Governance *in brief*
The Global Tax Reset and the reporting of tax in annual accounts

Headlines

- Following a sustained period of public scrutiny of the taxation of large corporates, governments are acting to reframe the tax rulebook and companies are beginning to respond.
- Key stakeholders, including investors, tax authorities and the Financial Reporting Council (FRC), are increasingly conscious of the potential significance of this reset and are demanding greater clarity in tax communications from multinational groups to help stakeholders understand what it means for them.
- Leading organisations are acting now to anticipate and address such stakeholder concerns by assessing the impact on them, making changes to their approach where necessary and readying themselves to report externally with confidence.

The Global Tax Reset?

The taxation of large corporates has been high on the public agenda for a number of years and governments are now increasingly willing to act, together and alone, to revisit international and domestic tax rules. The OECD/G20's Base Erosion and Profit Shifting (BEPS) project has brought together over 60 countries over the last two years to review and refresh international tax standards. The European Union has sought to address perceived issues, such as in the area of state aid, and some countries have moved unilaterally, as we have seen in the UK through the introduction of the Diverted Profits Tax (DPT) which, from 1 April 2015, applies a tax rate of 25% to profits of multinationals where the deemed artificial diversion of those profits from the UK gives a tax advantage to the multinational group.

On 5 October 2015 the OECD Secretariat published 13 final reports and an explanatory statement outlining the consensus actions under the BEPS project. These reports include and consolidate seven earlier reports presented to the G20 Leaders at the Brisbane Summit in 2014. There will be further policy developments but the main focus between now and 2020 will be on monitoring and adoption of the measures, including the reporting of country by country taxes to relevant tax authorities, by participating countries. Given the OECD's estimate that BEPS has cost some 4-10% of annual corporate income tax revenues, the expectation is that the implementation of this programme will have a material impact on the tax position of at least some corporates.

How will BEPS actions be taken forward by participating countries?

Minimum Standard	• Treaty abuse • Harmful tax practices • Permanent establishment	• Country by country reporting • Dispute resolution • Transfer pricing
Best practice	• Interest restrictions • Hybrid mismatches • Transfer pricing documentation	• VAT on business to customers • Digital services
Recommendations	• CFC rules	• Disclosure rules

Multilateral instrument

Gathering pace

A number of aspects of the Global Tax Reset are combining to create a specific pinch point for large companies. Some groups have moved promptly to provide early warnings to shareholders of the potential impact of the Global Tax Reset at a time when transparency requirements are tightening and scrutiny and challenge from key influencers, including analysts and regulators, is increasing.

Companies have been adapting to this evolving environment: most will have reflected on how they manage taxes; some have been prompted to make specific changes, for example, by eliminating redundant group entities; and many are making greater disclosures in relation to their tax affairs. On this last element, our latest data indicates that 60 of the FTSE100 voluntarily disclose a reasonable level of detail regarding tax governance, with just over half doing the same for tax contribution information.

Public transparency demands

Research[1] indicates that the importance of transparency was a key area of common ground between industry and public bodies when reflecting on the responsible tax debate. This perspective appears to be reflected in a growing raft of public tax transparency requirements and expectations being imposed on companies, just at a time when they may have significant risks arising from BEPS to disclose. These requirements include:

- **Local legislation** – Many jurisdictions are considering specific disclosure requirements. For example, the UK has just published draft legislation which requires large businesses to publish their board-owned UK tax strategy. In Australia, the Australian Taxation Office (ATO) is required to publish certain information extracted from large companies' tax returns – including name, total income, taxable income and tax payable – with the first information expected to be published on the ATO's website in December 2015.

- **Regional rules** – The EU Accounting Directive requires qualifying extractive businesses to disclose specific tax information on a project by project basis. Meanwhile the Capital Requirements Directive IV requires certain EU financial institutions to disclose specific tax and related information on a company by company basis. Some banks have provided more disclosure than required. The EU continues to consider whether to extend public country-by-country-reporting more widely.

- **Investor expectations** – Some investor groups in the capital markets have set out specific expectations regarding taxation disclosures. For example, since 2014 the Dow Jones Sustainability Index has included questions in its scoring criteria on the level of tax transparency shown by a company, specifically requiring those who want to achieve maximum marks to publish their tax strategy and country by country tax information.

In addition to the specifics above, broader corporate governance requirements are also contributing to the level of consideration given to tax. For example, the 2014 update to the UK Corporate Governance code has encouraged large companies to perform a robust assessment of their principal risks, just as tax becomes seen as one of those key risks, at a minimum in reputation terms, for the first time.

Rising scrutiny

Recognising the heightened relevance of the tax position of large corporates and the increasing level of information available to stakeholders, key influencers including analysts and regulators are casting a critical eye on what all this might be telling them.

Analysts are focused on the impact of tax on the future value of the organisation, and some see the BEPS and related developments as a potential risk they need to understand. For example, Sarah Deans at Citigroup stated in May 2015 that "we think investors should be asking questions of companies with significantly lower than expected tax rates to understand if they are at risk". In making this point she noted such questions were necessary as "tax information in financial statements is generally inadequate for investors to understand how low tax rates have been achieved, or assess the level of tax risk". Citigroup is not alone in focusing on this area; comment has also come from Schroders, Morgan Stanley, Credit Suisse and others.

Financial regulators are also alighting on disclosures regarding tax, raising questions as to whether current reporting standards really meet GAAP expectations. For example, the FRC has noted that one of its areas of focus when reviewing 2015/16 annual reports will be "disclosures of tax risks, accounting policies, judgements and estimates following increased uncertainties due to challenges by global and European institutions and governments". At the same time the International Accounting Standards Board (IASB) has confirmed it is reviewing how companies should disclose uncertain tax positions.

On 1 December 2015 the FRC announced a thematic review of companies' tax reporting, aiming for its findings to help companies raise the quality of their tax reporting. The review will cover a number of FTSE 350 companies who will be notified in advance. Areas covered will include the transparency of tax reconciliation disclosures, how well the sustainability of the effective tax rate is conveyed and uncertainties relating to tax liabilities (and assets) where the value at risk in the short term is not identified. It will also go beyond the accounting disclosures to consider narrative reporting, including the disclosure of principal risks.

1. Henley Business School: What Stakeholders Expect from Corporations When It Comes to Paying Tax: Corporate Reputation and Optimal Tax Planning – March 2015

How are organisations responding?

As these pressures come together, companies are starting to respond.

In the US we have seen over 80 US groups, accelerated by their quarterly reporting regime, make statements in their regulatory filings on the potential impact of the BEPS programme and DPT. Examples include:

"Changes in US federal income tax law and other tax laws, in particular resulting from the recommendations of the OECD, could materially affect us"

"If we are, in fact, subject to [the DPT], this could have a material adverse effect on our results of operations and financial condition"

Relatively little has been said publicly by UK headquartered companies in relation to BEPS. That said, one CFO of a high profile FTSE group did publicly state that the Group thought it would add "a few" basis points to their Effective Tax Rate. We anticipate that the coming reporting season will see many more reflecting as to whether something needs to be said.

In our experience, leading organisations work in a structured fashion through a three stage process, ensuring key internal stakeholders from across the business are involved.

1. Assess the current state

First, groups should look to understand the potential impact of BEPS and related measures on their organisation, and the existing reporting they provide externally. Looking at the impact of BEPS they will consider not only the potential impact of specific changes (such as restrictions on the deductibility of interest and the use of hybrid instruments) but also, critically, seek to understand the interaction of potential changes with the group's own strategic plans (e.g. location of target growth markets, future financing costs). In doing so they typically model the impact of individual risks as well as the overall impact, and benchmark their position against their peers.

In parallel to modelling the potential impact of BEPS, groups will be considering whether their existing standards of disclosure meet the changing needs of investors, analysts and others. They will challenge themselves as to how this information could be interpreted and whether it could be better explained. In doing so they will also consider the BEPS statutory country-by-country-reporting requirements to tax authorities and whether this reporting may also contribute to their risk levels. Once they have a vision of how their tax future is likely to look, recognising the inherent uncertainties, they will engage key stakeholders within the organisation to help them understand and get support for the next steps.

2. Reset: make the necessary changes

The next area of focus is in making the strategic changes necessary to ensure that the needs of key stakeholders continue to be met as the business grows. This could include revisiting how the group is financed or, more fundamentally, whether certain business models remain sustainable. Plans for this sort of review need to be long-term and detailed, reflecting the global scale of the organisations affected and the granular nature of the local implementation of the BEPS actions. Some quick wins will be possible but many changes could have significant lead times and involve wide ranging engagement across the business, including commercial teams, finance and IT.

The group is also likely to revisit how it actually manages its taxes – the governance and oversight in place, the understanding of risks and how they are controlled, the fundamental capabilities (people, processes and systems) in place and the ways in which the organisation can get assurance. A particular source of focus will be placed on tax systems and data and the ability of the organisation to command the information it needs to report its tax position, both to tax authorities and publicly, in an efficient and effective manner. Sometimes this will lead to limited changes in underlying processes but very often it can be a more transformational exercise, involving specific tax reporting tools or adaptations to consolidation or base accounting systems.

3. Communicate: report the outcome

Finally, groups should seek to ensure they report the outcome of their changes effectively to stakeholders. This will be based on a joined-up communications plan which connects their financial reporting, presentations to analysts, sustainability and other non-tax specific reporting to what they are increasingly required or expected to say from a tax perspective. It will be based on a consistent understanding – of their commercial context, their approach to the management of taxes, their key outcomes in terms of their P&L tax charge, payments and risks and their sources of assurance.

A key area of focus will inevitably be around ensuring that financial reporting remains in line with applicable GAAP and evolving industry practice. This could involve revisiting the presentation of their tax reconciliation, the guidance provided around future effective tax rates and comments made on uncertain tax positions. One trend is certainly toward adopting a simpler communication style, seeking to use less jargon in an effort to demystify some tax complexities.

The aim is for this response to help groups navigate not only the immediate crunch point of the Global Tax Reset but also the position as the rules and expectations evolve. This will inevitably require care and maintenance as the tax world develops, but hopefully this effort can be reduced (and the associated risks and tensions mitigated) by taking steps now to set the right course.

To help you gauge whether your organisation is on track we would recommend asking some or all of these questions:

Key questions boards should be asking

- What is the scale and timing of the impact of the Global Tax Reset on our Effective Tax Rate and our Earnings Per Share (EPS)?
- Do we understand the needs/pressures of our stakeholders in respect of our EPS and other key measures?
- When do we think the impact will be sufficiently certain to trigger a requirement to communicate the impact to the markets?
- What opportunities do we have to mitigate the impact and what is our plan to act on these?
- Can we explain our position, and in such a way as to differentiate ourselves from our peers? Do we understand what high quality tax reporting looks like?
- Can our systems provide the information required by the new transparency reporting requirements?
- Do we have a documented tax strategy or policy and, if so, would we be happy to publish it today?

Deloitte View

- There is increasing demand for better quality disclosure of uncertain tax positions and the judgements involved.
- Given the potential significance of the impact of the Global Tax Reset for multinational companies, additional disclosure of tax information is inevitable.
- Companies that delay the process of assessing the impact of the Reset, or of making any necessary changes to their structures and supporting systems, will find themselves out of step with their peers and unable to communicate as clearly and effectively with their key stakeholders.

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Members receive copies of our regular publications on Corporate Governance and a newsletter. There is also a dedicated members' website www.deloitteacademy.co.uk which members can use to register for briefings and access additional relevant resources.

For further details about the Deloitte Academy, including membership enquiries, please email enquiries@deloitteacademy.co.uk.

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