THE TRANSPARENT TAX DEPARTMENT –

A CIMA REPORT ON THE NEW WORLD FOR CORPORATE TAX COMPLIANCE

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In the past 18 months tax transparency has become one of the defining issues of corporate boardrooms. Since the first wave of tax-related stories hit in 2012, a number of factors have since converged to produce a perfect storm: businesses are under pressure to demonstrate a full and fair tax policy; regulators must address some of the glaring inconsistencies inherent in their tax codes; and governments have to work together to design an international tax framework that closes the door on excessive tax arbitrage and avoidance.

For corporates, certainly, the issues surrounding tax and its reporting and disclosure produce some fundamental questions. In this environment of increased scrutiny, can your tax function, previously used to laboring in the darkest recesses of the back office, adapt to the new oversight? Is the board sufficiently prepared to tackle the PR issues that tax can now create? And is the reporting of tax policy sufficiently transparent to satisfy what is now a far more demanding audience?

In order to address these questions, Thomson Reuters conducted research recently among leading UK corporates on the value of a transparent tax function and what's needed to equip the business with the tools and resources to be more transparent. The findings of the survey illustrate the confusion many executives have in this area: what exactly is tax transparency? How is it delivered? What should we be reporting? What audience are we serving with our tax disclosures?

The survey revealed some key findings:

- Only 35% of respondents' organisations already have or are currently planning a tax transparency strategy. 32% do not have a tax transparency policy and 33% don't know.

- More than 60% of C-suite professionals believe tax transparency is important to their business; however companies are only providing enough information on tax transparency to meet regulatory requirements. As a result, 64% of C-suite professionals are lacking understanding of the benefits associated with disclosing more than just the regulatory minimum.

- As many as 80% of C-suite professionals believe the purpose of tax transparency is to explain tax policies and strategies and to provide 'supplementary figures in the annual report'.

- The majority (66%) of respondents would like to see more guidance and advice around managing tax transparency. Only 15% believe there is already adequate guidance. A further 20% drive their own strategy.

- There is an even spread around what respondents perceive to be the major obstacles to improved tax transparency – 40% say lack of resources in the tax department. Another 45% say lack of visibility of consistent tax information across the organisation, while 51% cite internal processes that do not support efficient reporting and information gathering.

- While 84% of respondents say their organisation has understood the impact of tax transparency on the tax department, only 20% of companies have budgets in place for tax departments to meet tax transparency strategy and 63% believe that tax transparency will add a significant additional administrative burden on their tax department.

- However, only 20% said lack of appropriate tax technology was a major obstacle to improved tax transparency. Improved tax technology was given better than average rating: 3.6 on a scale of 1 to 5 (where 1=low and 5=high, how important is improved tax technology in helping to manage a more transparent tax department.)

In the wake of the survey findings, Thomson Reuters, in association with the Chartered Institute of Management Accountants (CIMA), brought together a selection of finance and business leaders to discuss the issue of tax transparency at a roundtable event in London. Among a variety of conclusions to come from the discussion was a clear sense that transparency in tax affairs means different things to different people.

Understanding transparency

For many at the discussion, the topic of transparency is an issue of ethics. As Philippa Foster-Back, Director of Ethics at the UK Institute of Business Ethics, pointed out: "We would say that tax is an ethical issue. Ultimately, you have a choice as a company: do you want to be aggressive in your tax planning or not? That's really what it comes down to."

Foster-Black observed that while there are obvious instances where tax avoidance becomes 'evasion' and, therefore, illegal, for most businesses, tax strategy (and how they report it) sits somewhere on a broad spectrum. "The question then becomes 'where does the company board actually want to be in that spectrum?' " she added.

"Is the business content to simply follow sensible tax planning as we would expect any large corporate to do to fulfil its compliance and fiduciary duties, or is it the sort of corporate that actually sees tax as an opportunity? Are you running the kind of business that identifies a loophole and thinks, 'let's play this tax treaty off against that one'.

"And you do actually have a choice of where you want to be in that spectrum," said Foster Black. "I'm not opining where it should be, where anybody should be, but somebody's got to choose."

Being seen to do the right thing
So what does a good tax reporting effort look like? Can we recognise thoughtful tax transparency when we see it?

One roundtable guest, from the insurance sector, pointed out that some industries are further down the line on this than others: "The mining industry is often seen as being further along in terms of being transparent, and that industry offers a few pointers on this. What they've done with their transparency reporting is to show the entirety of the tax that they pay," he said. "That cuts all the way across their employee taxes, their VAT, their service taxes, their mining taxes and, in some countries such as Australia, their corporate tax as well. Essentially, what mining businesses are doing is showing exactly what they're doing on tax as a holistic enterprise."

Other guests put forward a different view on what transparency actually means: "My gut instinct is that transparency really means being invisible," was the view of one participant, who works in real estate. "I mean that in the sense of keeping a low profile, not making yourself a target, and staying sufficiently in the white area so not to get into trouble. "

The same participant observed that once the business moves into a grey area it begins to be exposed to unnecessary risk. "In some industries, what the tax experts will tell you is that it is more about continually migrating in and out of the grey, so that you don't have a fixed position one way or the other. You're constantly testing boundaries and ensuring you avoid any penalty."

But this isn't simply a conceptual question. Tackling tax transparency also presents businesses with operational challenges. "When you talk about transparency, one of the issues from an operational point of view is that reporting in operational companies tends to be geared up to producing management information," said one guest from the advisory community. "And that isn't always very easy to turn into tax information. So I think there are some conflicts there."

Push – and pull – factors

So what is driving the move towards a more transparent tax culture? Tax has, after all, always been a fundamental part of business strategy, albeit without the daylight being shone into company affairs to the degree it is today. Why has tax transparency suddenly become so prominent – not only in the media but in government and boardrooms alike?

One attendee, an FD from the investment sector suggested there was a simple answer: "Essentially, it's because the governments globally need more money. That's fundamental. So, suddenly, tax has become a headline issue and transparency becomes part of that."

In addition to the need to raise revenues, there is a perception that governments are determined to catch up with the more sophisticated tax strategies employed by multinationals, that participant added. "The reality is that commercial cashflows and inter-country activity has got significantly ahead of the global tax system, so it's now much easier for companies to do business internationally – and effectively have costs in one location while generating revenues in another," he said.

"Given that, it's perfectly legitimate to try to arbitrage the tax behind that. But the tax regimes need to catch up with that global activity. Until they do, we will see an inter-governmental war, based on who's going to catch the tax dollars."

Know your audience

The global angle to transparency will be of particular interest to corporates operating cross-border. For them, there is no choice but to quickly develop an understanding of exactly which authority needs to be communicated with, the discussion heard.

"This area produces a lot of uncertainty," said one guest, who works for an advisory firm. "The key is to think about who you're being transparent with, and why. If you think about governments, by and large they are not hugely in favour of transparency with stakeholders other than themselves.

"In fact, they're interested in transparency with tax authorities, and they're interested in transparency between tax authorities – the sharing of information – and that's a lot of what the OECD action plan is about.

"But I think there is a broader set of stakeholders and groups that are thinking a bit beyond that, asking themselves to what extent they need to communicate more broadly."

That view was echoed by several guests around the table. At the same time, many felt the need to demonstrate a clear and fair tax strategy was intrinsically linked with the business's reputation.

"There is definitely an issue around reputation," said one adviser. "So it's not just about the transparency, it's about the reputation. You can play with the numbers, and get involved in transfer pricing and things and if you're playing within the rules that's fine. But at the end of the day, it's the reputation of the organisation that is impacted if you are clearly seen to be on the other side of the line."

Being seen as paying the right amount of tax at the right time could be a central plank of many firms' CSR efforts, the discussion heard.

For many businesses, CSR has developed along broadly simple lines: staff are encouraged to volunteer, the company focuses on its involvement in the local community and there is an emphasis on being seen to do good.

"Couldn't the business trumpet the fact that it contributes so much in tax revenue to support the economy in the UK, as part of its CSR work?" one attendee asked. "Or is that not seen as smart?"

Others agreed corporates that go to great lengths to design a series of extraordinary artificial tax arrangements could be better off taking this route. The cost of employing tax experts to devise these schemes can easily grow beyond the initial budget, it was said and, in one observer's view, can soon become counterproductive.

The Thomson Reuters research supported the call for tax transparency to be seen as a part of the CSR strategy – 47.1% of respondents cited CSR as the major driver behind their push to be more open on tax.

But does this type of transparency – somehow using tax compliance as a branding exercise – undercut or cheapen the importance of good tax planning?

One guest certainly believed that to be the case. "I'm sceptical about the idea that you could ever make your honest payment of tax a virtue from a brand point of view," he told the assembled guests. "Because I think it's like rich people trying to make a virtue out of how much tax they pay. The reality is, you only end up paying tax if you're very profitable and very rich."

Strategies for being transparent

It is fair to say that regardless of how determined regulators are to close loopholes and tackle tax avoidance, it requires individual businesses to take a proactive approach for genuine change to be seen. Despite a majority of attendees agreeing that transparency in tax affairs is a noble goal, enacting it isn't quite so straightforward, they said.

Unsurprisingly, of those who responded to the survey, 40% pointed to a lack of resources in the tax department as the main obstacle to a more transparent environment. Meanwhile, 45% said lack of visibility of consistent tax information across the organisation was holding them back. Meanwhile, half said a lack of efficient reporting and information gathering was the main obstacle for them.

Another concern for both attendees and those who responded to the survey was who bears the cost of increased transparency. In response to the question, 'Do you believe that tax transparency will add a significant additional administrative burden on your tax department?', for example, 52% answered that it would.

The answer, the discussion heard, rests with searching for a cost-effective way to conduct this vital tax compliance work without overly burdening the already pressured tax function? For many corporates, the answer is simple: outsourcing. As the tax burden has increased over the years, many boards and senior managers have identified back-office functions of tax, compliance and reporting as ripe for outsourcing. That was driven by cost reduction and the opportunity to free-up senior managers to focus on strategy.

One roundtable guest, who had spent a long time in the corporate world and is now working in the advisory community, believed that straight up outsourcing to shared service centres is increasingly viewed as not up to the task, however.

"Now, we are seeing a lot more organisations looking to move their compliance and reporting function into the practice environment, where they know they will have that certainty, and the robustness and the expertise, as well as the ability to focus on strategy internally. In the earlier days, there was a sense that with tax, that can be done in Bangalore or wherever. Now, that's more being done by the Big Four."

But while outsourcing the transactional and compliance elements to trusted advisers is clearly a well-worn tactic, there is nevertheless a fear among some businesses that greater transparency could lead to greater risk.

So if technology has a part to play, its use has to be seamless. Are systems set up to cope? "It's got to be the same source as the management information too, but just cutting in a different dimension," said Charlotte Rushton, managing director, Asia Pacific and EMEA for the Tax & Accounting business of Thomson Reuters. "We have seen companies that are actually asked to provide a download of their ERP system to the local tax authority, and then the tax authority was going to calculate the tax. That, of course, for a lot of companies would be very frightening, but because they have tax technology tied into the ERP system, then they can provide the information and be very confident that it's exactly what it should be."

One advisory expert agreed: "When you're consolidating your entire global operation and you've got businesses in China and in Thailand and in India, then it becomes so much more complex that the only way, really, to pull that all together is to have a good technology."

A tailored approach

As one roundtable guest put it, the range of external and internal stakeholders with an interest in tax is increasing, and each group should consider their own key stakeholders and what communications make sense to them. "After all, what concerns a regulator may often differ from that which interests your customers.

"Just providing information can give quite a misleading picture if you are going from a one-size-fits-all approach. Your stakeholders need useful information and business context, to find it really valuable."

Naturally, the fact that greater attention is being paid to tax avoidance and tax transparency strategies has to be a good thing: most agreed that by highlighting aggressive avoidance schemes the media (and other interested parties in government and academia) are performing a social good. However, there does, many agreed, come a point when attention bubbles over into hysteria, comment into hyperbole.

"That comes back to the holistic approach on the part of legislators," said one guest. "Decisions are being made, and pressure is applied to bring about changes in legislation or in the way that companies approach their tax that aren't representative. That ends up being very knee jerk, designed to generate headlines. And that's not the right way to set legislation."

Alongside regulatory efforts to compel better reporting and greater transparency, clearly there needs to be internal recognition of its importance. But without sufficient internal resource and expertise, where can stretched boards turn for help?

What of the advisory community? Are the tax professionals seeing their clients taking a more proactive approach? What is the mood among corporates facing up to the need to tackle the transparency? One adviser was cautious.

"People aren't rushing to put more information about their tax policy out there. I think there is a bit of a 'wait and see' approach," she told the guests. "There are so many different disclosure rules being talked about that there is a degree of inevitability of something big coming. And to the extent that it's possible to influence what that something might be, there is interest in different groups looking at doing that."

Indeed, there have been examples of additional disclosures coming from corporates, but to a large degree they have differed from business to business. "Clearly," one experienced adviser said, "they differ because everybody has different views on what is useful to them and their shareholders and other parties." Those disclosure policies also differ according to the type of business, and the countries in which they operate.

"So I don't think people will be rushing to put voluntary country-by-country reporting out there."

Alongside this caution, however, there is an encouraging trend emerging: the growth in status of the tax professional within the business. This in some ways mirrors the elevation of treasury from its mechanistic, transactional roots to a central element of business strategy when the global financial crisis hit, bringing with it an unprecedented squeeze on cash. Treasurers who had previously only been exposed to the board at bonus time suddenly found themselves the centre of attention when banks started to flirt with collapse.

So will the recent media and government interest in tax transparency have a similar impact on the tax manager? One roundtable guest certainly thought so.

"In an interesting way, perhaps some of the adverse publicity about tax has actually had an unforeseen benefit: it's made some of what we do edgy and interesting. We can actually be proud and say yes, I'm an accountant."

Charlotte Rushton of Thomson Reuters agreed."The interest coming from the board is increasing more than ever," she said. "But it's not just the board and the CFO. It's the audit committee, the head of risk, head of CSR, head of communications. And that is because it is now a growing reputational issue. So groups are looking at a range of matters in trying to address the sort of debate that's going on at the moment."

Ultimately, the responsibility for designing sustainable tax transparency strategy lies with those businesses that pay tax. For some, it's an issue that has yet to rear its head. For others, the option of kicking the can down the road is no longer viable. Shareholders, regulators, customers and the media are unlikely to backtrack on their calls for greater transparency. It's now up to boards to pick up the gauntlet.

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