Analysis

The new tripartite era for tax directors

SPEED READ A new Affecton *Tax Journal* survey shows that almost half of companies believe that their tax strategies could cause controversy, amid a realisation that in this new era tax directors are being stretched in three directions by regulation, public opinion and competition. With some high profile global companies hitting the headlines over their tax regimes, it is clear that the new era means taking into account reputation and brand, as well as savings that are needed to enhance company competitiveness. How best to respond to these pressures is not immediately obvious; nevertheless, a more proactive approach should be considered.

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Tax directors are now being stretched in three directions – by regulation, by community and by competition – in a new era that is seeing tax departments re-evaluate their strategy to fit present day conditions.

The 2013 Affecton *Tax Journal* survey of leading tax department heads in the UK and follow-up face-to-face discussions have found that community and public opinion are now a stakeholder in companies' tax strategies at a time when regulation is also being significantly strengthened and fiscal authorities use public concerns to raise the stakes in their enquiries (see figure 1).

It is clear that we have entered a new era … in the current climate, companies need to think about what they should do to manage their reputational risk

Figure 1: Are we really in a new era?

86% We appear to be entering a new era in which companies have to recognise public opinion as an interested stakeholder in the company's tax policies and strategies.

14% Public concerns stem primarily from concerns over public finances and will abate when growth returns and tax revenues rise.

At the same time, half of companies reported that they are not under so much pressure to deliver ever increasing tax savings to enhance company competitiveness. But recent controversies have caused all respondents to consult their finance director on these issues and 68% have also consulted their board.

What matters to the board?

Based on these consultations, tax directors believe that their board's key concern in this new era is to ensure that their tax strategies do not cause damage to the reputation or brand of their company (see figure 2). This perceived reputational impact on brand was discussed in face to face meetings where a range of views emerged on the potential impact of tax controversy on reputation and consumer behaviour.

Indeed, one group had undertaken detailed consumer group testing, which showed that tax controversy was not a major factor in buying decisions. However, most reported a high internal sensitivity to being on the front page of a daily newspaper, irrespective of the degree of impact this might have on brand and consumer spending patterns.

The survey found a similar sensitivity to what finance directors expect from their tax department towards ensuring no surprises and not risking the company's reputation. 'No tax surprises' was clearly rated as the most important objective, perhaps reflecting the importance of predictability and sustainability in earnings that investors are looking for. Furthermore, sustainability, attention to risk management and preserving company reputation, which are high up on tax directors' agenda, are closely related to no tax surprises.

It is clear that trying to deliver a sustainable competitive tax rate, with no tax surprises and reputation intact, means that tax directors are being stretched in these three directions of regulation, community and competition. The last is relatively weaker than the other two forces, but delivering tax savings is still a key objective and, of course, is one of the main supports for maintaining tax department resources and budgets.

How are tax directors responding?

Because the public opinion risk, via the force of community, is by its nature based on sentiment and emotion, there can never be clear rules to guide tax directors on what tax planning, if any, would be acceptable to this audience.

Indeed, the Affecton *Tax Journal* survey shows that 48% of companies believe that their tax strategies could cause controversy but only a minority is willing to change its plans, even if almost all of them recognise that the community has a stake in what they do (see figure 3).

It is clear, in the current climate, that companies need to think about what they should do to manage the risk that they may feature on the front pages of newspapers on account of their tax planning, as has happened recently with some well-known multinationals. There is an awareness that this kind of scenario is something the board wants to see avoided.

The survey results also show that there seems to have been a shift in views in a number of areas. Almost half the respondents to the survey indicated that their group now places much greater emphasis on the 'spirit of the law' in organising their tax affairs.

There has been a trend away from a strict letter of the law approach to take account of political and community concerns, compared with earlier Affecton tax function surveys in 2006 and 2009. Relying on the letter of the law is now seen by more companies as insufficient if it produces what may be seen as an absurd result, i.e. one contrary to the intended result or the purpose of the legislation. It is however impossible to discern or discover the precise overall purpose of thousands of individual pieces of legislation interacting with one another.

Transparency

Most companies are looking closely at the whole area of transparency. However, there are issues with greater general transparency, including the extra work and commercial sensitivities involved. Many companies indicated they are attempting to disclose much more tax related information and an internally consistent approach to transparency will thereby underpin the company's overall tax reputation. Also, tax directors gave general support to the seven tax principles recently proposed by the CBI, but with some reservations that UK companies should seek to increase public understanding in the UK tax system in order to build public trust. Some respondents felt that the government itself should take a lead in the public debate on tax and defend its recent business friendly changes on CFCs, patent box and lowering the rate of corporation tax. This would provide more balance in what is currently a hostile media environment.

Most, some 72%, are against country-by-country reporting. In follow-up discussions, it was deemed to be unhelpful and could lead to the unnecessary use of resources in providing the information. Many expressed a concern that country-by-country reporting would give a distorted picture, with reams of information rendered meaningless without a proper narrative, which could lead to more confusion. Also, the current focus is only on corporate tax, whereas taxes paid are much broader.

Many think it is better to provide commentary rather than just the amount of tax by country, while some respondents believe country-by-country reporting could lead some countries to push for a greater share of tax when they jealously look at the tax share which some other countries are receiving.

Those in favour of country-by-country reporting think greater transparency will allay some suspicions about corporate behaviour, but are still concerned about the lack of a materiality test in respect of information to be provided. They are fearful of the compliance burden this may entail. Country-by-country reporting was thought more acceptable if it relates to disclosure of payments to governments by country, but less acceptable if full financial statements by country would be required, particularly as accounting rules throw up anomalies. In any event, a globally consistent standard was generally preferred.

Figure 2: **What matters most to the board**

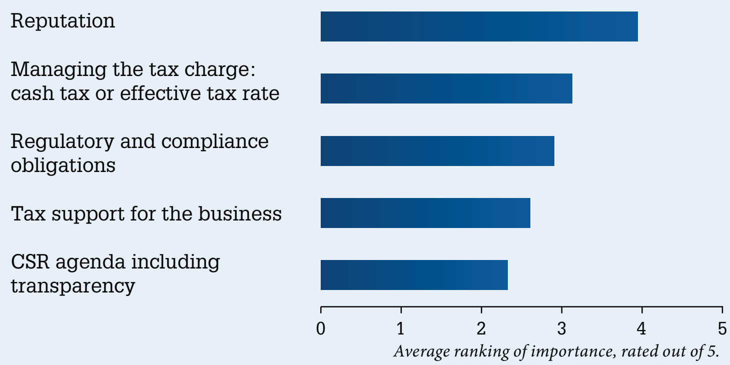
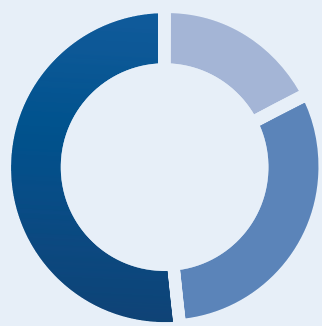


Figure 3: **Tax practice controversy**



52% Our tax practices would not cause controversy.

17% Our tax practices could cause controversy and we have or are planning to modify out tax strategy.

31% Our tax practices could cause controversy but we are not planning to modify our tax strategy.

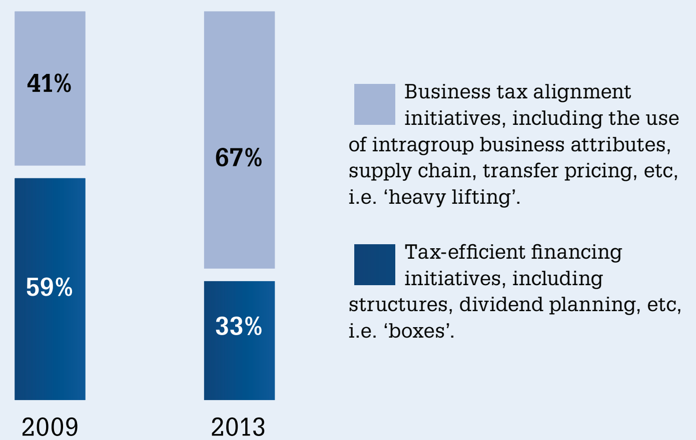
Some 48% of companies believe that their tax strategies could cause controversy but only a minority is willing to change its plans

The GAAR and planning

The UK GAAR is seen by most respondents as having little or no impact on tax planning, but it is seen by some as defining what is and is not

There is a clear shift away from more ‘artificial’ tax planning based on creating tax-efficient financing structures (‘boxes’) to ‘business tax alignment’ initiatives

Figure 4: Tax planning



acceptable tax planning. But since most recent controversies would not have been affected by a GAAR, this is perhaps of limited use as a guide for what is acceptable to public opinion.

There is, however, a clear shift away from more ‘artificial’ tax planning based on creating tax-efficient financing structures (‘boxes’) to ‘business tax alignment’ initiatives. In 2009, most companies surveyed by Affecton relied primarily on ‘boxes’, while in 2013 much more emphasis is placed on ‘business tax alignment (see figure 4 above).

One company told us that recent controversies have led them to scale back on all their tax planning. This tax director also saw little future for tax departments as separate units; he would envisage them being rolled back into controllers in due course, in recognition of the remaining role of compliance. This seems to be a minority view, but it is at least internally consistent, although most of our contacts believe that tax departments are needed to deal with the traps created by the complexities of the legislation and to help avoid risks such as double taxation.

The importance of consistency

Consistency and credibility carry a great deal of weight in external affairs and reputation. If a company can explain what its beliefs and values are and can show that it is acting honestly and consistently in line with them, it at least has a defence for its actions. Some leading tax departments are therefore re-evaluating the whole of their strategy to fit this new era.

Recognising that companies need to show that they make a contribution to society and that they are a part of the community seeking to judge their behaviours, these tax directors have decided to be clear, both internally and externally, about their company’s tax policies and the values and beliefs that underpin them. However, barely half of the companies surveyed publish or intend to publish their tax policy at present.

Holding to a consistent line between values, policies and behaviours (tax strategies) increases trust and credibility and allows the company to point to the total tax contribution made. Such an approach will also ensure that the board, the finance director, the business and tax department staff have all been involved in developing the policy, understanding the trade-offs and risks, and ensuring that tax strategies are internally consistent. They will then be in a better position to justify and support tax positions when challenged.

Furthermore, the involvement of staff in creating a tax strategy that embraces community expectations can be a very powerful motivational force. This is particularly important in countering the challenge to personal beliefs – the sense of meaning and purpose that a tax professional holds on to – which may have been unsettled in the wake of recent controversies.

This should not be underestimated, as some recent tax controversies have been triggered by whistleblowing. Clear guidance is also needed to ensure that plans are escalated to the right decision making level when they show any unusual features. The tax planning strategies will vary from company to company, reflecting each one’s own set of values, priorities and policies. Such a realignment to reflect the changing community and regulatory environment requires a significant commitment of time, energy and money. However, without embracing change, the tax department risks being all at sea and unprepared for the storms ahead.

A proactive approach

In conclusion, it is clear that we have entered a new era. The proactive approach can go yet further, by seeking to influence the debate. Perhaps the most useful approach we’ve heard about is for ‘off the record’ briefings on the complexities of international taxation for business editors of the major newspapers, non-governmental organisation directors and MPs. These approaches could help to change the climate to one based on a little less condemnation and a bit more understanding.

The 2013 Affecton Tax Journal Survey of Tax Directors builds on earlier research by Affecton on tax function effectiveness. The survey was undertaken by 35 companies, with most respondents being the group head of tax for tax functions ranging in size from two to 420 tax staff, with an average size of 48 tax professionals. The survey findings will be published in full in due course.