

Two miscalculations don't make a misprice

If you visit Christian Aid's website, you'll see that the charity is a campaigning organisation as well as a provider of overseas aid. Two of its campaigns involve taxation: one claims that \$160bn annually is diverted from poor countries by multinationals. The second one ('country-by-country reporting') argues that multinationals should include in their annual accounts details of the profits earned, people employed and tax paid in every country they operate in. Christian Aid provides an automated service on its website, whereby its supporters can send emails to the senior partners of the Big Four in the UK, asking them to persuade the International Accounting Standards Board to adopt a country-by-country reporting standard.

Is it really possible that multinationals could divert \$160bn by 'transfer mispricing'? What Christian Aid did – using World Bank data – was to add up the average ratio of trade volume to total tax revenues. They then assumed that 7% of trade was wrongly priced – and multiplying this amount by the average marginal corporate tax rate gave them the \$160bn. There are so many holes in this approach that it seems unkind to point them out; the most obvious one is that none of the figures actually tie back to anything that a country or its tax authorities could possibly recognise. The charity is aware of this and its document states that they would prefer to have more realistic data. However, the problem is that Christian Aid supporters now seem to think the \$160bn is a real number, when it manifestly isn't.

The second Christian Aid report attempts to use bilateral trade data from US and EU databases to calculate 'out-of-range' transfer pricing amounts. They assume that an arm's length price is between the upper and lower quartile prices, taking all the records shown in each product category. Anything outside these ranges is defined as 'mispriced'. In the case of the UK, they say that £33bn (over a three-year period) is mispriced into the UK. The first trouble with this is that the two biggest 'losers' are the US and Japan, accounting for nearly half the total. Anyone asked to rank transfer pricing authorities would put the US and Japan among the most aggressive; it's simply not plausible that so much value could have been

transferred into the UK without proper justification. The rest of the top 10 is China, Switzerland, Norway, Turkey, Hong Kong, Canada, Taiwan and Thailand. It's equally implausible that value would be transferred into the UK from most of those countries – and especially Hong Kong and Switzerland. The second area of difficulty is that the report deals with all transfers, ie, those between unrelated parties, as well as those within a multinational group. Finally, the report only looks at transfers into the UK, the US and the EU – and doesn't consider transfers the other way around.



Two economists from the Oxford Centre for Business Taxation looked at the numbers generated by these and other studies carried out by or for charities. They said: 'Overall, it is fair to conclude that most existing estimates of tax revenue losses in developing countries due to evasion and avoidance are not based on reliable methods and data.' They thought that '... too much emphasis is put on producing aggregate estimates of tax revenue losses for the developing world as a whole'. Instead, they recommended that much more work be done using individual country and individual firm data.

Having concluded that there are no reliable numbers, Christian Aid puts forward solutions that aren't based on any firm foundation. The charity thinks that publishing more information will encourage the payment of more tax in developing countries.

How realistic is this? First, tax authorities do have access to the underlying information,

through tax returns and normal tax information powers. Tax authorities do exchange information with each other, as well. However, let's assume there is some basis for debate here.

This isn't really something about tax – it's a point about terms of trade between the developed and developing world. Pretending that it can all be lost in the complexities of tax isn't fair or sensible. The answer on terms of trade also isn't at all clear. What is the right balance between activities performed in developed countries, compared with those in developing countries? My digital camera was made in Thailand – but both the hardware and software were designed in Japan, and it's a well-known brand. It would seem fair to me that Japan should take the lion's share of the profit – and, no doubt, Thailand benefits from the workers employed in the factory there. Global statistics have no information at all about the split between activities – so the bald numbers give no clue to the fairness or otherwise of the pricing. Christian Aid does a huge disservice by giving the impression that there is a magic pot of money available for developing countries, which can be delivered to them without a cost elsewhere.

However, let's not forget that developing countries do need to raise tax, to support their populations. Schools, hospitals and infrastructure need to be paid for. The World Bank data that Christian Aid used shows that tax as a percentage of GDP is much lower in developing countries than it is in developed countries. It ranges from 14% in the lowest-income countries to 18% in the highest income group. In the UK, it's about 38%. Surely what we need to do is help developing countries with their tax systems and tax administration – and do so by helping them design systems that work best for them, rather than simply following the rich country model. For example, there's a clear policy in the OECD to eliminate withholding taxes and customs duties. It's not clear that these policies would work for developing countries; Brazil notably rejects such policies and clearly thrives.

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