Western firms still doing business in Russia finance the war. Here's how to recoup the huge cost to taxpayers

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Credit: AI-generated image (disclaimer)

In Russia this summer, you can still enjoy a Cornetto, but you can forget about eating a Tunnock's tea cake or a Big Mac. This is because Cornetto's UK-headquartered parent company, Unilever, is still operating in Russia after its invasion of Ukraine, alongside many other western firms such as PepsiCo.

While lots of firms, including McDonald's and the Scottish confectionery maker Tunnock's, have cut business ties with the country since the war started, the Kyiv School of Economics estimates western companies still operating in Russia made over US$213.9 billion (£168.2 billion) in revenues in 2022.

The resulting US$3.5 billion in taxes on profits paid to Russia is only a small part of their contribution to the war: the income taxes and social contributions of their employees, as well as the VAT on their sales, feed into the state's budget. The sense of normality they give to Russian citizens also arguably fosters support for the invasion of Ukraine.

Companies still doing business in Russia also hurt the citizens of the countries they come from. By essentially supporting the war, they share responsibility for higher energy prices, for example. They also increase the cost on western taxpayers of supporting the defense of Ukraine.

Like many western companies that have stayed in Russia, PepsiCo and Unilever (Cornetto's parent company) have defended the decision by claiming they provide essentials and need to stay for humanitarian reasons.

In addition to detailing donations made to Ukrainian refugees, the statement from PepsiCo said the company "must stay true to the humanitarian aspect" of its business as a food and beverage company by continuing to offer "daily essentials" in Russia "such as milk and other dairy offerings, baby formula and baby food." PepsiCo pointed out it also continues "to support the livelihoods of our 20,000 Russian associates and the 40,000 Russian agricultural workers in our supply chain."

Unilever said in a statement earlier this year that, while it's still selling products in Russia, it stopped imports and exports, all media and advertising spend and other capital flows into and out of Russia in March 2022. It's not "trying to protect or manage" its business in Russia, the company said, but "exiting is not straightforward."

Indeed, many of those who provide non-necessary items say they cannot leave because the Russian government would seize their assets and intellectual property if they do.

But every time a business makes the choice to leave Russia or has their assets seized, the ones who stay face lower competition, and potentially make even more profit. As of today, the only price they pay for staying is a tarnished reputation in western countries.

A tax on the cost of war

But there is a way to make foreign companies pay the cost they impose on the world, while acknowledging the impossibility of making them completely leave Russia.

In fact, western governments have already designed the two main tools necessary. What it would take is a coalition of sanctioning countries and a mechanism that's already being used in other regulations: the "Pillar 2" OECD strategy on taxation, due to come into force next year, as well as the EU's new Carbon Border Adjustment Mechanism, due to come into force in October 2023.

The coalition of sanctioning countries must first implement a tax on a western company's Russian revenues. This is public information available in company financial reports—other organizations already track this information. The tax would cover the company's sales, based on the goods and services bought by people in Russia. But the tax would be collected by the country in which the company is headquartered.

In the case of sales of Cornetto ice creams, for example, Unilever is the parent company and is based in the UK. So the UK government would have the first option to tax Unilever, but if it chose not to, any other country in the coalition could do so instead.

That would mean a country has nothing to gain from protecting its national businesses. If the UK does not tax Cornetto sales in Russia, Unilever could be taxed by the EU or US and the proceeds would go into their government coffers instead.

The OECD's Pillar 2 tax agreement uses this principle in its aim to end the practice of fictionally locating profit in tax havens. By the end of this year, countries have committed to charge at least 15% in profit tax to the largest multinational companies in the EU and in the UK.

If some part of a multinational's profits is not taxed abroad, the country in which the company is headquartered can tax extra, up to the 15% limit. And if that country does not impose the extra charge, other countries in which the firm is active can collect the unpaid tax.

What about non-western companies?

Charging the tax on western companies only would disadvantage them in global markets. It may also make it even more profitable for other countries to trade with Russia. To avoid such "leakage", non-western companies who trade with the west and continue to do business with Russia should also be made liable for the tax.

This amounts to a form of extra-territorial trade sanction. The approach is simple: if a company wants to do business with the west, it must pay a fine for any trade in Russia. The US already does something much stricter to companies trading with Iran or Cuba. French bank Société Générale paid US$1.3 billion to the US government in 2018 as a punishment for providing financial services in Cuba.

Taxing foreign companies to level competition is very similar to a border adjustment mechanism for polluting industries. This is what the EU will begin to do in 2026 under the Carbon Border Adjustment Mechanism. It will charge a carbon tax on certain products or activities, starting with the most energy-intensive industries such as cement, iron and steel production, unless a company can prove it has already paid the equivalent at home.

Global public opinion has turned against Russia since the invasion of Ukraine. Just like with global tax evasion and climate change, most countries understand that it is in everyone's interest that a nuclear power is not allowed to invade other countries with no consequence.

The tools the world has developed to cooperate on international taxation and carbon emissions could now be used to take definitive action on economic sanctions and make the war in Ukraine much more difficult for Russia to sustain.

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