Dividends and other mismatches in the Dutch CbCRs

Summary
The Netherlands analysed the bias in 2016 CbCR-profits due to the inclusion of participation results and other mismatches in CbCRs. An exact estimate is not possible, but the order of magnitude of the biases in CbCR-profits is very large. Under reasonable assumptions, accounting for these biases leads to an estimated profit of 17.3 billion euros, instead of 24.8 billion euros for the companies with positive profits, meaning that profit is overstated by almost 50%. Without these biases the ETR for the Netherlands would be 16% instead of 10.6%. As CIT is in principle calculated over profits and losses during the life-cycle, the impact of loss carryovers should be taken into account to calculate an unbiased ETR. Taking this into account would bring the ETR to 21%.

- The possible inclusion of dividends and other participation results in reported CbCR-profit has been discussed in the brochure and the the disclaimer accompanying the CbCR data. As guidelines were not clear on this point, companies will have made different choices.[1] This analysis aims to indicate the size of the bias in reported CbCR-profits due to the inclusion of participation results and other mismatches in CbCRs filed in the Netherlands in 2016.
- The Netherlands received 155 CbCR-reports from Dutch ultimate parent entities over 2016. Of these, 108 reported positive profits and the other 47 reported losses in the Netherlands. The MNEs with positive profits reported a total profit of 24.8 billion euro and a total tax accrued of 2.6 billion euro in the Netherlands, resulting in a reported 'effective tax rate' of 10.6%.[2]
- CbCR filings were compared to company's corporate income tax ("CIT") filings and annual reports. Even with case-by-case analysis it is not possible to determine the differences between CbCRs, CIT filings and annual reports as differences like various accounting standards, included transactions or revaluations are unknown. Therefore, the analysis requires assumptions and a certain bandwidth in the comparisons. However, the analysis does show the large order of magnitude of the overstatement in profits.
- From the fiscal filings it could be retrieved that dividends included in the profit account for an overstatement of approximately 2.7 billion euros of the profit.
- Based on annual reports it was found that other biases account for approximately another 6.5 billion euros of overstated profit. This is probably due to shares of result in associates and joint ventures, differences in accounting standards between the two reports, one-off (de)mergers, takeovers or disposals. As the results of all entities are aggregated, the same intracompany transaction (such as a received dividend) can also be included multiple times in the worldwide CbCR-profit of a company.
- The correction showed 12 MNEs to have a negative CbCR-profit after the corrections instead of the positive reported CbCR-profit.
- Correcting for these biases results in a profit reported in the Netherlands for 2016 of 17.3 billion euros instead of 24.8 billion euros for the 96 companies with positive profits, meaning that profit is overstated by almost 50%.

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[1] Only per November 2019 has the OECD issued guidance stating that: "This guidance clarifies that, consistent with Revenue, Profit (Loss) before Income Tax excludes payments received from other Constituent Entities that are treated as dividends in the payer's tax jurisdiction." This guidance deals with the issue of dividends in profits, but does not cover the exclusion of other participation results from profits.

[2] Note that the originally reported total tax accrued was 1.9 billion euro. A close inspection showed 23 MNE's reporting a negative tax with a positive profit. After a check with the paid tax according to the fiscal files of the Dutch Tax authorities, the negative tax accrued was for 21 MNEs recoded to a positive tax accrued. This recoding was only done in case of a positive CbCR-profit in combination with a positive fiscal profit.
Besides this a few CbCR-reports were submitted by pension funds and university hospitals. These CbCR were excluded from the statistics as the size of these foundations is so large that the statistics would be breaching confidentiality standards. In a few cases the CbCR made an explicit statement to the Dutch Tax authority about the size of the dividends in the CbCR. These CbCR-profits were corrected according to the statement.

- The definition of 'tax accrued' could also lead to interpretation differences[3]. In the case of the Netherlands, it was found that UPEs report 2.5 billion euros as tax accrued whereas their actual payable amount was 2.7 billion euros for 2016.
- These MNEs often made losses in earlier years. As CIT is normally calculated over the total of profits and losses during the life-cycle, the impact of loss carryovers should be taken into account to calculate an unbiased ETR. Dividing the 2.7 billion by the corrected CbCR-profit after loss carryovers leads to an ETR of 21%.
- There is still a discrepancy between corrected profits from CbCRs and fiscal profits of 5.5 billion euros. It is not possible to analyze these differences from the available datasources. This discrepancy could, in addition to commercial-fiscal differences, also relate to among others the use of different data sources (including different accounting standards), commercial revaluations, and (de)mergers, takeovers or disposals.
- The profits can be further decomposed to match the taxable base in the Netherlands by adding non-deductible costs and interest and subtracting the base for the IP-box, liquidation losses, and other deductions. A final correction relates to loss-making subsidiaries.

Table 1: Corrected CbCR- profits

CbCR-positive profits (108 MNEs)	**24.839**
- Correction for dividends based on CIT filings	-2.706
- Correction for other biases based on annual reports	-6.530
CbCR-profits after corrections	**15.601**
CbCR-with positive profits after corrections (96 MNEs)	**17.263**
- Loss carry-overs (CIT-filings)	-4.211
CbCR-(excluding dividend, after loss carryovers)	**13.052**
CIT	**2.725**
ETR	**21%**

[3] See Klaassen, P. and Bobeldijk, A. (2019), Country-by-Country Reporting and the Effective Tax Rate: How Effective Is the Effective Tax Rate in Detecting Tax Avoidance in Country-by-Country Reports?, INTERTAX, Volume 47, Issue 12

Technical assumptions with respect to the analysis

The Netherlands received 155 CbCR-reports from Dutch ultimate parent entities over 2016. Of these, 108 reported positive profits and the other 47 reported losses in the Netherlands. The MNEs with positive profits reported a total profit of 24.8 billion euro and a total tax accrued of 2.6 billion euro in the Netherlands, resulting in a reported 'effective tax rate' of 10.6%.[4] However, as stated in the accompanying OECD-brochure and the disclaimer accompanying the CbCR data, the reported profits can lead to biased effective tax rates for various reasons.

First, there is evidence that in many cases dividends and participations results are included in the profits. These intragroup results are generally speaking already taxed at the level of the subsidiary and are therefore generally exempt in the UPE country, leading to overstatements of taxable profit. As the guidelines prior to the 2016 submission were not clear on this point, companies have made different choices. Secondly, accounting standards differ between countries, using different data sources, and MNEs are not required to adjust for differences in these standards between the various tax jurisdictions. This effect can sometimes be determined by use of the CIT filings. But, as the total figures in the CbCR are determined by way of aggregation, without the elimination of transactions that are included multiple times like in consolidated financial statements, the same dividend passed on through multiple entities could show up several times in CbCR profit.[5] It is not always possible to reconciliate the CbCR with the annual report, or the CIT filings. For the purpose of this analysis this reconciliation was made, but with several assumptions and a bandwidth.

To analyse the quantitative importance of possible inclusion of dividends, and the differences in accounting standards, for the Dutch MNEs the reported CbCR-profit before tax was compared with both fiscal profits filed to the Dutch Tax Administration as well as the reported profit before tax in the financial statements of the MNEs. If the worldwide CbCR-profits are comparable with the profits in the annual consolidated report, it is concluded that no dividends are included in the CbCR-profits and that the same accounting standards have been used for the CbCR and the financial statements. In that case, any difference between the fiscal profit and the CbCR-profits is a result of commercial-fiscal differences. In the other cases the CbCR-report could be biased by the treatment of dividends or by accounting bias.

Corrections based on annual reports and fiscal filings

In 92 cases of the 108 MNEs with positive profits, the annual report was publicly available. In only 44 cases the sum of the worldwide CbCR-profits was comparable with the profit before tax as reported in the annual report.[6] In these cases no corrections have to be applied for dividends or accounting biases.

In the other 48 cases the worldwide CbCR-profit clearly differed from the annual report, showing in 38 cases a clearly higher profit in worldwide CbCR-profits (total difference 15 billion euro) and in 10 cases a lower profit (difference 800 million euro). In a first step the 48 MNEs were compared with the Dutch CIT-filings. This included a comparison with the total filing of the parent company as well as the filings of the subsidiaries. This comparison with the CIT-filings is useful as in the fiscal filings the MNE reports the fiscal profits as well as the amount of dividends and participation results, from which the dividends and participation results are is tax-exempted. In 10 cases a match could be found between the fiscal profits including and excluding dividends, resulting in a correction of 2.3 billion euro based on the dividend and participation results.[7] This also shows that the dividend-problem mostly relates to the parent company as the parent company receives most

[4] Note that the originally reported total tax accrued was 1.9 billion euro. A close inspection showed 23 MNE's reporting a negative tax with a positive profit. After a check with the paid tax according to the fiscal files of the Dutch Tax authorities, the negative tax accrued was for 21 MNEs recoded to a positive tax accrued. This recoding was only done in case of a positive CbCr-profit in combination with a positive fiscal profit.
Besides this a few CbCR-reports were submitted by pension funds and university hospitals. These CbCR were excluded from the statistics as the size of these foundations is so large that the statistics would be breaching confidentiality standards. In a few cases the CbCR made an explicit statement to the Dutch Tax authority about the size of the dividends in the CbCR. These CbCR-profits were corrected according to the statement.

[5] See Klaassen, P. and Bobeldijk, A. (2019) for an elaboration.

[6] Using a margin of 10%.

[7] There is a strong correlation between the correction based on annual reports (2.8 billion euro) and the fiscal filings (2.3 billion euro). This relation was tested with a log-log regression and was significant at the 1%-level.

of the dividends and also includes the participations results in case of a (de)merger, a takeover or disposal.

In the other 28 cases where a clearly higher worldwide CbCR-profit was reported in comparison to the annual report, no clear relationship could be found between the Dutch fiscal profits, be it excluding or including dividends. These 28 MNEs reported 10.6 billion euro higher worldwide CbCR-profits than the profits in their annual reports. These MNEs also reported 6.9 billion more Dutch CbCR-profits with respect to the fiscal filings, from which 0.4 billion can be related to dividend. Together the 38 companies are thus corrected for 2.7 billion euros worth of dividends.

As this difference is lower than the total difference between total worldwide CbCR-profits and the financial statements, this is very likely due to different accounting standards. For each company, the profit was corrected by scaling down to the lowest of the two differences (difference with financial statements or fiscal filing profit).

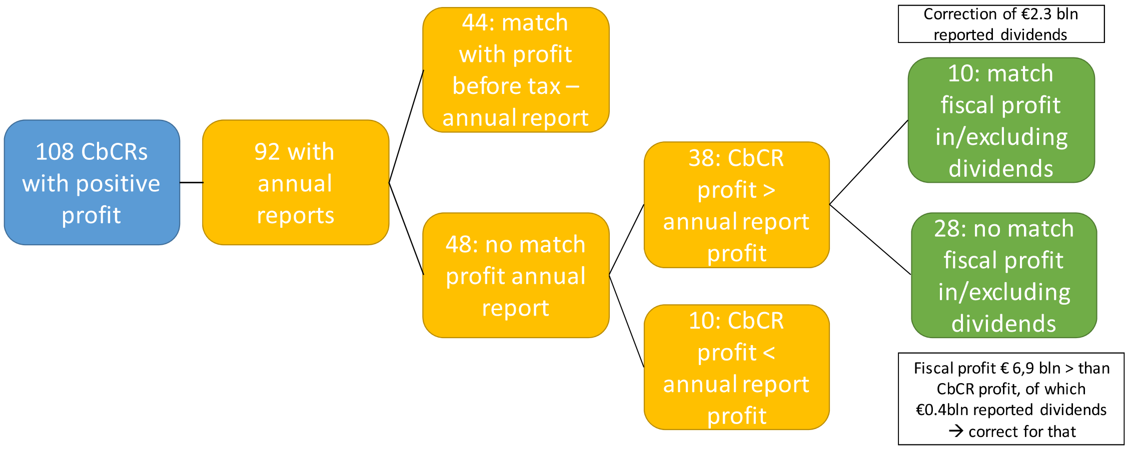

Figure 1: Decomposition of CbCRs using annual reports (yellow) and fiscal filings (green)

The correction showed 12 MNEs to have a negative CbCR-profit after the corrections. The total loss of these MNEs was 1.7 billion euro while these MNEs reported about 0.1 billion euros tax accrued. These 12 MNEs were left out of the further analysis.

Results

The 96 MNEs with a positive CbCR-profit (after corrections) of 17.3 billion euro report a tax accrued of 2.5 billion euro. The definition of 'tax accrued' could also lead to differences in interpretation[8]. In the case of the Netherlands, it was found that these UPEs report 2.5 billion euros as tax accrued whereas their actual payable amount was 2.7 billion euros. Dividing this 2.7 billion by the corrected CbCR-profit of 17.3 billion euros leads to an ETR in the Netherlands of 16%. This is still lower than

[8] See Klaassen, P. and Bobeldijk, A. (2019), Country-by-Country Reporting and the Effective Tax Rate: How Effective Is the Effective Tax Rate in Detecting Tax Avoidance in Country-by-Country Reports?, INTERTAX, Volume 47, Issue 12

the statutory rate of 25%, but this difference can be explained by the IP-box, loss carryover and other deductibles. Table 2 shows a decomposition of the fiscal profit to the taxable base.

As CIT is in principle calculated over the total of profits and losses during the life-cycle, the impact of loss carryovers should be taken into account to calculate an unbiased ETR. This amounts to 4.2 billion euro, which has a significant effect on the effective tax rate. The fiscal profit after loss carryovers then comes down to 13.1 billion euro, resulting in a ETR of 21%.

This still leaves a discrepancy of 5.5 billion euros with respect to the fiscal profits. This could then be due to other biases in CbCR-reporting, as well as differences in commercial and fiscal accounting. However, as the CIT-filing in the Netherlands does not require companies to state the commercial profit in the Netherlands, it is impossible to analyse this difference further.

Besides this, various tax base broadeners and deductions apply. A major correction is the addition of non-deductible costs and non-deductible interest. Costs related to participations are not deductible. As these costs are included in the calculation of the commercial CbCR-profits, a correction of the fiscal profits is made by adding the costs to the fiscal profits. The same line of reasoning holds for the non-deductible interest payments.

Two other major deductions are included in this calculation. First the IP-box showing a reduction of profits of 2.1 billion euro, and a reduction of profits of 0.5 billion euro due to liquidation losses.

A final correction relates to the losses of subsidiaries who are included in the CbCR-filing of the UPE, but filing an individual CIT file in the Netherlands. These losses reduce the commercial CbCR-profits. However, as these losses of independent filing subsidiaries cannot be transferred to the parent MNE, the profit has to be corrected with that amount. This amounts to 2.2 billion euro. The total corrections result in a taxable profit of 11.0 billion euro for the Dutch CbCR-filing MNEs.

Table 2: Detailed table CbCR-analysis

	Million euros
CbCR-profits (108 MNEs)	**24.839**
- Correction for dividends based on for tax filings	-2.706
- Correction for other biases based on annual reports	-6.530
CbCR-profits after corrections	**15.601**
CbCR-positive profits after corrections (96 MNEs)	**17.263**
- Loss carry-overs (from CIT-filings)	-4.211
CbCR-profits	**13.052**
- Commercial-fiscal differences (estimated)	-5.520
- Non-deductable interest	276
- Non-deductable costs	3.576
- IP-box deduction	-2.125
- Liquidation losses	-481
- Other deductions	-35
- Correction for MNEs or subsidiaries with losses	2.239
Taxable profits	**10.980**
CIT	**2.725**
- Tax credits	267
CIT-payable	2.457
Tax accrued	
- all profit reporting MNEs (108 MNEs)	2.637
- MNEs with postive profit after correction (96 MNEs)	2.512