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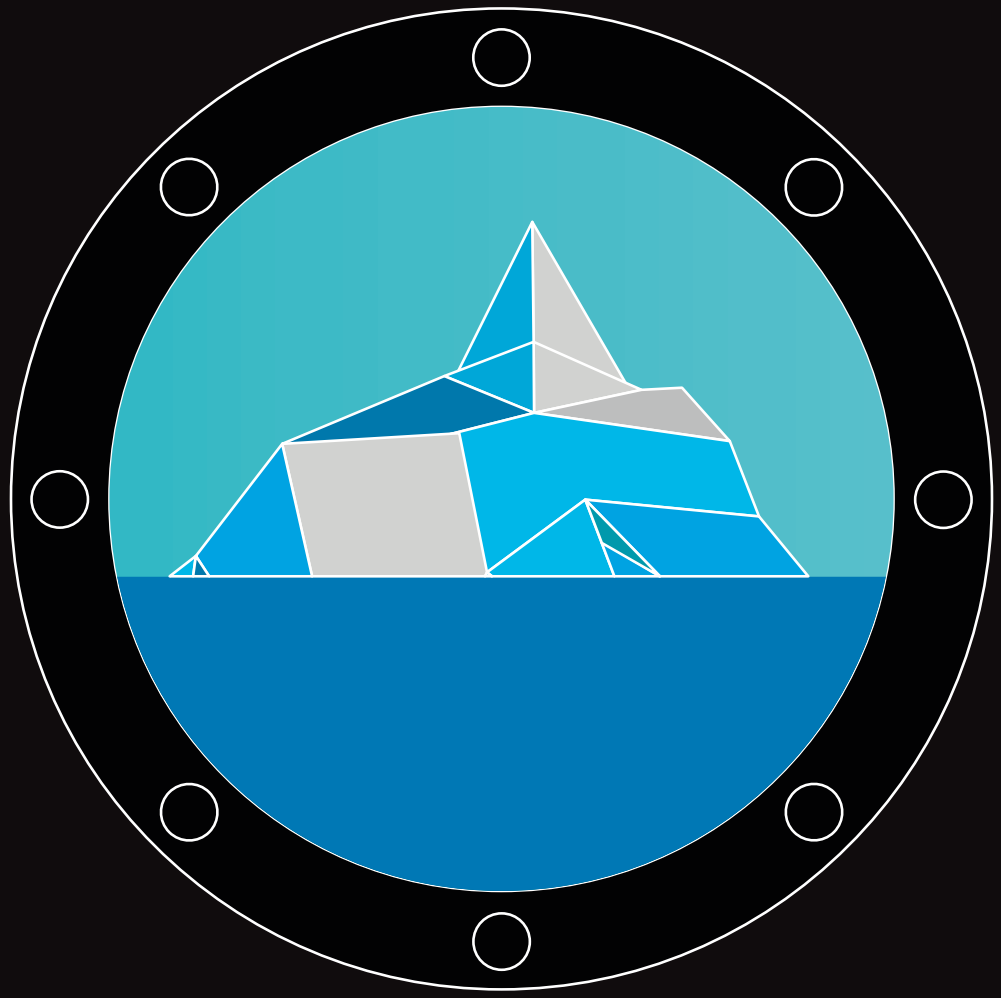

# Above the water line

## Deloitte Annual Review of Tax Reporting and Transparency Trends

November 2017

This 4th edition of the Deloitte Annual Review of FTSE 100 tax disclosures sets out our view of the tax reporting and transparency trends for 2016/2017. In particular, we reflect on how companies are improving the clarity of their tax communications through responding to the Financial Reporting Council's thematic review of tax disclosures and the new requirement to publish a UK tax strategy.

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November 2017

**Sources**
The data in this document was taken from annual reports and tax strategy statements by the top 100 companies listed on the London Stock Exchange (FTSE 100). 94 companies with 31 December 2016 and subsequent year-ends had published their annual reports and/or a standalone tax strategy statement November 2017, and this report is based on those 94 companies.

**Further information**
Please visit the link below for our Information portal with guidance documents, practical information and archive materials on the responsible tax debate, and the Global Tax Reset:

www.ResponsibleTax.com

# Foreword

Over the last 12 months, we have seen businesses seeking to report their tax position in a period of significant **uncertainty** in the international tax system, due to changes (enacted, expected, and possible) in the US and other key jurisdictions.

At the same time, they have needed to continue to respond to evolving tax **transparency** requirements and expectations as interest in their approach to managing taxes continues to move up the agenda for regulators, investors and others. The increased disclosure of tax information by companies in this period is also coming at a time of greater **scrutiny** and challenge, both internally from those charged with approving the statements and monitoring their application of internal processes, and from key external stakeholders, in particular tax authorities.

This 4th edition of our Annual Review of tax reporting and transparency trends reflects on each of these three developments (changes in law leading to uncertainty, evolving transparency requirements and greater scrutiny), and also anticipates the potential **confusion** caused by a range of disparate regulatory and other developments which may be called for in 2018.

Multinationals are responding to these challenges, but it places a significant burden on their people, processes and systems. For substantive progress to be made in this area, we believe we need:

**Simplicity:** effort from regulators and key influencers to avoid creating a potentially confusing array of tax disclosure requirements through measured, coherent calls for further tax information. While there is undoubtedly a need for businesses to talk about their tax position and approach to managing taxes, it needs to be proportionate to tax as a public issue, especially when compared to other aspects of corporate governance. This will, however, be difficult to achieve because of regional challenges, uncertainty regarding the unilateral moves of the US and others, and ongoing competition within the international tax system between policy makers.

**Clarity:** communications on tax from large businesses should meet the regulatory requirements and broader stakeholder needs in an integrated, straightforward way. Key risks and uncertainties should be disclosed, along with explanations on what drives their key tax outcomes (e.g. payments, effective tax rates etc.). Consistency should be driven through year-on-year comparisons and there should be clear links between, and alignment with, financial reporting and other tax disclosures.

**Assurance:** businesses should ensure that they are able to demonstrate that they operate in line with the policies and behaviours summarised in their public disclosures. Users of the statements should be confident that these will have been reviewed internally by the board, audit committees and internal audit functions, and potentially tested by tax authorities and other regulators. Making these statements and operating to them should go a long way to giving the public confidence that the companies they work for, buy from, and invest in, are operating in line with acceptable standards.

# Uncertainty – reporting taxes

**Deloitte reviewed the financial statement tax disclosures of FTSE 100 companies:**
Out of the 94 companies (as at November 2017) that had published accounts since January 2017:

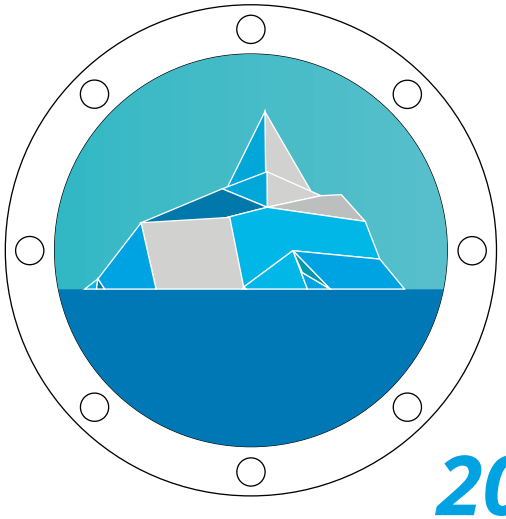
***Estimation uncertainty:***

**22** disclosed the quantum of the tax risk provision recorded

**20** provided background on uncertain tax provisions

**19** discussed potential material adjustments in the next 12 months

**65** included tax as a critical accounting estimate or judgement



***Effective tax rate:***

**61** explained their current ETR

**34** estimated their future ETR

***Factors affecting future tax rate:***

**32** mentioned BEPS

**20** mentioned US tax reform

**10** talked about EU State Aid

Source: FTSE 100 annual reports

**The sustained public interest in businesses' tax affairs has resulted in many companies assessing the quality of tax disclosures in their annual reports and financial statements proactively over the past few years.**

### Financial Reporting Council (FRC) thematic review of tax disclosures

The FRC sought to encourage boards further to review their tax disclosures to ensure their annual reports provide improved information to investors through a thematic review of this area. Particular areas of interest were the transparency of tax reconciliation disclosures, including how well the sustainability of the effective tax rate is conveyed, and uncertainties relating to tax assets and liabilities and assets where the value at risk in the short term is not identified.

The FRC published the findings of its review in late 2016, providing examples of best practice and encouraging companies to use these as a basis to assess and enhance their own disclosures.

It is clear from our review of the annual reports and financial statements of the 94 FTSE 100 constituents with year-ends of 31 December 2016 or after, as published by October 2017, many groups had responded positively to the FRC's comments, making improvements in a number of areas.

### Effective tax rate

The FRC is clear that the ETR reconciliation should enable users of the accounts to understand both the relationship between the tax expense and accounting profit, and the significant factors that could affect that relationship in the future.

Our review of the tax reconciliations of the FTSE 100 companies in scope showed a trend towards a greater degree of disaggregation and more meaningful explanations of adjusting items.

The value of items which may cause variances between current and future effective tax rate were clearly disclosed in many cases. These included significant one-off items such as transaction costs or settlements with tax authorities, or finitely-lived benefits such as tax holidays or intragroup financing structures.

Frequently, narrative disclosure of factors which may influence businesses' future tax profile was made either in the front-end of the annual report, or included in the financial statement tax note.

This included items such as the Base Erosion and Profit Shifting (BEPS) action plan, potential US tax reform, the European Commission's State Aid investigations and Brexit.

### Estimation uncertainty

The FRC has explained that companies need to consider carefully whether they have significant judgements and estimation uncertainties (as defined in IAS 1 *Presentation of Financial Statements*) relating to tax, and then ensure the nature of these risks and the framework to assess and measure any associated provisions is appropriately disclosed.

Judgements typically relate to application of accounting standards where there is a policy choice, whereas estimation uncertainties relate to assumptions made about the future and other uncertainties relating to the measurement of assets or liabilities. IAS 1.125 requires disclosure of the assumptions made for balances whose measurement involves significant estimation uncertainty that have is a significant risk of resulting in a material adjustment to the carrying amount within the next financial year.

In respect of such balances, the notes should disclose their nature and their carrying amount at the end of the reporting period. This disclosure may well be relevant to potential changes to tax liabilities due to uncertain tax positions.

The annual reports of the FTSE 100 companies reviewed showed a marked improvement in disclosure of tax risk provisions for groups who had identified tax as a key area of judgement or estimation uncertainty, in many instances explaining both the process by which such provisions are quantified, the nature of the uncertainty and quantification of the uncertain tax risk provision.

### IFRIC 23 *Uncertainty over Income Tax Treatments*

IFRIC 23 *Uncertainty over Income Tax Treatments* relevant to IFRS reporters, published in June 2017, is effective for annual reporting periods beginning on or after 1 January 2019 (although earlier application is permitted).

This interpretation clarifies how to apply the recognition and measurement requirements in IAS 12 where there is uncertainty over income tax treatments.

It offers guidance in several areas, including:

- the circumstances under which tax uncertainties should be considered separately or together with one or more uncertainties;
- the requirement to assume tax authorities will examine amounts it has the right to examine and have full knowledge of all related information when making those examinations;
- the circumstances under which it is appropriate to provide on a 'most likely amount' basis or a 'expected value' basis; and
- how to treat changes in facts and circumstances.

Companies may look to enhance their disclosure further, to explain how they have applied the guidance.

**Financial Reporting Council Non-Financial Reporting Guidance**

The FRC originally published guidance on the Strategic Report in June 2014. As a result of the increasing focus on the need for businesses to consider the effect on society and report broader matters since then, an amended version has been issued for consultation (comments were invited by October 2017). The revised version includes specific illustrative examples in relation to tax, covering the impact an entity may have on the community in which it operates and social matters, and its strategy in terms of having a transparent tax structure and paying a fair rate of tax in in each of its major areas of operation.

The guidance also places greater emphasis on explaining directors' duties under s172 of the Companies Act 2006 to promote success of the company. Some of the considerations set out the in the Act are of relevance to a group's tax policy and strategy, such as fostering business relationships with various parties (which could include tax authorities), and maintaining a reputation for high standards of business conduct.

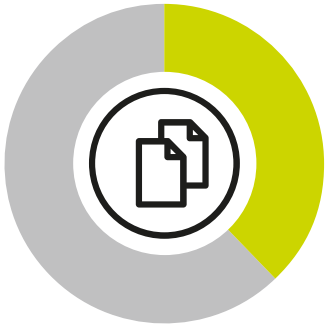
The guidance remains non-mandatory with a view to encouraging best practice, but we expect many groups will respond by bolstering their disclosure across a number of areas including tax.

# Transparency – disclosing tax strategy and other developments

On 15 September 2016 a package of measures came into force in the UK which included the requirement for many large businesses and partnerships to publish a UK tax strategy. Deloitte reviewed the annual reports and standalone tax strategy statements of the FTSE 100. Out of the 94 companies reviewed with a year-end of 31 December 2016 or later, 55 had a 'Tax Strategy Statement' which appeared to address the themes covered by the UK requirements.

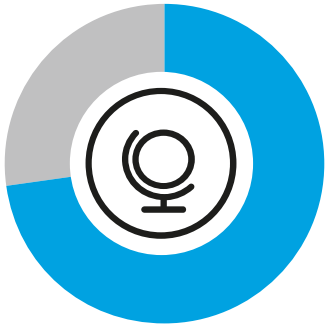
**Percentages are based on the 55 businesses (59%) who had published:**

**Where they published:**



- 36% Annual Report (20)
- 64% standalone statement (35)

**Scope:**



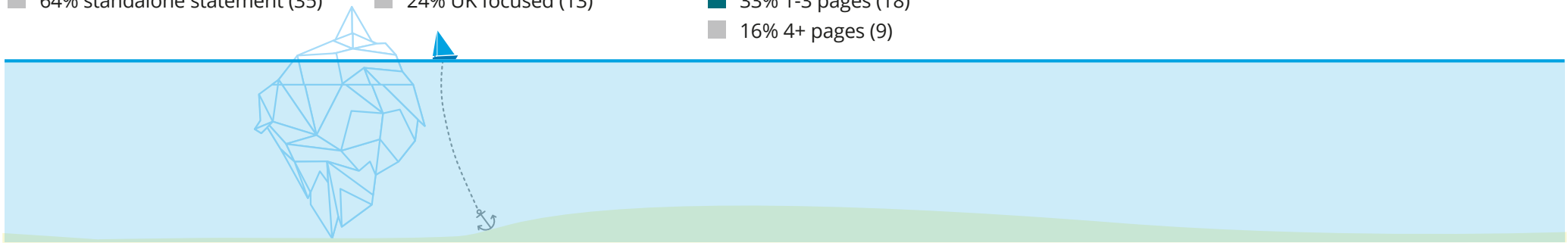
- 76% globally focused (42)
- 24% UK focused (13)

**Length of strategy in number of pages:**

- 51% less than a page (28)
- 33% 1-3 pages (18)
- 16% 4+ pages (9)

**Disclosing:**

**25%** – no explicit commitment to statutory compliance (14)
**84%** – clarity on approving body (46)
**31%** – reference to arm's length pricing (17)
**56%** – tax contribution information (31)
**22%** – country-by-country tax information (9)
**21%** – reference to tax havens (12)
**9%** – reference to HMRC risk assessment rating (5)



### Observations on tax strategy disclosures

We have observed the following trends based on the disclosures seen to date:

- 64% of businesses made a standalone statement, rather than embedding it within their Annual Report. In our experience, businesses tend to do this so that they have greater flexibility when it comes to the length and timing of publication of the statement.

- The majority (75%) of businesses made a global statement, rather than limiting their disclosure to the UK requirement. This reflects the global scope of their organisations and, in some cases, it has been prompted by international developments such as the Dow Jones Sustainability Index's expectation of a global statement.

- The tax strategies published were typically reasonably concise: over half were less than a page in length and only 16% extended to over 4 pages.

- While not a legal requirement, most (84%) noted that the statement was approved/ overseen by a senior management body, such as the board or audit committee, in line with HMRC's stated expectations.

- While many businesses (55%) emphasised the tax contribution they made and provided headline values, most (84%) steered clear of providing detailed country-by-country analysis. Based on discussions with our clients, we understand this is largely due to a lack of certainty on external expectations in this regard and the undoubted practical challenges of collating the data concerned.

- Not all tax strategies included an assertion that it is intended to comply with the UK tax strategy legislation. In many cases, this is because the statement preceded the finalisation of the UK rules, but some further attention will be required by these groups to ensure their disclosures fulfil the UK requirement.

- A few groups made voluntary comments on other themes, including: activities and entities in perceived tax havens, arm's length pricing and HMRC risk ratings, but none of these seem common enough as yet to be regarded as an emerging norm for additional content.

### Country-by-country reporting – going public?

In Europe, discussion on public disclosure of country-by-country tax information continues. In July 2017 the European Parliament voted 534 to 98 to send proposals to the Committees to start negotiations on the basis of a Parliamentary mandate.

The latest proposals suggest a turnover threshold of €750 million and require that EU-based multinationals should disclose details by country of operation outside the EU as well as inside. The disclosures otherwise look like those under the BEPS programme, with additional details on whether operations benefit from patent box or similar regimes. Significant opposition remains within the Council of Ministers and elsewhere. Many are concerned that the aggregated nature of the data provided (rather than consolidated, as with group financial reporting) has significant potential to confuse users, as most groups' sales and profits are counted several times (both within countries and globally) although cash tax is counted only once.

Outside Europe, there is minimal debate on this subject with the implementation of Action 13 of BEPS, i.e. the confidential provision of this information to tax authorities, being the key focus.

### Investor expectations

Regardless of local, regional or other requirements, some investors are pushing for greater tax disclosure from the companies in which they invest. For example, the UN-backed Principles for Responsible Investment has specifically considered the expectations of investors in relation to the disclosure of corporate tax information.

The Dow Jones Sustainability Index continues to include tax criteria within its assessment, rewarding those companies that provide additional disclosure regarding their approach to managing taxes and what this means country by country.

Norges Bank Investment Management, the Norwegian sovereign wealth fund and one of the world's biggest investors, went further in making a public statement that, in addition to expecting large businesses to be generally transparent in relation to how they manage taxes, they see public country-by-country reporting of taxes as a "core element of transparent corporate tax disclosure".

### Regulatory developments

Non-tax regulators are becoming interested in the connection between their remit and the behaviour of their regulated entities from a tax perspective. For example, when Ofwat produced a document setting out its guidelines for the format and content of Annual Reports of entities within its sector, specific reference was made to tax disclosures. This guidance went further than the UK tax strategy disclosure requirement in that it recommended that all regulated businesses should make such a disclosure, not just those that are in the scope of the rules. It also recommended the location of the disclosure (the Annual Report), rather than the greater flexibility afforded by law.

### Broader stakeholder interest

It remains to be seen how much interest will be generated among broader stakeholder groups, e.g. consumers, by the wave of disclosures of UK and global tax strategy statements. However, it is certainly the case that those selling to governments and related agencies are keen to ensure that they have met the expectations of relevant procurement teams.

### Link to the 'Corporate Criminal Offence'

While companies are making disclosures in relation to their own tax affairs, they are also now having to take more responsibility for the tax affairs of others as they seek to comply with the Corporate Offence for the Failure to Prevent the Criminal Facilitation of Tax Evasion, which became law on 30 September 2017. Few businesses have yet made a public comment in this regard, but it is leading to an increasing desire for businesses to seek assurance from counterparties that they have appropriate governance and controls in place.

# Scrutiny – managing expectations

Increased disclosure of tax information is leading to more **scrutiny** and challenge, both internally from those charged with approving the statements and monitoring their application of internal processes referenced in statements, and from key external stakeholders, in particular tax authorities.

## Internal confidence in the disclosure

In order to make a public statement, those charged with tax governance within a company are likely to want to put in place management processes, perhaps including internal audit, to provide the necessary assurance that they could provide evidence of' their approach if challenged.

It is key for the individual accountable for the management of taxes to put in processes to understand the current state, address material issues and communicate with the board or those charged with tax governance.

The level of effort needed to get such assurance will vary with the level of disclosure made. For example, those businesses that make a global statement that includes tax contribution data will need to do more than those that stick to the statutory minimum for UK tax strategy purposes.

## Not a one-off

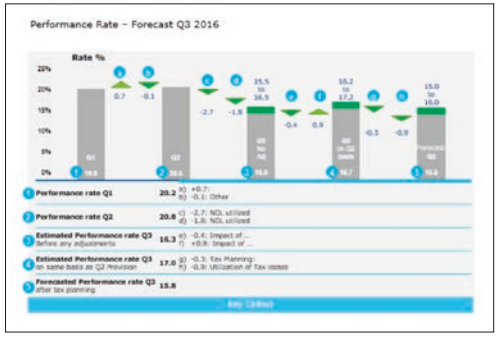
This engagement with the Board/Risk Committee cannot be a one-off event. The tax strategy disclosures explicitly include reference to ongoing governance and risk management.

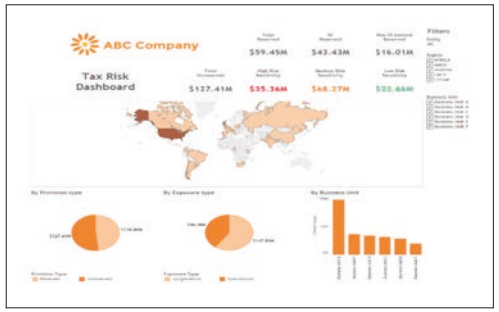
Those changed with tax governance will want to track their key tax measures, understand how risk levels are shifting over time, assess the key judgement matters which require their input and monitor the progression of improvement programmes.

To support finance and tax teams to be able to provide this ongoing insight, many organisations are investing in better quality tax management systems which enable the tracking and reporting of key data points, including:

- Compliance status;
- Forecast cash tax and ETR; and
- Key risks and their movement.

To help communicate this information, often dashboarding is used as illustrated below for forecast ETR and global risk information:




## Looking below the water line

While only a few groups to date have passed their publication due date per the legislation, we are already seeing interest from HMRC as to the nature of these statements and, critically, how the principles expressed in them are embedded within the organisation.

As part of an increasing trend over the last few years, HMRC is looking to undertake 'audits' of tax governance within large organisations and, as part of this, often asks for documentation and access to management to help inform their assessment of the extent and effectiveness of oversight and control over key tax risks.

In a few instances this activity is focused on specific issues, reflecting particular HMRC concerns in how the taxpayer has handled recent key tax decisions.

More often, however, the review forms part of the non-statutory Business Risk Review which HMRC undertakes every one to three years. The nature of the information requested as part of one of these reviews is summarised on the next page.

**HMRC governance review**
Illustrative scope:

- Internal tax policy – Does it exist? Can it be shared?
- Tax governance – Which body oversees UK tax risk? Please provide the terms of reference of the Committee. Please provide examples of recent matters considered.
- Tax risk management – Do you have a Control Framework for taxes? Can you share an extract from your risk register?
- Tax testing – Does tax feature in your Internal Audit plan? Can you share recent reports? What other tax testing is undertaken?
- Tax people and processes – Can you provide details of the qualifications/ experience of staff involved with tax management? Do you have tax process documentation? Please share it.
- Senior Accounting Officer (SAO) – Please provide details of your SAO framework. Can we speak with the SAO?

Taxpayers that are able to respond to such reviews effectively should find that they achieve lower risk assessments from HMRC which should mean a reduced compliance burden and greater ease of obtaining comfort on areas of uncertainty. It should also mean a lower exposure to penalties and reputational damage for the company and its SAO. Getting it wrong, however, could cause significant damage to the relationship with HMRC and have the reverse outcomes for the company and its senior management.

### Beyond our coasts

Over the water we are starting to see interest in the same themes from certain tax authorities, in particular: Germany, Spain, Ireland, Australia and Canada. We can expect to see more as overseas authorities get access to the UK tax strategy statements that are made and are able to use them in their local discussions. For example, the French may enquire about a US group whether their local subsidiary applies the same standards as they have disclosed in the UK. More broadly, the OECD is promoting the concept of Tax Control Framework, which HMRC has acknowledged through its consultation document on the Business Risk Review methodology, and could lead to more countries taking this approach.

# How we can help

Deloitte's established team of tax risk management consultants is on hand to:

- Assist you in identifying your strategic tax objectives and develop an action plan for achieving them
- Assess your tax governance and control framework to ensure your key strategic risks are addressed. Don't have a framework? We can help you develop one!
- Carry out specific testing of your key tax controls and report to management
- Help you develop your tax communications strategy, including peer benchmarking

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# Looking ahead

This is the latest in an ongoing series from Deloitte's tax risk management experts. We aim to publish a survey next on the changing relationship with HMRC:

- Recent changes in HMRC structure and how this impacts the interaction between HMRC and business
- Trends in dispute resolution and HMRC interventions: what they are and what they could mean for your business
- Developments in tax transparency and the automatic exchange of information – what does this mean and what do taxpayers need to consider?
- Helping you communicate with HMRC either ahead of an event or during a formal enquiry

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