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Directors' Series
BEYOND COMPLIANCE

Succeeding amid change and uncertainty: Action plans for audit committees

Paying a "fair share" of tax

The obligation that organizations have to pay taxes has long been understood. Recently, however, agreeing on exactly what a "fair share" of tax actually means has become less certain.

While governments are implementing stringent cost cutting measures to control expenditures, there has been a growing perception that the general public must bear a higher tax burden than necessary because some taxpayers are not paying their fair share.

In this environment, organizations and their tax strategies have come under significantly increased scrutiny. Between activist groups and the media, many organizations have been called out for not paying their "fair share" of tax. That is not to say these organizations weren't paying all of the taxes they were required to pay under the law. Instead, the amount they were seen to be paying was deemed to be insufficient in the court of public opinion.

No one – individual or organization – wants to pay more tax than they owe, and the purpose of tax planning is to ensure that unnecessary tax expenses are not incurred. Tax law, however, is often very complex with many grey areas where the ultimate effectiveness of a particular tax strategy is only determined through a court decision. Nevertheless, some indicators of possible abuses that will likely attract the attention of tax authorities and the public include:

- Unnecessarily complex organizational structures
- Entities incorporated in jurisdictions where the organization has no business activities
- Significant amounts of permanently reinvested earnings in foreign jurisdictions
- Low consolidated effective income tax rates
- Geographic disconnects between where profits are earned and taxes are paid.

The boundaries of an organization's tax management strategy should be set by the board of directors and/or audit committee and the organization's Chief Tax Officer and the Chief Financial Officer. The board needs to ensure that the organization employs tax strategies that are well founded in well founded in tax law, and also understand how those strategies may be perceived in the court of public opinion.

Canadian tax developments

The Canadian government has taken steps to improve the transparency of taxpayer transactions. Three provisions introduced in the 2013 federal budget provided for:

- Enhanced reporting of foreign assets and income
- The introduction of a whistleblower program to reward individuals for information leading to the collection of tax resulting from international non-compliance
- Requiring certain electronic funds transfers to be reported to the Canada Revenue Agency.

These new measures follow the earlier introduction of reporting requirements in respect of certain transactions that are considered to be for the purposes of tax avoidance.

Canada and other G20 countries are concerned about the erosion of their tax bases. In Canada, the Department of Finance has introduced legislation that addresses certain tax planning ideas that are considered to have unintended consequences. This legislation is in addition to Canada's general anti-avoidance rule (GAAR), which addresses abusive tax planning and includes various specific anti-avoidance rules. The House of Commons Standing Committee

Audit committee action plan…

- Review the organization's current tax strategies and tax risk profile and compare them to its policies and statements (e.g., Corporate Social Responsibility) or investor profile.
- Ensure that the organization's strategic and other decisions are in accordance with its tax strategy.
- Ensure that a comprehensive communications plan is in place to ensure the consistency of statements regarding tax made in the media, in financial statements or elsewhere.
- Review the organization's tax arrangements in each jurisdiction in which it operates.

on Finance has also released a report, *Tax Evasion and the Use of Tax Havens*, which provides various recommendations, including greater international cooperation among countries and their tax authorities.

The Canada Revenue Agency's commitment to "combat international tax evasion and aggressive tax avoidance" is supported with an investment of $15 million, which is dedicated exclusively to international compliance issues and revenue collection. This follows the recent implementation of a large business audit strategy, which is based on a taxpayer's risk categorization that is determined by its corporate structure, audit history, industry sector issues, existence of unusual and/or complex transactions, international transactions, participation in perceived aggressive tax planning, level of corporate governance, and openness and transparency.

International developments

The Organization for Economic Co-operation and Development (OECD) has published an *Action Plan on Base Erosion and Profit Shifting (BEPS),* which had been presented at the G20 Finance Ministers meeting in Moscow on July 19, 2013. The *Action Plan* sets out 15 areas for further work and a timetable for completion.

The OECD's objective, with support from the G20, is to have countries adopt a common platform regarding international taxation, thereby eliminating competition between countries based on income taxes. The measures the OECD are proposing will remove some of the sovereignty that countries now have related to income taxes. For the OECD plan to succeed, all countries must agree to adopt the new rules, which will require them to change both their domestic laws and all of their current tax treaties. Since that could be a lengthy process, the OECD is proposing a novel and untried approach of enabling countries to implement a multilateral instrument that would change all of their tax treaties with one measure. Time will tell whether or not all countries will agree to accept the OECD's plan, and whether the multilateral instrument will prove to be an effective way to amend their tax treaties.

Organizations should begin preparing for the proposed changes. At a minimum, multinational organizations should prepare for an increase in documentation and disclosure requirements. A potential outcome of the OECD's project is that multinational organizations that have, for example, taken advantage of the tax incentives available in a particular country in return for operating in that country may find these arrangements are no longer effective. Audit committees should carefully determine which of the organization's tax structures might be affected and in what countries. They should ask management to determine the potential impact on the organization's effective tax rate and, therefore, on its financial statements.

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