Governance *in focus*

Keeping pace with tax change: a briefing for non-executives

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The Deloitte Academy: Promoting excellence in the boardroom

Contents

The current tax landscape

Tax continues to feature in the press to an unprecedented degree. There is nothing to suggest that this enhanced level of interest in taxation will abate. While specific issues come and go, the overall direction is clear – tax is no longer a 'back-room' issue. For many in fact, tax is too much a front of house reputation issue.

Important changes being introduced now

Many companies are implementing **changes in their approach to managing taxes** to address uncertainties within and outside the organisation. Papers on tax strategy and policies have been produced for board approval; there is more information in the annual report on tax; tax is being expressed as a contribution to society and there is also much greater internal communication so that a company's employees, its human capital, have the opportunity to inform themselves.

There are a number of significant new issues for businesses to consider, from the Organisation for Economic Co-operation & Development's (OECD) *Base Erosion and Profit Shifting* project (BEPS), which is already delivering on its aims to implement unilateral actions by jurisdictions to tackle planning such as the UK's proposed Diverted Profits Tax (DPT), to calls for greater levels of publicly available information about taxation.

Directors, executive and non-executive alike, need to understand:

- the nature of the debate and the emerging consequences;
- the potential implications for their business; and
- the key questions to ask in the boardroom.

In this 'Governance in focus' briefing document, we provide a summary of the debate, recent developments and different perspectives, we reflect on the implications for businesses and we consider what resources businesses might use to evaluate their own positions.

We have included references to our other briefings and materials which provide further details and insights on some of the topics mentioned. As ever, do get in touch with your Deloitte partner or the Deloitte governance team if you would like to discuss any areas in more detail. And please join us at the Deloitte Academy, where we host events live with the opportunity to air issues and swap notes with your peers – most useful at a time of great change.

Summary of key matters

Led by the OECD, the international tax system is changing, giving rise to a range of strategic issues for business to consider.

- The response of business to these issues will come under scrutiny and the level of attention currently focused on the taxation of large corporates will continue for the foreseeable future.
- Conducting business in this new environment, at the very least, requires changes in communication strategy and will likely need a more substantial review of the approach to tax management.
- Resources are available, see the Appendices for:
  - Key questions to ask in the boardroom.
  - An overview of different perspectives on tax.
  - The CBI's Statement of Tax Principles.

Background to the tax debate and emerging consequences

The key question asked by politicians, the media, non-governmental organisations (NGOs) such as ActionAid and The Tax Justice Network, tax authorities and business is: can the amount of corporation tax paid by companies be said to be fair? Unsurprisingly, each commentator has its own definition of fair in this context, and there is significant variation in both the definitions used and the quality of the information under debate. See Appendix 2 for more detail on the different perspectives on the debate.

However, there is a great deal of common ground. Most people accept that international tax reform is needed, as the international tax framework has not kept up to date with the developments in international business. This is particularly the case for the 'digital economy'. Historically, tax value has been weighted towards the location where employees are based, where real property such as offices and factories are located, and where sales take place as a matter of contract law.

The past decade has witnessed a far greater focus on the *taxation* of intangibles (which has often followed the legal ownership of assets rather than the commercial substance of transactions) and the *valuation* of intangibles (although the question of how to attribute tax value properly to intangibles is still under review by the OECD). While the location of customers is now the important determinant for intangible service delivery for indirect tax, agreement over the direct tax consequences of placing internet servers in location X as opposed to location Y is one of the cornerstones of the regulatory and other changes which are now emerging as a consequence of the direct tax debate.

To give a sense of the emerging challenges for large corporates we explored three of the key changes:

- The OECD's BEPS plan
- The UK's new Diverted Profits Tax (DPT)
- Transparency in tax reporting – EU legislation and CBI principles

The OECD's Base Erosion & Profit Shifting plan

In July 2013, the OECD delivered its fifteen point Action Plan to the G20 Finance Ministers. All G20 governments and OECD Members have signed up to the Action Plan. However, this does not simply involve the G20 nations, as the United Nations itself is participating, to represent the interests of the wider developing world.

The political momentum behind the OECD's BEPS project is significant, so it is guaranteed that changes will take place. In the UK for example, the government announced in the 2014 Autumn Statement a consultation into implementing the BEPS proposals relating to hybrid mismatches. It has also confirmed that following an agreement with Germany changes will be made to the UK's preferential regime for the taxation of patents, to align it to new guidelines from the OECD. Draft legislation addressing country-by-country reporting to tax authorities is included in the draft Finance Bill published in December 2014. Considering the potential impact of BEPS and how to manage possible changes to strategies is vital.

The OECD Action Plan covers four main areas:

- Addressing the tax challenges of the digital economy
- Establishing international coherence of corporate income taxation
- Restoring the full effects and benefits of international standards
- Ensuring transparency and rapid implementation

The plan is certainly a rapid one for an international body and over 50 governments: the first Actions were reported in September 2014 and the others will be completed by December 2015 at the latest (see figure 1 overleaf for an overview).

Figure 1. Overview of BEPS Action Plan against 18 month timetable

September 2014	September 2015	December 2015
• Digital economy. • Hybrid mismatches. • Treaty abuse. • Transfer pricing documentation. • Transfer pricing of intangibles (1). • Preferential tax regimes.	• CFC rules. • Permanent establishments. • Transfer pricing of intangibles (2), risks and capital, other. • Disclosure of aggressive tax planning. • Dispute resolution. • Data collection and analysis measuring BEPS.	• Interest deductions. • Harmful tax practices. • Multilateral instrument to address BEPS.

Addressing the challenges of the digital economy

In developing their plan, governments are clear that there should not be a separation of digital business from traditional approaches. Governments recognise that most businesses have to some extent embraced the opportunities that the internet provides and their aim is to address the tax consequences of the digital aspects of all businesses. The EU rules on place of supply of services (which took effect from January 2015) are viewed as a possible precedent for levying VAT in the country of consumption.

Establishing international coherence of corporate income taxation

The work on international coherence covers four areas:

- Hybrid instruments
- Controlled Foreign Company (CFC) regimes
- Best practices in restricting relief for interest deductions
- Harmful tax practices

In December 2014, the OECD outlined three main alternatives to tackle non-taxation through the use of interest deductions – deduction limitations based on group attributes; deduction limitations based on fixed economic ratios; and targeted anti-avoidance measures. The proposals are far-reaching and, if agreed by the G20/OECD, will make a major change to multinational financing.

The OECD suggest that total interest deductions should be limited to the multinational group’s third party financing costs, but both the group limitations and fixed ratio limitations, as proposed, give rise to scenarios where third party financing costs would also be disallowed. The OECD is engaging with business to better understand its concerns.

A hybrid instrument is one which can be used to create a cross-border tax arbitrage, for example where one jurisdiction treats payments arising from an instrument as tax deductible interest, whereas the recipient jurisdiction treats the income as non-taxable equity receipts. The OECD has done considerable work on hybrids, and the UK government’s proposals for implementation into UK law closely reflect the OECD recommendations. Specifically it is proposed that, from 1 January 2017, the UK will introduce rules to deny deductions and/or include taxable income where there is a direct or indirect hybrid mismatch arrangement between related parties.

CFC regimes apply where governments prevent artificial diversion of profits to low-tax jurisdictions, typically by taxing the income of a low-tax subsidiary in the hands of its high-tax parent without the need for the profits to be paid to the parent. The work on CFCs is favoured by governments which consider that tighter CFC rules could counter certain planning by some multinationals.

The work on Harmful Tax Practices has, to date, focussed on intangible regimes including the UK's Patent Box, although other regimes will be reviewed during 2015. It proposes the so-called 'nexus approach' to define substantial activities for intangibles regimes, which is something of an unknown quantity: it has never been tested in practice. Conceptually, it is predicated on there being a link between R&D expenditure and the income arising from the patents developed. There are significant practical issues. These include the need to identify and track qualifying expenditure (potentially including historic expenditure) and the proposed denial of the regime for companies whose patents are not held by the company which performs the R&D activities. Again, the OECD is seeking the views of business as to how the nexus approach can be made to work in practice.

Restoring the full effects and benefits of international standards

Restoring international standards covers three Actions: treaty abuse, updating the permanent establishment definition, and transfer pricing rules as they primarily affect intangibles, risk and capital.

The permanent establishment definition in double tax treaties sets out when a business has a taxable presence in a country, and when it does not. The issue of permanent establishment is primarily one of the boundary between different governments and the allocation of taxing rights between countries in relation to trading activities. The OECD's main concern is of groups artificially avoiding permanent establishments by availing themselves of current exemptions that do not adequately reflect the transformation in communications and business practice that have gathered pace over the last decade, or arise from commissionaire structures (which do not apply in the UK anyway due to our different legal system) and perhaps less on legal contracts.

The intangibles discussion document considers when and how returns from intangibles should be shared between companies contributing towards their development or exploitation. There is also a focus on greater alignment between the employees performing the functions that create value from intangibles and the resultant profits. Other issues (such as risk allocation, different ways of pricing transactions that would be unlikely to occur between unrelated parties, and pricing the use of capital) are also on the agenda.

Ensuring transparency and rapid implementation

The final area includes transparency to tax authorities, which covers the introduction of enhanced reporting requirements, including the disclosure of key tax and other financial data on an entity-by-entity basis for each country where the group conducts its business. The data requirements represent a significant compliance burden for all affected companies. The aim is to improve risk assessment and group transparency for tax authorities.

Outcomes

The outcome of the project will be a series of proposals. Some will involve changing the Model Tax Treaty (which is typically used by countries as the basis for negotiation with others); others will involve changes to the Transfer Pricing guidelines; yet others will involve changing national law. In all cases, governments remain in control of change and will need to reach agreement on broad outcomes. Implementing changes to international treaties will be challenging in practice; the OECD notes that there are over 3,000 tax treaties!

Diverted profits tax

The UK government announced at Autumn Statement 2014 that it would introduce a new Diverted Profits Tax which is intended to apply to profits of multinationals artificially diverted from the UK. Details were published on 10 December 2014, including draft legislation to be included in the Finance Act due to be enacted before Parliament is prorogued for the May 2015 General Election. HMRC also published guidance with some examples of cases where it considers the legislation could apply. The opposition has expressed broad support for the proposals.

The tax will apply where there is a tax advantage for a multinational group and it is reasonable to assume that the alternative would be for additional profits to be taxed in the UK. The tax is not intended to apply to profits from activities carried on outside the UK. There are two scenarios considered – where a group avoids the creation of a UK permanent establishment while nevertheless engaging in substantive activities in the UK, and where a group already has a UK corporate taxpayer (either a UK company or a UK permanent establishment of a foreign company) but the profits booked to artificially depressed.

The new tax is designed to sit outside the UK's double tax treaties, and as such will not be limited or supported by standard double tax treaty clauses such as permanent establishment provisions, rules on the taxation of business profits, access to double tax relief and mutual agreement procedures, and exchange of information between governments.

The UK's move is a surprise, given its general commitment to the multilateral process underpinning the BEPS project. It is clear that the UK would like to encourage multinationals which have structures potentially affected by the BEPS project to change at least the UK aspects of those structures. Indeed, the provisions have been written to remove a charge to the new tax where those adjustments are made. The tax rate specifically encourages this, since the DPT is 5% higher than the regular 20% corporation tax.

At this stage, before the G20/OECD publishes the agreed Actions on Transfer Pricing and Permanent Establishment – due in September 2015 – companies may be concerned that they do not yet have sufficient information on which to make structural changes, or to comply with this new tax. The government accepts that aspects of the first draft of the legislation require amendment, although there is limited time given that it is scheduled to be enacted in March 2015.

Transparency in tax reporting – EU proposals and CBI principles

The issue of transparency – meaning here the level of public disclosure by companies of their tax affairs (as opposed to transparency with tax authorities as addressed by the BEPS project) – continues to be an important feature of the political and media agenda.

Charities and campaigners have called for multinationals to provide country-by-country reporting which they define as publishing details of the balance sheet, profit and loss, employees and corporate tax borne, for each country in which the multinational operates.

The European Union has introduced Country-By-Country Reporting (CBCR) for regulated companies in the financial services sector. The Council of Ministers and the European Parliament have also agreed there should be a with a review in 2018 into whether to extend this more widely. Groups operating in the extractives and forestry industries will be obliged to report details of the payments they make to governments from 2016, although the UK has chosen to adopt the proposals early, from 2015.

In the UK, the CBI has stated that it is opposed to CBCR as it does not consider it produces useful information. The CBI emphasises two key points on transparency: first, the importance of being transparent with HMRC about a company's affairs; and second, the value in increasing public understanding of taxation, by adopting a range of approaches relevant to the particular company.

The CBI also highlighted that, in the UK, over 30% of total UK tax is actually borne by companies: the biggest components of tax borne by companies being employers' national insurance, corporation tax, business rates and irrecoverable VAT. If a company were to decide to publish high-level figures about its tax position, then its total tax contribution is more reflective of the value contributed to society than simply the corporate tax paid on its profits. In addition, companies collect the vast majority of the rest of the tax in the UK – income tax and employee national insurance on earnings through the PAYE system and VAT. This continues to be brought out in the annual surveys published by the Hundred Group.

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Prompted by the increased public interest in tax and the desire of at least some companies to explain their tax position more clearly, we are seeing increased disclosures within financial statements in relation to tax. Based on a survey of the FTSE100 reports as at 31 July 2014 we identified three particular trends of note:

Figure 2. Summary of survey of FTSE100 Annual Reports 2014

1. Governance
64 groups made some disclosure of tax-related governance. Of those:

- 7 made partial reference (e.g. mentioning that the Audit Committee had reviewed tax accounting judgment areas).
- 57 provided fuller details, setting out processes for setting and monitoring adherence to tax policies and strategies.

2. Taxes paid/contribution
46 groups disclosed total taxes paid/tax contribution. Of these:

- 6 made partial disclosure, setting out total taxes paid with no further analysis.
- 40 disclosed the split between various categories of tax. Only one made this disclosure in the actual financial statements.

3. Geographical split
16 groups split tax payment disclosures on a geographical basis. Of these:

- 8 disclosed payments on a regional basis.
- 8 disclosed payments on a jurisdictional basis.

These trends are echoed, albeit to a lesser extent, within the FTSE250. A couple of examples of these disclosures, from BT Group plc (FTSE100) and Greene King plc (FTSE250), are:

Figure 3. BT Group plc Annual Report & Form 20-F 2013

Tax strategy
Our aim is to comply with relevant regulations. We try to structure our affairs in a tax efficient manner where this is a consequence of our operating activities and has underlying commercial substance, with the aim of supporting our capital or operational expenditure programmes and customer service initiatives. The Board sets the parameters which govern our approach and regularly reviews our tax strategy.

We operate in more than 170 countries and this comes with additional complexities in the taxation arena. The majority of our tax liabilities arise in the UK. In terms of our UK corporation tax position, all years up to 2010 are substantially agreed.

We have an open, honest and positive working relationship with HMRC and are committed to prompt full disclosure and transparency in all tax matters. We recognise that there may be areas of differing legal interpretations between ourselves and tax authorities. Where this occurs we will engage in proactive discussion to bring matters to as rapid a conclusion as possible.

Figure 4. Greene King plc Annual Report 2013

Tax
The effective rate of corporation tax (before exceptional items) was 24% compared to 25% in the previous year, resulting in a charge to operating profits (before exceptional items) of £38.9m. This is in line with the standard UK corporation tax rate and is expected to remain in line.

However, our full year contribution to HM Treasury was much higher with a total of £375m in total taxes paid or generated (including beer duty, VAT, PAYE etc.). This is equivalent to 31% of our turnover and is seven times the dividends we paid out to our shareholders.

The group’s tax policy, which has been approved by the board, is aligned with the business strategy. It seeks to protect shareholder value by structuring operations in a tax efficient manner, while complying with all relevant tax laws and legislation and fulfilling our obligations as a responsible UK tax payer.

Tax in other areas of reporting

Other areas of corporate reporting now include tax.

On 11 September 2014, The Dow Jones Sustainability Indices (DJSI) report was released, which included 'tax strategy' as a criterion for the first time. The index is intended to help investors take account of sustainability when assessing their portfolios. For some companies, the index has become an important benchmark of their sustainability credentials, with some including a target rating in their published KPIs.

Tax Strategy Questions in the Dow Jones Sustainability Questionnaire

1. Tax Strategy – Does your company have a tax policy/principles/strategy in place which indicates your approach towards taxation? Please indicate if this policy is publicly available and provide supporting evidence.
2. Tax Reporting – Does your company publicly report on key business, financial and tax information for regions or countries in which you operate? Please provide the weblink for where this information can be found.
3. Do you provide a public explanation of your effective tax rate which addresses why your tax rate may differ from the expected tax rate in the respective countries where you generate profits? Please provide supporting references.
4. Do you evaluate the risks of taxation on future company value creation? If you do risk evaluation, please indicate which risks you have identified as being material, also including business risks, and provide supporting evidence.

Source: http://www.robecosam.com/images/sample-questionnaire.pdf

The Lloyd's Risk Index last year identified tax as the highest risk (up from number 13 in 2011) in their survey of global business leaders' perceptions of the greatest risks to their business and the level to which they feel prepare to deal with them. Evidence from 2014 supports this as the increase in board interest in tax suggests.

CORPORATE TAXATION – A NEW GLOBAL PRIORITY

The public scrutiny given to corporate taxation has become increasingly intense over the last two years, with governments and the taxpayer alike demanding greater transparency and changes to legislation. Since 2011, this pressure has clearly been felt by respondents, who now rank the risk of high taxation as their highest overall risk, up from number 13 in 2011. In the US, the priority scores given to this risk are particularly high.

Source: http://www.lloyds.com/~/media/Files/News%20and%20Insight/Risk%20Insight/Risk%20Index%202013/Report/Lloyds%20Risk%20Index%202013report100713.pdf

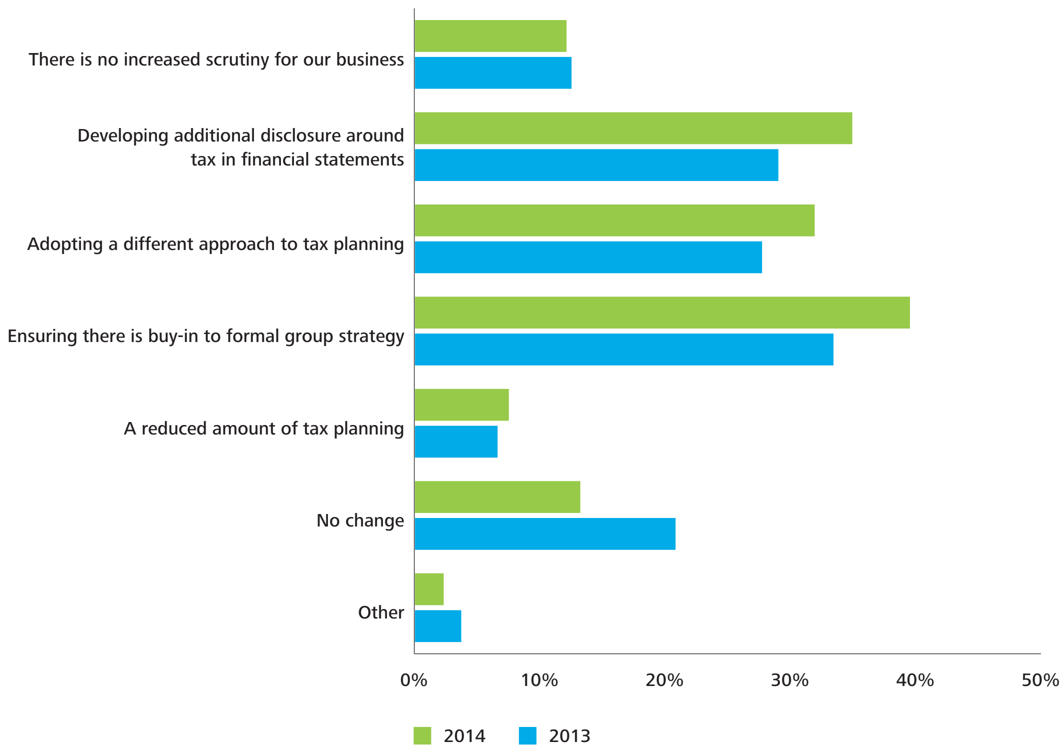
The concept of a 'Fair Tax Mark' has been introduced in the UK by a non-governmental organisation seeking to raise the profile and importance of companies explaining their tax position clearly. The first companies were awarded the Fair Tax Mark in 2014, including FTSE 100 energy company SSE, who has publicised this in recent advertising.

Implications for businesses

In response to these emerging regulatory and other changes there are a number of activities that we see companies undertaking either at board level or across the organisation. Based on our experience (and as cited in our 2014 survey of European tax professionals – see figure 5 below) these activities tend to come within three broad areas:

- Refreshing the group's overall approach to the management of taxes, including revisiting its tax strategy and policy.
- Developing a communications strategy for taxes including developing additional disclosure within financial statements.
- Where necessary, making specific changes to adapt to the changing environment and commercial priorities, including undertaking different types of planning.

Figure 5. Recent survey of European tax professionals



Overall approach to the management of taxes

Companies are assessing what the changing environment means for their business and reviewing their strategic approach to tax and the associated policy framework to ensure it remains fit for purpose. This may mean avoiding short-term gains that could expose the group to longer-term damage, and typically involves:

- Reviewing the current tax profile, including legacy structures;
- Defining the organisation's appetite for tax risk within a formal policy framework – informed by an analysis of its stakeholders and their needs (e.g. investors, customers etc); and
- Developing a strategic plan which meets the future needs of the business within this policy framework.

Two specific prompts for such activity include:

- *Government procurement rules* – From April 2013, a new policy applies to all central government contracts in excess of £5 million and many local government contracts are now also applying the policy. The policy is intended to "use the procurement process to promote tax compliance". The policy is set out in HMRC Action Note 06/B and related Guidance. Worldwide tax compliance (and specifically "Occasions of Non-Compliance") will be taken into account in the procurement process; egregious failures in compliance can result in bidders being excluded from the procurement process.
- *Directors' duties* – Directors' duties, as set out in the UK Companies Act 2006, have also been questioned

in the context of the tax debate. Some commentators have referred to the duty of a director of a company to promote the success of the company for the benefit of its members as a whole as a justification for pursuing aggressive tax strategies. The Tax Justice Network has circulated an opinion from a law firm dated June 2013 on whether "a person may be said to be under a 'fiduciary duty' to avoid tax". The opinion concludes that it is not possible to construe a director's statutory duty to promote the success of the company as constituting a positive duty to avoid tax.

Developing a communications strategy for taxes

As we have seen, many companies are responding by explaining their tax position more fully in their financial reporting or other communications. At the same time, regulators are looking to require at least some companies, principally those within the extractive and financial services industries, to report more tax information.

Financial reporting disclosures

The primary mechanism for public reporting of tax information is as part of the organisation's normal financial reporting cycle. Given that there are no standards for additional reporting or commentary on tax issues, companies are now experimenting with additional reporting to stakeholders.

Improved financial reporting of taxes could be achieved by, for example, including comments in the front half of the annual report on tax policy and key tax risks. In addition, many companies could enhance the explanatory notes to the financial statements to provide greater clarity on the tax reconciliation and rate commentary. Sometimes the cash tax paid is materially different to the current tax charge; again, giving details of the reasons for this helps inform investors and other interested parties.

Companies may also wish to provide greater disclosure of subsidiaries in the group, their activity and jurisdiction in order to allay any concerns regarding the activities of certain entities in particular jurisdictions.

Practice is clearly evolving and companies need to respond to trends in tax reporting. One final point: companies do need to make sure that they comply with statutory requirements. Work by ActionAid, for example, has highlighted that not all members of the FTSE100 have complied with the obligation to list all subsidiaries, either in the annual financial statements or in the annual return sent to Companies House. This type of omission does not enhance the reputation of business.

Reporting to tax authorities

In 2009, in order to emphasise the public responsibility of tax reporting, the UK introduced the Senior Accounting Officer (SAO) regime (Finance Act 2009 Section 42) which includes personal penalties for failures by the designated officer. The regime requires that the Senior Accounting Officer, usually the Finance Director, takes personal responsibility for the tax declaration and the end-to-end finance and tax procedures and systems that support them. Personal finance penalties can apply where an SAO fails to fulfil their duties.

The Disclosure of Tax Avoidance Schemes (DOTAS) Regime (which first came into force in 2004 and has evolved since then) obliges tax payers and, if relevant, their advisers to provide details of certain tax schemes to HMRC before implementation.

There is a correlation between the items highlighted above, the general compliance status of the business, and its assigned HMRC 'risk rating'. A low risk rating brings the benefit of a reduced level of enquiries from HMRC.

Making changes

As the strategic goals and operations of a business change over time, so should the tax strategies adopted to support them. In developing these strategies, a close eye needs to be kept on the regulatory environment to ensure that the business not only achieves its commercial aims, but also meets its compliance obligations.

To achieve this we see large companies periodically working through the following process:

- Critically assessing the actual or potential impact of changes in the environment to provide a 'risk-adjusted' base case, i.e. the likely outcomes given the impact of regulatory changes like those proposed under BEPS if no changes are made;
- Reviewing the options and, armed with this assessment and an understanding of any future business plans, determining whether alternative strategies may result in better future tax outcomes; and
- Implementing and regularly reviewing the chosen strategies which may involve adjustments to the people, processes and systems of the business, both within finance functions and beyond.

To help inform your understanding of where your business sits in relation to the current environment, we would suggest exploring the key matters outlined overleaf.

Many companies are responding by explaining their tax position more fully in their financial reporting or other communications.

Key matters for boards, or audit committees on behalf of boards, to consider

- What is the oversight exercised by the audit committee over tax matters? To what extent are key risks and judgements escalated?
- Who is accountable within the organisation for the management of taxes? Is accountability different for some taxes (e.g. employment taxes or excise duties?). For a UK group, who is the Senior Accounting Officer?
- Are the group's people, processes and systems fit for purpose to generate the information needed for accurate and timely tax reporting and compliance?
- What disclosures, if any, have been made under the DOTAS or equivalent overseas regimes? Does the audit committee have an understanding of these? What schemes, if any, have been entered into with others (e.g. law firms) which may have been disclosed?
- What is the business's relationship with the authorities in its key taxing jurisdictions? What are the influencing factors? In the UK context, what is the company's risk rating?
- Could the business' tax position (or others' perception of it) have an impact on the wider business? For example, do the 'Procurement and Tax' rules potentially have any impact on the group's ability to win government contracts?
- To what extent would the anti-avoidance measures being developed internationally (e.g. via BEPS) or locally (e.g. the recently introduced UK GAAR) be relevant to any structures or transactions already in place, if they were being entered into now?

Appendix 1: Key questions for the boardroom

The following key matters are those we believe boards at leading companies are considering:

Policy

1. Does the organisation have a board-endorsed policy for the management of taxes, including a defined appetite for tax risk?

2. Are accountabilities for the management of different taxes clear within the organisation?

Management of tax risk

3. How is tax risk considered in the design, implementation and maintenance of commercial decisions (e.g. an acquisition, entry into a new market, launch of a new product)?

4. Given the highly technical nature of tax issues, are the right capabilities and structures in place to support senior management in evaluating the significance of tax risks that are reported to them?

5. Is adequate financial provision made for tax risks?

Controls

6. What processes and systems are in place to identify, evaluate, manage and report tax risks to senior management?

7. To what extent does Internal Audit (or others) provide assurance that the controls in place to manage tax risks are appropriately designed and/or operated?

8. What steps have been taken within the organisation to ensure that relevant tax expertise is applied to considering the implications of key transactions?

Transparency

9. Is the relationship between the income statement tax charge, tax paid and business results, both on a global and country-by-country basis, able to be explained?

10. Do you have any significant disagreements with tax authorities? How and when will they be resolved?

Appendix 2: Overview of the different perspectives

Governments

In the face of continuing large deficits and, in many countries, economies that are only beginning to recover from the financial crisis, governments need to raise tax revenues.

Governments also face increasing demands from the public for welfare reform and increased transparency and fairness within the tax system. At the same time, any economy needs an internationally competitive and attractive corporate environment that encourages growth and prosperity. Tax has steadily become a more central topic in this. The UK's coalition government has lowered the rate of corporation tax and encouraged international holding companies to the UK; the previous Labour government exempted gains on disposal of shares in operating companies.

At the G8 Summit in June 2013, numerous actions were set out in the **Lough Erne Declaration** in order to help drive the growth agenda.

Investors

Investor interest in the tax position of a company has tended to focus on three areas:

- Free cashflow calculations are based on after tax flows so the measurement has a direct bearing on the calculation and on valuations.
- Discount rates use an after-tax cost of debt. This is an important factor as discounted cashflow models are sensitive to discount calculations.
- Effective tax rates embed the tax authority's view on the taxable profits of the entity. As taxable profits deviate from accounting earnings, concerns can arise about the quality of the company's earnings.

Recently, however, attention has shifted toward the reputational risk associated with media coverage of tax and also the sustainability of a company's tax position given the calls for a regulatory response to these stories. A recent report from Citi Research (Taxing Times, September 2013) showed how investors and analysts now adopt highly sophisticated approaches to valuing tax in companies' financial statements. Groups that have historically managed their effective tax rates through arrangements that may no longer be available in the future (for example, due to regulatory changes) will increasingly find that investors have already priced higher effective tax rates into their valuations.

Some of the key points to note from the Citi Research include:

- Tax structures using intra-group financing are common, and analysts are increasingly stripping out the benefits of such structuring in evaluating the financial performance of companies.
- There is an increased focus on possible vulnerabilities from actual tax paid being different from expected tax.
- Transfer pricing is generally viewed with some suspicion, even when agreed by tax authorities to be on appropriate terms.
- Changes in legislation relating to disclosures could also impact analysts' views.

In a further development, the **Dow Jones Sustainability Indices (DJSI)** are to include questions around tax for the first time in 2014. The DJSI is a set of indices which aim to evaluate the sustainability of the world's largest 2,500 quoted companies (including the top 200 or so UK companies). Their assessment criteria include corporate governance, risk management, branding, climate change mitigation, supply chain standards and labour practices. To inform their view they look at four sources of information: a questionnaire, publicly available documentation, media and stakeholder analysis, and direct contact with the company. Within their assessment criteria for 2014 are questions on tax strategy, tax reporting and key tax risks. A poor score on these questions could affect a group's overall standing within the indices. The overall outcome is that companies that are perceived not to operate in a sustainable and ethical manner are excluded from the index, influencing the investment decisions of those who track DJSI.

Non-governmental organisations (NGOs)

Particular NGOs have been active in this area for a long time but recent developments and increased media coverage have brought initiatives such as **Christian Aid's Tax Justice campaign** to wider attention and added fuel to the debate. In this campaign Christian Aid seeks to address perceived tax avoidance by large companies through supporting three key measures: first, public country-by-country reporting of taxes (as opposed to just to tax authorities); second, automatic information exchange between tax authorities and, third, public registers of beneficial ownership.

Role of advisers

Deloitte, and others, support clients by advising on tax strategies that fit with the group's commercial needs, and by providing insight into appropriate interpretations of tax legislation. Both HMRC and the OECD acknowledge the importance of tax advisers in the system as intermediaries between tax authorities and tax payers. Increasingly, advisers are being called to account by governments for their actions, most prominently in the UK with appearance of the Big 4 and a number of other firms before the Public Accounts Committee.

Business

Businesses generally treat tax as a cost to be managed in shareholders' interests but is increasingly paying more attention to the reputational and financial risk associated with tax. The CBI produced in May 2013 its own statement of seven tax principles for consideration by its members. The CBI's statement of principles in which it outlines its view on the responsible management of tax within business is reproduced at Appendix 3.

Appendix 3: CBI Statement of Tax Principles

Tax planning principles

1. UK businesses should only engage in reasonable tax planning that is aligned with commercial and economic activity and does not lead to an abusive result.

2. UK businesses may respond to tax incentives and exemptions.

3. UK businesses should interpret the relevant tax laws in a reasonable way consistent with a relationship of 'co-operative compliance' with HMRC.

4. In international matters, UK businesses should follow the terms of the UK's Double Taxation Treaties and relevant OECD guidelines in dealing with such issues as transfer pricing and establishing taxable presence, and should engage constructively in international dialogue on the review of global tax rules and the need for any changes.

Transparency and reporting principles

Relationships between UK businesses and HMRC should be transparent, constructive and based on mutual trust with the result that HMRC should treat business fairly and with respect, and with an appropriate focus on areas of risk.

5. UK businesses should be open and transparent with HMRC about their tax affairs and provide all relevant information that is necessary for HMRC to review possible tax risks.

6. They should work collaboratively with HMRC to achieve early agreement on disputed issues and certainty on a real-time basis, wherever possible.

7. Firms should seek to increase public understanding in the tax system in order to build public trust in that system, and, to that end:

   - They should consider how best to explain more fully to the public their economic contribution and taxes paid in the UK.

   - This could include an explanation of their policy for tax management, and the governance process which applies to tax decisions, together with some details of the amount and type of taxes paid.

What underpins the principles?

This statement of principles is intended to promote and affirm responsible business tax management by UK businesses. These principles are based on five key observations:

- Public trust in the tax system is a vital part of any flourishing democracy.

- Transparency and co-operation between HMRC and business contributes to greater compliance and a better functioning tax system.

- Most businesses comply fully with all applicable tax laws and regulations, recognising the obligation of the UK government to protect a sustainable tax base.

- Tax is a business expense which needs to be managed, like any other, and therefore businesses may respond to legitimate tax incentives and statutory alternatives offered by governments.

- UK businesses contribute significantly to the UK economy and pay a substantial amount of tax comprising not only corporation tax, but also National Insurance, business rates and other taxes.

What is the aim of the principles?

- To enhance co-operation, trust and confidence between HMRC, UK business taxpayers and the public in regard to the operation of the UK tax system.

- To promote the efficient working of the tax system to fund public services and promote sustainable growth.

Contacts and recent, relevant publications

The Deloitte Academy

The Deloitte Academy has been designed for main board directors of listed companies. The Deloitte Academy provides support and guidance to boards, individual directors and company secretaries of listed companies through a programme of briefings and update sessions. Bespoke training for the whole board or individual directors is also available.

If you would like further details about the Deloitte Academy, including membership enquiries, please email enquiries@deloitteacademy.co.uk.

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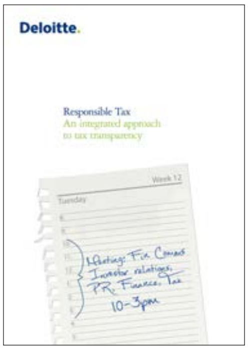
For further information on latest governance developments please visit: **http://www.corpgov.deloitte.com/site/uk/**

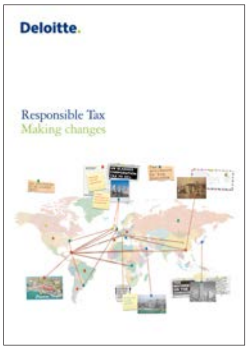
Recent, relevant publications

Responsible Tax
Tax transparency – developments in 2014

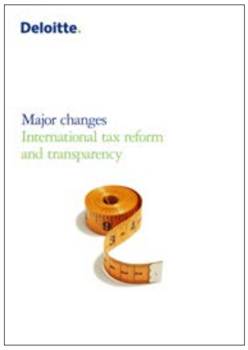
Responsible Tax
Sustainable tax strategy



Responsible Tax
An integrated approach to tax transparency



Responsible Tax
Making changes



Major changes
International tax reform and transparency

Notes

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