacked in their favor. So, you know, this isn't surprising, but, you know, I think it's still incredibly powerful to have proof, to have these, these concrete examples. And these revelations were also, they were consequential in that it dramatically changed the whole U. S. conversation on tax justice and such that now, President Biden has a proposal for a billionaire tax in his budget, in his, in the official presidential budget. And something like that would have been unthinkable just a few years ago. So. really, you know, I think it shows how lifting the curtain on how taxes work or don't work in these specific cases can inform tax policy and tax debate. And it's, and really it's maybe I would say one of the best ways to do that, I think, and in this case, that's absolutely what happened.

Naomi Fowler: Yeah, yeah. And I mean, if you're listening, Charles Littlejohn, thank you. Solidarity to you, because that's a long jail term.

Zorka Milin: It's under, it's under appeal, so fingers crossed there.

Naomi Fowler: Good to know, because yeah, without that, we wouldn't have known that, you know, um, the year he won the presidency, Trump paid 750 dollars in federal income taxes and no taxes at all in 10 of the previous 15 years, you know, so if that's not public interest information, then I don't know what is!

You know, you have these billionaires and the super wealthy, they're very happy to use their fame and power to have a really disproportionate influence on governance and on the public conversations we all have, quite happy to be public there, but when it comes to the public seeing what kind of citizens they are, oh, then they want privacy, you know, so I know that in some countries, Scandinavian countries, I think, everyone's taxes are actually published or they're accessible to the public, you can look people up for free, so it's all out there. What are your thoughts on that?

Zorka Milin: Oh, yes. I think there's definitely something to be said for that. Sunshine is the best disinfectant. Transparency is like a, is like a kind of a miracle drug that can deter and cure the worst abuses. And so just imagine if the taxes of the top wealthiest individuals were routinely made public, not through a one off leak like this, but on a regular basis. We could name and shame, yes, of course, but we could also have a race to the top to see who contributes the mo the most to, to the public good.

It's interesting what you say about the Nordics, I mean, it really shows that tax secrecy. It's not like a law of nature. It's a choice, it's a political choice, and we've seen, uh, the opposite choice made to tax transparency in, in different places, and even in the U S in different time periods, there were several occasions when individual tax information was briefly made public. It happened, it first happened during the civil war. And then again when the modern income tax was first introduced in the twenties, uh, and then there was one, uh, one more time during the New Deal, very briefly in each case.

I will say like the, the transparency was kind of shut down by the, by the wealthy interests, so there's that lesson there as well. But, you know, if you look at history, it shows that tax secrecy wasn't always the norm and, and so it's not the way it has to be. And let's do what we can to change it.

Nomi Fowler: Thanks, Zorka. Zorka Milin of the FACT Coalition. Now it's time for the Taxcast special feature. If the government where you live struggles to tax multinationals doing business there, why is that and what are the ways forward? Well, the solution we need is one of the Tax Justice Network's longest running areas of work, unitary taxation and formulary apportionment.

I've got Tax Justice Network researcher Alison Schultz with me to talk us through how unitary taxation can make things much fairer. Hi Alison!

Alison Schultz: Hi, I'm very happy to be here! So unitary taxation is a simple way to tax big companies that operate in different countries. And it's called unitary taxation, as we would tax a multinational company as one unit. So we would tax the company as what it really is, as one big player. This means we would be adding up all the money a company makes worldwide and tax this money based on where the money was actually made, where the economic activity was actually happening.

So if we take a multinational electric car company as our example, we could have a company which, for instance, designs its technology in the Netherlands, manufactures the cars in India, and sells them to Brazilian customers and to other parts of the world with unitary taxation. Each of the involved countries, so the Netherlands, India and Brazil, would all get to tax a part of the company's total profits.

Naomi Fowler: Right, and how do we decide who taxes what?

Alison Schultz: To determine how the taxes are taken by different countries, we would usually use a method which is called formulary apportionment. It's called formulary apportionment Because we apportion the profits to different countries with the help of a formula. And this formula is set to measure how much economic activity is happening in the different countries where the multinational is active. So usually to measure this economic activity, the formula uses the number of employees a multinational has in each country, the value of assets located in each of the countries, or the volume of sales going to each of the countries where the goods of the multinational are sold. So we look into how a company's employment, assets, or sales are distributed among different countries to then decide how much of the profits each of these countries is allowed to tax.

Naomi Fowler: Okay, okay. Well, that sounds logical. And, uh, so how does that work then with our electric car?

Alison Schultz: Okay. So, so let's say we have a rule where we would split the taxes based on where the company's workers are and based on where the company's sells its products. So half of the profits in this rule would be taxed by the countries where pupils are employed and half of the profits would be taxed by countries where the products are sold. So in our electric car multinational companies, we have some workers based in the Netherlands where some employees design their car technologies, and we would have some workers based in India where other employees assemble a car. That would mean that half of the company's overall profits, so the part of the profits which are allocated based on employees, would be taxed by the Netherlands and India, depending on the number of the company's workers in each of the countries.

Naomi Fowler: Right, so that's one half, and what about the other half?

Alison Schultz: Yeah, so the other half of the multinational companies, in our example, the other half of the profits would be taxed by the countries where the cars are sold. So previously I said that some of the cars are sold in Brazil. Let's assume that 10 percent of the cars are sold to Brazil. Then Brazil would tax 10 percent out of this other half of profits. This way Brazil, the Netherlands and India can all tax those parts of the company's profits that apply to their territory. And for those parts of the profits that they are allowed to tax, each country can decide for itself, based on the democratic rules they have, what exact tax rate to charge.

If we think about this unitary taxation, for me, it always sounds very straightforward. And it actually is straightforward, because the money these companies make is because all the different parts of the company work together. So it's just fair and also reflecting the reality to tax these big players as one whole company, so unitary taxation is the right way to do this.

Naomi Fowler: Yeah, and the thing is, that's not what we're doing, right? And, uh, what multinationals are actually enjoying is a kind of a crazy system where the global tax rules allow them to complicate everything, to their benefit and our loss. So tell us what the system actually does.

Alison Schultz: Sure. The way we actually tax these big multinational companies is very different. So in the current system, every smaller sub-firm inside this one big company is treated as if it were a totally separate business. So we don't look at the big company's whole earnings, but instead each sub-firm reports its own profit or losses.

Naomi Fowler: How does the multinational company handle the way it's presenting its profits made by each of these sub-firms?

Alison Schultz: To, to organize that the sub-firms have contracts with, with each other. So for example, the companies making cars in India would pay the tech designers in the Netherlands to use the technology designed there. The company selling the cars in Brazil would buy these cars from the Indian maker and so on. So how much profits or losses each sub-firm makes would then be calculated after all these different payments which have been made between the different sub-firms. But that also means that the amount of profits or losses each sub-firm makes heavily depends on the prices which are charged between the different sub-firms of the same global player.

Officially, the sub-firms of this big company pretend that they are not related when they set these prices. This is what is called the arm's length rule. So this means that when a sub-firm buys goods or services from a sister firm, it should actually pay what it would be paying to an outside company, to a company that it's not connected to at all.

So the idea behind this principle is that the goods or services that each sub-firm receives by a sister firm could just as well be provided by another non-connected firm in the market. So following this idea from our example, we would assume that the car making sub-firm in India could buy the technology just from anyone, not just a sister firm. And a firm in Brazil that sells the car could just buy them from a random firm at the market as well. Based on these assumptions, there's a bunch of rules that tell the sub-firms how to treat each other and how to charge for what they sell or buy.

These rules are called transfer pricing rules in the current system. And the idea is that if these prices were fair, in the end you could see clearly how many profits are made by each sub-firm. So the profits are not made by the multinational, as we had in the previous example with unitary taxation, but the idea is that each sub-firm has made its own profits or losses. And this means that it could even happen that one of the sub-firms of the same multinational makes very high profits while other sub-firms make huge losses in the same year.

And this system creates opportunities for companies to use all kinds of tricks to shift their profits around artificially. So why would companies want to do that? Why would they want to report profits in one place but not in the others? This is because companies can then act as if profits were made in a country where taxes are low to minimize their overall taxes.

Naomi Fowler: Okay, so let's apply that to our electric car company then. How would that actually work?

Alison Schultz: Sure. So for the example of before, we could assume that a multinational company which produces electric cars knows that the profits it would report or it will report in the Netherlands will be taxed at a lower rate compared to India or Brazil thanks to some special tax breaks it can enjoy in the Netherlands, so the company will try to report as many efforts profits as possible in the Netherlands and as little as possible in the two other countries.

So how can the company do this in the current system? The sub-firm that manufactures the cars in India will pay the sub-firm based in the Netherlands to use its technology, as I said before. The two firms, the two sub-firms, which are part of the same big firm, could now agree on a really high price for this technology. And it's really hard to say what the correct price for such a very specialized technology is, so they have lots of room for maneuver here and could just set this price very high. And after paying this high price, the Indian sub-firm might not have any profit left to be taxed on in India. So this means the Indian sub-firm might record no profits at all after having paid to use technology from what is actually an arm of the same company in the Netherlands. This would mean that India won't get any tax money, even though the large multinational company makes profits, and even though India is providing everything which the company needs to make these profits. It supports the factory, it provides the infrastructure, it educates the workers, all the things the tax are needed for. At the same time, a lot of the company profits might be reported in the Netherlands, where the rates to pay are much lower. In a similar way, when it comes to the Brazilian sub-firm of the multinational company, the sub-firm might report very few or no profits at all after having paid different prices and license fees and other payments to other subfirms of the same company. Then, similarly, Brazil might not receive any or very few taxes from the company's profits, even though it's the Brazilian people who are buying the cars.

Naomi Fowler: And there'll be a centralized head office where I guess the multinational head of tax and his friendly big four accountancy firm associates will sort all the books centrally, shifting all these things around that you're talking about?

Alison Schultz: Exactly, exactly. And that's just one more illustration that multinational firms act as one big player. And actually, it's also part of their success to be able to act as one big player, including in their tax planning, so we should also tax them as one big player.

And that's just maybe to reinforce again that the current tax system doesn't work well for anyone except for a few multinational companies. Countries like India and Brazil in our example, which help companies succeed, aren't getting the tax benefits they should. The Netherlands where a lot of the profits are getting shifted to also don't really benefit because they tax these companies profits at a very low rate, so it's a loss for the entire world.

But we also have to highlight how, how bad the system is for fair competition or for fair play in business. Because smaller companies generally operate in one country so they cannot use all these loopholes that big multinationals can. Also multinationals who would like to be fair taxpayers, or would like to pay their fair share, lose out because they might have competitors who are exploiting the rules as good as they can.

Multinationals are also wasting so much time and investing so much more money just to minimize taxes instead of having productive innovation and developing. And the whole accounting industry that's grown up just to serve them is also a big waste of smart, skilled people who could actually be doing something way more useful for the world.

Naomi Fowler: Yeah, definitely. Financiers seem to have taken over some of our biggest corporations and it's bad outcomes all round when companies are over focused in this way on tax minimization and financial engineering. Um, and when it comes to the safety disasters at Boeing, where people actually died, there's research linking those terrible events to investment in all the wrong things with that firm. And what had suffered for years there was investment in safety, design and innovation. And I suppose at the moment, each country can only tax based on how the global rules, the global tax rules say companies must declare their profits. So there must be limits to what sovereign governments can actually do to tax these profits? We have global rules that allow a company to kind of pretend that its sub-firms operate as separate entities when in fact they're part of the same company. The accounts say the profits were made elsewhere, right? So, in a way, government hands are a bit tied, right?

Alison Schultz: Yes, exactly, exactly. It's quite hard for countries to tax profits that a company isn't declaring as being made in their jurisdiction. So, there are some ways around this, but very tiny ways, so this is where some governments have been brave and creative and trying to find ways outside of the system and maybe also implement some unilateral measures.

With unitary taxation companies are taxed based on where they actually do their work. Things would be much fairer. Every profit is taxed fairly and every profit is also only taxed once and not multiple times. With that system, countries would get back for their investments in things like roads, schools, and other services that make it possible for companies to succeed in the first place, and each country would still be free to set its own tax rates. They would even allow to set very low rates if they choose to, but they'd be only able to apply these rates on the money that is actually made in their territory, so changing to unitary taxation would stop profit shifting immediately on the money that is artificially shifted and would also end the unfair race to the bottom of different countries who fight about reported profits by setting their tax rates very low. Instead, it would support fair competition and ensure that all companies pay their fair share.

Naomi Fowler: Yeah, thanks Alison. Unitary taxation, it's a no brainer, and it's been an area the Tax Justice Network's been working on and campaigned on for a long time.

Sol Picciotto: Unitary taxation was a very early proposal from Tax Justice Network. It originated in the important analytical work that we did at the beginning of Tax Justice Network, which really showed the defects of the existing rules, specifically, of so called arm's length principle and transfer pricing.

Naomi Fowler: This is veteran tax justice champion and emeritus professor of law Sol Picciotto. He's also coordinator of the BEPS Monitoring Group which analyzes efforts to tackle profit shifting by multinationals. He's a senior advisor at the Tax Justice Network and self-proclaimed 'scourge of corporate capitalism'. We've always taken the long view on tax justice reforms, and unitary taxation is perhaps more long-termist than most.

Sol Picciotto: It was one of the early strategies for Tax Justice Network, early proposals, together with country by country reporting and automatic exchange of information. But like our other demands at that time, that was regarded as way beyond the pale. Well, you know, we first put forward automatic, comprehensive exchange of information between tax authorities back in the early 2000s. OECD people told us that was really impossible, they started bilateral. That took 10 years. Country by country reporting, equally, that was regarded as fanciful, and that took around 10 years. Now, with unitary taxation and formulary apportionment, it probably is more challenging than those because those are transparency, but these are substantive corporate tax rules, and that will take longer. But we have made really quite surprising progress.

Naomi Fowler: In 2012, the OECD 'Rich Country Club', as we call them, launched their project on base erosion and profit shifting, the so called BEPS Project.

Sol Picciotto: We identified that as potentially significant, and when the action plan was published in 2013, they started then to talk about going beyond the arm's length principle. Uh, so that was really very early days, but they at least talk about going beyond the arm's length principle. Probably more important was that through the political process, I think we made a significant impact on that because from a common sense point of view, allocating the global profits of multinationals according to where they do business is sensible. And that, in fact got through to the G20. So the G20 leaders were asked to support the BEPS Project. They did, and in the 2013 G20 declaration, at that time in St.

Petersburg, they said the mandate was to reform international tax rules so that multinationals could be taxed where economic activities occur and value is created.

Naomi Fowler: G20 leaders themselves knew reform was needed towards a system that recognizes where economic activity takes place. And the BEPS Project work began.

Sol Picciotto: So they were treating multinationals as unitary entities, tax multinationals, where activities occur. No mention at all of the Arms Length Principle. But the more detailed technical action plan really largely envisaged patching up the existing rules. So it was a very slow start.

Naomi Fowler: But then the realities of the way economies were developing started to add to the pressure for reform.

Sol Picciotto: The impetus really was provided by the fact that digitalization had clearly made a major impact, and they were very concerned about the impact of digitalization, and that was action one of the BEPS Project. Now, they didn't make very much progress on that in the first phase of the BEPS Project by 2015, so they asked for more time to continue the work, and eventually in 2018, they produced an analytical report which was really quite significant because it showed digitalization had a very broad impact. It wasn't just the digital giants. What the digital giants have done is to transform a lot of existing economic sectors, in fact now all economic sectors are affected by digitalization. I mean, if you think of something as physical as motor vehicles, your ordinary car is now really a computer on wheels, or a number of computers on wheels. We now have the Internet of Things.

Naomi Fowler: Yeah, and now no one could deny the urgent need to redefine taxable presents and profit allocation rules.

Sol Picciotto: And so digitization has affected all the economy. Plus, it has really completely finally overturned the idea of the arm's length principle. Because it's really very easy for companies to do business in countries with no physical presence, which is a very significant problem. But there's really very little relationship between, uh, where they have physical presence, and where they derive profit. So the 2018 report from the BEPS Project said really we need to rethink what's the basis for taxing multinationals. Not only do you not need a subsidiary, you may not need any physical presence at all, so you need a new principle for taxable presence. Secondly, you need a new approach to allocating profits. That was in the 2018 report from the OECD, but even so, the OECD countries were thinking in fairly cautious terms.

Naomi Fowler: Then in 2019, the G24 group stepped up and entered the debate. The G24 group coordinates the position of so-called developing countries on monetary and development issues, and they favored unitary taxation.

Sol Picciotto: We tax justice campaigners had a significant impact, uh, because we did have a line in to finance ministers of the G24, and they easily grasped the notion of taxing multinationals as unitary enterprises. And, in fact, they, uh, mandated their technical group, and the technical group, uh, sent a proposal to the OECD.

By this time, the process had been enlarged beyond the G20 to include a wider range of developing countries through the so called inclusive framework. And so Uh, in addition to some of the G20 developing countries, India, Brazil, South Africa, we now have a number of other developing countries, and they work together through the G24. And the 2019 proposal from the G24 really was significant in that it put forward a taxable nexus based on significant economic presence, so it should not require physical presence, nor even a locally incorporated subsidiary or even a branch, and therefore, I mean, once you say that you should be able to have a share of the profits purely on sales, you need a method of allocating the profits, and a formulary approach seems best. And that's exactly what the G24 proposed in 2019. What we heard was that they had some struggle even getting it on the agenda. Uh, but they did. And I think that was, in a sense, a game changer.

Naomi Fowler: This really moved things forward with the argument that taxing rights should be independent from physical presence. And once you allow countries to tax without the multinational having a physical presence like a subsidiary in their country, the arm's length rules just don't work anymore. This is all particularly useful for countries where a company makes profits from sales, yet has no physical presence there. And as Sol explains, progress on one, tax justice reform feeds into another.

Sol Picciotto: By now, by this stage, we had achieved country by country reporting. That had been probably the main significant victory in the first phase of the BEPS Project. So this meant that for the first time, at least the tax authorities were now getting country by country reports. And this, I think, refocused their attention. I mean, previously, they always started from the accounts of each individual subsidiary. I remember talking to a former tax official from the UK who told me, you know, it took him days to reconstruct a picture of a particular multinational he was looking at that had a very complex structure going through Mauritius to India and so on. But now with country by country reports, they've been getting that. So I think that has refocused the attention of tax authorities to the, what share do they get of the global profit, and how should that be done? And so the G24, I think, built on that. So in the, it's only really then in the second phase of the BEPS project, so called BEPS 2.0, since 2019 that that's come to the fore. But again, it's always two steps forward, one step back, because you're having to cope with many of the OECD countries that are really, some of them are completely recalcitrant, so they're really completely unwilling to go anywhere in this direction.

Naomi Fowler: The G24 group really did push forward and in 2021, the OECD came up with what they called their two pillar solution. Pillar two's the better known one, and that's all about the global minimum tax on corporate income from the jurisdictions where companies operate. Pillar one aims to expand a country's authority to tax profits from companies whose services and products are consumed in a country where it doesn't have a physical presence. A good example of that might be a country that contributes to Google's profits with loads of Google users even though Google doesn't have any subsidiary there. *But* pillar one only applies to around a hundred of the world's biggest companies. And there are other reasons it's not great, as Sol explains.

Sol Picciotto: It's the OECD secretariat that does all the technical work, which I think partly accounts for the great complexity of everything they put out, because they were under time pressure, so they had to tell the G20 they'd got a solution, and it was this complex package. They've still not finally completed all the elements, but I'll concentrate on the ones that deal with the central question of how to allocate the income of multinationals. And that's in Pillar 1, so called Amount A of Pillar 1.

Now, they say it's partly to make it manageable, but we say that's because the approach they've got is highly complex, amount A will only apply to a very small number of companies. Now, it does have formulary allocation of profits, but only on the basis of sales, so it's only to allocate a small share of the global profits of a small number of the biggest and most profitable companies on the basis of sales. And it's a complicated system where they're not allocating from the total global profits, but only from the so called residual profits, so that makes it really very complicated. And it means also that although this amount does entail a formulary approach and does start from treating them as unitary entities and starts from their worldwide profits, it only applies to a small share of those global profits. So it's 25 percent of the so called residual profits.

And then the biggest problem is, it's added on top, it's a new layer of rules on top of the existing transfer pricing arm's length principle. So even for those 100 companies, aside from the small share that will go by sales, the rest all has to be done by the existing arm's length rules, which makes no sense at all. And then for all of the companies, the existing rules are unchanged. So, it's really a pig's ear, in terms of their actual proposal.

Naomi Fowler: A pig's ear! And there's another reason it's not going to work. It's always the same elephant in the room when it comes to global tax agreements.

Sol Picciotto: It won't run. The main reason it won't run also is that it has to be introduced through a multilateral convention which has to be signed but also ratified by really a large proportion of the countries concerned, really all countries in which these big 100, biggest most profitable companies have significant operation, they all have to be involved because they're allocating the profits for tax purposes of those companies. So essentially that means, in particular, the U. S. has to be involved. 60 percent of the companies involved are obviously American based.

And for the U. S. to ratify a multilateral tax convention is extremely difficult. It needs the advice and consent of the U. S. Senate by a two thirds majority, which in the present situation of U. S. politics is not conceivable. So, it's very unlikely that Amount A will come about. They still actually have not got a final agreed text after all this time, uh, several deadlines missed. There's still some prevarication going on. They keep saying that it's only small technical issues but the issues do seem to be widening. And it seems now to be some U. S. red lines that's holding it up, and it may well be that because the U. S. negotiators know that it's vanishingly improbable that the U. S. will ever ratify, they want to put the blame on other countries for not agreeing the final text. So that's the downside, if you like.

The very great upside is that because Amount A is a unitary tax system, and it involves formalary apportionment, they have now developed detailed technical rules for how it should be done. So, although in Amount A, they were going to adopt a modest version, that's unlikely to go through. The next challenge, obviously, is now we have all the details, uh, technical basis for doing it, how could we move forward and achieve this?

Naomi Fowler: Yeah, and obviously there are, as we've seen with the G24, they tend to be the countries that are more interested in pushing this because in some ways they, they will benefit, whereas some of the richer countries are not so keen, so I wonder if you can explain a bit how the many ways the Global South, so called, is kind of really quite ideally placed to lead the way on this. Is that how you see it?

Sol Picciotto: Uh, yes, what I'd say is that what the BEPS process has showed is that all countries really have to grapple with the problem. And I think the tax authorities increasingly have become aware of that. The problem is that they're stuck in old ways. They're stuck with the old paradigm. But all the work done in the BEPS process, particularly the work on digitalization, shows that we need a new approach. And it has to be formulary. All the countries understand this. So that's why they've introduced other measures.

What we know is that they've introduced digital services taxes. That really is what provided a big part of the pressure for other countries, particularly the U. S. in relation to digitalization, clearly the U. S. was most reluctant. And it was only when other countries introduced digital services taxes, actually led by India with what they call the equalization levy, but then European countries were not far behind, and even the UK countries adopted digital services taxes. But they have their limitations, their short term measure to deal with the problem and an increasingly number of countries have done that. In some ways, it's easier for developed countries to do that, because they have large markets. For a smaller developing country, it may be more problematic, in fact, although they need it, they do need it in relation to their corporate income taxes. It's very important, relatively speaking. So, a wide number of countries have adopted digital services taxes. Even more may consider doing so.

Naomi Fowler: And digital services taxes are an imperfect fix to a bigger problem, while some countries continue to drag their feet on unitary taxation and formulary approaches. Some countries have been doing their best.

Sol Picciotto: Nigeria, for example, adopted an approach which was not listed actually in the draft that we have of the Amount A Multilateral Convention. They don't regard that as a digital services tax and that, in a sense, moves towards a formulary approach. What Nigerians did was to firstly establish a taxable presence based on significant economic presence. So that's if you have significant activities in the jurisdiction for the Nigerians, they're not concerned only with digital, they're also concerned with other business services, business to business services, which are not necessarily digital. So the Significant Economic Presence is a fairly broad, uh, concept and they also have a provision actually in their Companies Act that says that any company wishing to do business in Nigeria must do so through a local entity, must incorporate locally. So that gets around, if you like, the taxable presence requirement in tax treaties.

And then they've introduced a system where you then allocate a share of the profits based on sales revenue in the country.

So that begins to be a formulary approach, particularly based on sales. And because it applies to the profits, whereas digital services taxes are conceived of as transaction taxes, as based on the payments, then it's not a digital services tax. And that kind of makes sense, because a pure digital services tax, which is a transaction tax, generally is easier to pass on to consumers in a number of countries where digital services taxes, if they are applied to the payments, then it tends to be the consumers that are most immediately impacted. So, for example, Amazon, in most countries, I think, has passed on the digital services tax to the third parties who trade on the Amazon platform, so it could be local companies that are using the Amazon platform to deliver to local customers who are really bearing the brunt of the digital services tax. So that's why I say it's a short term fix, and it's not really taxing Amazon's profits. So, the phasing out of a transaction based digital services tax would be a good idea, and it could go in the direction that Nigeria's gone.

But now, even more important is, India again was in the lead, and in 2019 proposed, and this would build on a similar approach to Nigeria, because India also had enacted a significant economic presence test, but they also put out a consultation paper saying that they could attribute a profit to entities that had a significant economic presence based on a formulary approach, and their approach would apply each multinational's global profit rate to the local revenues. So whatever the profit rate of the company as a whole would be, you would apply to local revenues. Now that's, that's a kind of shortcut way of doing it and that would be a formulary approach that was proposed by India in 2019, and you could build on that. But now what we're arguing is now that we have these global standards, countries could go a stage further and start from the global financial accounts, so instead of looking at local revenues, start from the global financial accounts, adjust them in line with the template in Pillar 1 for tax purposes, and then apply the detailed technical standards for apportionment to those global profits. So you could go a step further than India proposed in 2019 and adopt that global formulary approach. And countries could do that.

Obviously the big challenge now is how far can they do it without needing a multilateral convention that everybody has to sign. What we're saying is it could and should be done by a concerted approach between countries. Countries could start adopting this approach.

Naomi Fowler: Mmmm. And in terms of that tension between the limit, how far countries can go domestically with their tax rules and how they apply it and multilateral agreement, how hopeful do you feel about the United Nations playing a role that will progress that a lot faster than under the current circumstances under the OECD?

Sol Picciotto: Well, I think it's interesting there's been this kind of parallel process going on, because all this detailed technical work through the inclusive framework has been going on obviously in parallel with the broader political issue of the fact that it clearly is not satisfactory at all from any point of view that it should be an OECD led process. I think even OECD countries must realize that. They keep getting criticized for, you know, this being all OECD and so on and so on, which it is. That's a problem. And it's because it's OECD led that I think they've been so reluctant to break out of that paradigm. They need to take the blinkers off. But I don't think it's really possible within an OECD led process really to take the blinkers off.

The hope would be that a new global framework would make it possible really to have a reset, you know, to rethink the approach. But it could and should build on the progress already made. So that I think is a difficult transition. And the issue now is that the two are at different stages of development from the inclusive framework OECD side, as I say, we have all the technical building blocks in place for a formulary apportionment approach, but very little political will to do it.

On the other hand a potential global framework, I think there will be a lot more political work, a lot more understanding, particularly if it was politically led. But, it'll be some time before we have a global tax body. Let's be optimistic, I think it's quite possible, but it will take time. So that's why we say that it's important for there to be a new initiative now, to move forward, for willing countries to do that. I think a variety of countries could potentially be interested in it, but I think it's most likely that it would be developing countries, largely because they're the ones that have mainly suffered from the problem. Because they are mainly capital importing countries, very few multinationals, if any, are headquartered in developing countries. So they realize the problem of not being able to tax, uh, and it goes well beyond digital services. What I would stress very much is that the service-ification of the economy, the trend to services long ante-dates digitalization, and the developing countries have been aware of it since the 1980s, since in fact the UN model was first developed in 1980, and that has a broader scope for taxing the delivery of services.

And business services now can be delivered with no physical presence. I mean, you can, you can even deliver medical services over the internet. You've got a slew of companies now delivering healthcare over the internet, but all kinds of services now; software, for example, Microsoft and so on. Software itself is delivered electronically. Business services, a really wide range of services. And these are not taxed at all. Not only are they not taxed in the countries where the services are delivered, they actually drain your tax base because the payments for those services are deductible from the businesses that pay for the services. If you pay for, uh, a license to Microsoft for software, that payment is deductible from your business profits. So it reduces your business profits at source, and then the tax authority doesn't get to tax the profits of the company that's getting the payment. So they're very aware of that. But I think a range of other countries are aware of that too, even many OECD members, so there's a real need to go beyond it.

Naomi Fowler: Yeah, that's, that's interesting. So, you've mentioned Nigeria, you've mentioned India, which countries are you expecting the most from in terms of being able to progress this either unilaterally or as, as a bloc? I mean, if people were to be looking in particular places, where, where would you put the most of your hope for the coming years?

Sol Picciotto: Well, I think there are a number of blocs. I mean, I hope that the G24 will pick up from its proposal in 2019. That obviously depends on them, but the G24 includes, very importantly, G20 countries.

A lot depends on the politics. Now in Latin America, we've had a significant change. a political direction in Colombia and now we're very lucky that the finance minister for a period was Jose Antonio Ocampo who was chaired the uh, Independent Commission for the Reform of International Corporate Tax, ICRICT, and he's put that firmly on the agenda in Colombia. Colombia has now set up PTLAC, the Latin American Platform on Tax. Obviously Brazil under, under President Lula now. At one moment Argentina might have been in a leading position, now with the political change now to this crazy loco presidente, who knows? I mean, even America under Trump adopted some measures that move towards a global minimum tax. You don't know with politics, but for the tax justice movement, I think if we set our sights on what would be the best solution for the world, a public interest solution, sooner or later, the political alignment will come right, I hope, and I believe. That's really, I think, where the strength of the Tax Justice Network and tax justice campaigning organizations has really laid, being able to bring together convincing technical proposals that also are in the public good. You can't rely on the vagaries of politics. But sooner or later, the political alliance will occur if we keep pushing.

Naomi Fowler: That's it for this month. You've been listening to the Taxcast from the Tax Justice Network. You can subscribe to the Taxcast wherever you listen to your podcasts. You can go to our website for further reading and more information, it's a brand new website on podcasts.taxjustice.net You can check out all our podcasts there in all our different languages too. Thanks for listening. We'll be back with you next month. Bye for now.