Tax risk management, corporate governance and the enhanced relationship

Grace Perez-Navarro looks at how tax administrations are stepping up their enforcement efforts

The financial, economic and now debt crises have not only put the spotlight on tax reform to raise revenue but also on increasing tax compliance. Tax administrations are stepping up their enforcement efforts to ensure that companies are paying the tax legally due, and are increasingly focusing on cross-border transactions. They are also working more closely together through the OECD's Committee on Fiscal Affairs and Forum on Tax Administration (FTA) to identify trends in aggressive tax planning, devise responses and foster greater voluntary compliance.

More targeted initiatives such as JITSIC[1] allow for more co-ordinated efforts among participating countries. Further, there is increased interest in information sharing between tax administrations and more agreements are available under which to carry that out - over 800 such agreements signed since 2009.

The amounts at stake in some major tax disputes are measured in billions of dollars and can take years to resolve, which implies significant costs for both the taxpayers and tax administrations involved. Multinational enterprises (MNEs) also have to grapple with the increased reputational risks arising from the growing public attention being drawn to companies that pay little or no tax due to clever tax planning. Businesses and tax administrations need to adapt to this changing environment. Both are beginning to see the benefits of moving away from an adversarial relationship to one of co-operation.

The changing environment: increased disclosure requirements

Tax authorities are increasingly recognizing that traditional audits alone are inadequate to deal effectively with aggressive tax planning. Disclosure requirements are on the rise to assist tax administrations in managing this risk. The objective of these requirements is to ensure the availability of timely, targeted and comprehensive information to allow governments to identify risk areas in a timely manner so as to able to quickly decide whether and how to respond, thus facilitate a more risk based approach to tax administration activities. While this may increase compliance burdens for taxpayers, it also increases certainty to taxpayers and provides that certainty sooner than a traditional audit would.

OECD countries have established a variety of disclosure initiatives ranging from mandatory early disclosure requirements such as the requirements in the US and Australia to disclose uncertain tax positions, to questionnaires targeted at particular taxpayers and focused on particular areas of risk (eg. New Zealand), to penalty linked disclosures (e.g. Ireland, New Zealand)[2]. The pace of change in this area is accelerating and we can expect to see more countries adopting similar approaches in the future.

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Putting tax in the boardroom: the OECD Guidelines for Multinational Enterprises

The *OECD Guidelines for Multinational Enterprises* are far reaching recommendations for responsible business conduct that 44 adhering governments – representing all regions of the world and accounting for 85% of foreign direct investment – encourage their enterprises to observe wherever they operate.

The *Guidelines* were updated in 2011 and include important changes to the tax aspects of the recommendations. First, the *Guidelines* encourage enterprises to "*comply with both the letter and spirit of the laws of the countries in which they operate*". Second, they call on enterprises to *"treat tax governance and tax compliance as important elements of their oversight and broader risk management systems. In particular, corporate boards should adopt tax risk management strategies to ensure that the financial, regulatory and reputational risks associated with taxation are fully identified and evaluated."*

The *Guidelines* build on the work of the OECD's Forum on Tax Administration which, since its 2006 Seoul Declaration has been calling on businesses to make tax risk management an element of their corporate governance. Although these Guidelines are relatively new, the Forum on Tax Administration, led by Douglas Shulman, Commissioner of the United States Internal Revenue Service, is engaging with business to assess the impact of the guidelines on the behaviour of MNEs and the role of boards in tax risk management in particular.

The enhanced relationship: moving towards co-operative compliance

In 2008, the OECD's Forum on Tax Administration published the *Study into the Role of Tax Intermediaries* which was a response to growing concerns among the Forum's over 40 Tax Commissioners about aggressive tax planning and how to improve management of this significant risk. While the study's initial focus was on the role of tax intermediaries (eg. accounting firms, law firms or other tax advisory firms, financial institutions, etc), the study also focused on the importance of influencing the behaviour of the large corporate taxpayers who were the customers of the intermediaries and ultimately determined whether to adopt particular tax planning approaches.

The Study concluded that managing this risk effectively depended on early disclosure from taxpayers. To encourage this type of co-operative compliance from large corporate taxpayers would require tax administrations to operate using the following five attributes when dealing with all taxpayers: understanding based on commercial awareness; impartiality; proportionality; openness (disclosure and transparency); and responsiveness. The Study describes this "enhanced relationship" between the taxpayer and the revenue body as one based on co-operation and trust, with both parties going beyond their statutory obligations. Adopting a cooperative approach to compliance does not mean that taxpayers will get a lower tax bill as a result of taking part in "enhanced relationship" programmes. What it does mean is that the taxpayer will get greater certainty, in shorter time frames and at lower cost in terms of compliance.

The purpose of this cooperative approach to compliance is to create a joint approach to improving tax risk management and overall tax compliance with benefits to both the tax administration and the taxpayer. Countries that have established cooperative compliance programmes include: Australia (Annual Compliance Arrangement); Ireland (Co-operative Compliance); Italy (Risk Management Monitoring); the Netherlands (Horizontal Monitoring); New Zealand (Co-operative Compliance Agreements); Spain (Large Companies' Forum), the United Kingdom (Large Business Strategy) and the United States (the Compliance Assurance Process).

The Forum on Tax Administration is currently undertaking an assessment of enhanced relationship programmes, which it expects to publish in May 2013, at its meeting in Russia. The preparation of the study is aimed at identifying lessons learned from experience to date with such programmes so as to continue to improve them. It will also address the perception that cooperative compliance programmes somehow involve preferential treatment of the taxpayers involved, including examining the benefits to society in terms of the lower costs and more secure tax revenues that result. The FTA will seek input from business as it assesses the developments over the five years that have elapsed since it published the *Study into the Role of Intermediaries*.

Looking ahead, we can expect to see other approaches to co-operative compliance from FTA members, which highlighted in their January 2012 Buenos Aires Communiqué

> *An adversarial relationship between tax administrations and multinational corporate taxpayers serves neither of our purposes well and is contrary to our common goals, which are earlier and greater certainty, consistency, and efficiency. To this end, we agreed that we need to create innovate strategies for issue resolution that are less time and resource intensive for both while still promoting a climate that encourages compliance with the tax laws.* ■

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Endnotes

1. Joint International Tax Shelter Information Centre. JITSIC was formed in 2004 by Australia, Canada and the United States to supplement the work of their tax administrations in identifying and curbing cross border tax avoidance. Japan, China, France, Germany and Korea now also participate in JITSIC.

2. Tackling Aggressive Tax Planning through Improved Transparency and Disclosure (OECD 2011).

3. OECD Guidelines for Multinational Enterprises: Recommendations for Responsible Business Conduct in a Global Context (OECD 2011) http://www.oecd.org/document/28/0,3746,en_2649_34889_2397532_1_1_1_1,00.html