Responsible Tax
Sustainable tax strategy

Summary

Tax is a noisy subject right now – in public, in politics, in the press. Action groups and media campaigns have woken public interest in the tax strategies employed by large companies and high profile individuals at a time when the economy is creating pressure on taxpayers to demonstrate their contribution to society.

In response, boards are seeking a responsible approach to the management of taxes. One which is able to deliver sustainable outcomes that are right for the business, and that would still feel right should the media spotlight settle upon them.

Here we explore this new best practice and suggest practical steps to help companies arrive at a tax strategy that is aligned with their broader corporate and risk management strategy and which the board can be confident is the right fit for the business and its aspirations. This involves:

- **Reviewing the current tax strategies** and comparing them to company policies and statements, for example Corporate Social Responsibility (CSR) or investor briefings, as well as taking a look at the tax risk profile in the light of today's environment. Do they sit well together? Can today's priorities be reconciled with historical tax positions?
- **Where differences emerge, working out how to close them**. Consider immediate changes and look forward by redefining the strategic approach and policy framework. This needs careful consideration of the impacts, both financial and reputational, and the interests of all of the stakeholders – from investors to employees and customers, and of course including governments.
- **Communicating the tax strategy**, explaining the key elements and what it means to all concerned.
- **Making the strategy work for the long term**, ensuring the business takes all its relevant decisions in accordance with it. Consider whether to periodically update investors, governments, customers and employees on how the strategy is being brought to life day to day.

Definition: Policy versus Strategy?

- **Tax policy** = the governance framework that sets standards for the way tax decisions are made and subsequent activity executed. It formally sets out the organisation's standards, accountabilities and key policies for the management of taxes.
- **Tax strategy** = the plan, based firmly on data and the facts of the business, which sets out the tax decisions made in supporting the organisation's goals.

Understanding current strategies

Many boards may be unaware of the tax risks their businesses are exposed to and whether they are in line with company policies and goals. There are a number of steps to take to get a better handle on the strategies driving the group's tax outcomes:

1. **Build a tax model**. This involves creating a mini P&L for each element of the tax strategy, incorporating benefits from the strategies and the costs of delivering them. Clearly defining the attributes contributing to the group's tax position (e.g. impact of low tax jurisdictions, permanent differences, prior year adjustments etc.) is key. This may involve accessing granular data that is currently not available.

   The tax model will help identify the most significant drivers of tax outcomes (e.g. the Effective Tax Rate (ETR), recoverable VAT, net pay of key employees) as well as those that have a greater risk of not being sustainable in the current environment.

   Example: One group that developed a tax model identified that their low ETR was dependent on a number of transactions which were vulnerable to law change and tax authority scrutiny.

2. **Identify and prioritise stakeholders**. There are many stakeholders to consider – those outside the business and those placing demands on it – for higher dividends, greater capital growth, better pay, lower priced products, more jobs, more tax. Companies should be as specific as possible in their analysis. Consider the composition of the investor base, the split between institutions and retail. What are the natures of the different types? Do they have an ethical agenda, for example?

   Overlaying stakeholder needs with the strategies identified helps to determine whether specific strategies conflict with key stakeholder requirements. For example, where governments are key customers, some companies may need to review their strategy in response to signs that governments are looking at tax policies when considering commercial partners.

   These stakeholders should be prioritised and, for those with the highest priority, some way of measuring whether their needs are being met is vital. Most stakeholders will have a 'representative' within the business who can accelerate the process of gathering this insight. For example, where investors are concerned, typically the emphasis is on understanding the sustainability of the company's tax position and how it compares with peers. Other stakeholders will have different measures.

   Example: One leading multinational has identified the impact of negative press in relation to its tax affairs on its customers. It has done this by gathering sales data and insight from its customer care teams as well as monitoring social media.

   Prioritising stakeholders and their needs should be done in conjunction with senior management. Benchmarking the group's position against competitors, in terms of risk appetite and reporting, can help inform this discussion. The endpoint is a clear and balanced view, based on facts, on what needs to be delivered and to whom.

3. **Assess risk and resource**. In addition to identifying which strategies are vulnerable to law change or adverse stakeholder reaction, organisations should also question whether they are capable of delivering the strategy. Some strategies will not be suitable where the Tax team is resource constrained, and therefore where there is a risk that they will not be implemented effectively.

Definition:

- **Effective Tax Rate** = "tax expense (income) divided by the accounting profit" as explained in IAS12.

Close the gaps

A review of the group's tax position will often reveal differences between where the organisation is and where it needs to be. There are key steps which can be taken to close these gaps quickly but these need to be assessed carefully in light of the financial and reputational impact, whilst of course considering stakeholder needs.

- **Exit**. Some may consider exiting specific strategies which are perceived to be contributing negatively to overall corporate goals.

Example: One FTSE 100 company is actively reviewing ways of increasing its tax base to reduce the risk of it being seen in an unfavourable light by governments of countries in which it operates.

Exiting tax strategies may also involve group structure reorganisations. Entities which may have been set up in overseas territories to make use of available tax reliefs, may no longer be generating benefits in line with corporate goals and may be sitting dormant. These entities, particularly those in perceived 'tax havens', may attract adverse press coverage and may warrant being closed down.

- **Communicate**. It is essential to have a comprehensive communications plan which ensures consistency of statements regarding tax, whether it be in the media or in financial statements. Many organisations have recently been through a process to decide which tax statements they make in their annual accounts and several are publishing statements regarding tax governance on their websites or within CSR reports.

Example: One UK consumer business was concerned that it would be scrutinised for intragroup payments paid from the UK. It has therefore prepared statements which could be used to communicate its tax position with journalists and others. It is also looking to formalise its tax policy, supporting controls, and reporting plan.

A new kind of tax policy

While many businesses have a tax policy document of some sort, the purpose they will have traditionally served and the way in which they will have been arrived at, mean that few are fit for purpose in today's environment. In the new world, the tax policy and the process of its development needs to clearly direct the business' tax choices by defining the group's goals and attitude to risk, setting expectations and clarifying boundaries.

Businesses operating without a tax policy may be taking on more tax uncertainty than they have the appetite for, or, in contrast, may be missing out on wholly reasonable tax efficiencies or government incentives. It's not uncommon for parts of the business and the tax function to take a more conservative approach to tax management than the board would consider appropriate.

An appropriate policy provides confidence to external stakeholders that tax risks have been considered and addressed. Sometimes, this allows tax authorities to adopt a more relaxed approach to compliance obligations, for example, by reducing the company's risk rating. In some cases, tax policies have helped reduce a company's exposure to penalties on historic tax issues.

There are steps companies can take to get to the right tax policy:

1. **Define the risk appetite and principles of tax governance**. Reviewing existing corporate governance documentation, tax or otherwise, will establish if commitments have been set out which may influence the group's tax policy or conflict with its tax practices. For example, the Group Governance Statement may commit the organisation to complying with the purpose of the legislation and the tax policy would need to interpret this in the context of tax. Given the review of current tax strategies, what risks from the past is the company exposed to? What uncertainties does it have currently or is it planning to take? It's important to critically assess the decisions made in relation to the structuring of commercial transactions for tax purposes and see what, if any, risk they imply. What is reported for tax purposes? Financial statements tell some of the story but also look at the CSR report, analyst presentations and other communications touching on tax.

2. **Tailor and look forward**. In formulating a policy, some organisations find that they need to focus more on tax value and commit more time and energy to reducing tax bills but under appropriate controls. Establish key criteria for consideration when evaluating tax planning and set out the sign-off procedures required before it can be implemented.

   Others will want to shift towards a policy which emphasises reputation protection and a commitment to compliance. The policy should clearly set out the approvals needed before planning can be undertaken. It's essential that the policy is developed with the intention that it will be implemented. Many policy documents exist primarily as defensive statements developed with tax authorities in mind. When this occurs, there is a risk that they say something which then prevents consideration of future tax planning or which commits the organisation to something it has little chance of complying with.

3. **Test and refine**. Test the policy against past, current and planned tax activities and ask how the policy would change these activities – what tax strategies would the group need to stop, start and continue and what would the cost impact of this be? The tax model used to assess existing strategies can be used for this purpose and should indicate the impact that particular risk appetites will have to the group's success.

4. **Get the message out**. To begin the process of embedding the thinking in day-to-day activities, communication should start with those responsible for managing taxes. It won't always be appropriate to communicate the full policy. Instead the key messages can be used to inform specific communications with other stakeholders.

   Example: One consumer business which found itself in the news for a tax story wanted to assure all its employees that tax matters were under control, and produced a targeted statement to this effect.

   It is important to ensure that any communication on tax is consistent with the policy itself and other statements made. This involves working through not only the financial statements but also analyst presentations, sustainability reports, press releases and a host of other outputs to ensure that a consistent story is being told.

Making it work

Recent public events and the associated media coverage mean that businesses operating in the UK and elsewhere need to navigate a new tax landscape. Companies are responding and most are at the first stage of the journey – assessing what the changing environment means for them and reviewing their strategic approach and policy framework to ensure it remains fit for purpose. Staying on track involves ensuring:

- **Board-level ownership**
  Only when the business leadership is engaged in the development process can there be confidence that the tax policy complements the broader corporate strategy and that it will be used to determine the appropriate tax planning choices for the business.

- **Alignment to corporate goals**
  Both the policy and strategy should recognise the group's long-term goals and the role that the responsible management of taxes plays in their achievement. In particular, they should reflect and seek to balance the specific needs of the group's differing stakeholders.

- **Standards**
  It's essential to state the parameters within which the group's goals will be pursued in the context of tax – the type of risks the company will take and those it won't. Expectations should be made clear such as: the criteria for evaluating tax strategies, the standards for disclosure of tax positions, guidance for those engaging with tax authorities, and control measures (documentation, monitoring, testing). These work best when they provide a pragmatic, workable framework and are at their worst when they are too detailed and pedantic.

- **Defined accountabilities for the management of different taxes**
  For the most part this might be clear. For example, Group Tax typically owns corporate taxes. But what about employment taxes – who takes the lead between HR, Tax, Payroll and Finance? And what about the responsibility for financial data for tax purposes: is it down to Group Tax to adjust for everything or should Finance get the data at source?

- **Commitment to reporting**
  Ideally this would include standard metrics for measuring success and regular reporting outlets, going beyond the standard delivery of insight on the numbers to the Audit Committee.

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Designed and produced by The Creative Studio at Deloitte, London. 25739A