

# The Governance of Tax

Reprinted from *Canadian Audit Committee Update*, Issue 2007-01

Increasingly, investors and other non-owning stakeholders are beginning to include tax management in their evaluation of the effectiveness of corporate governance. An enterprise needs to adopt clear, carefully considered communication of its tax affairs.

Today's businesses are facing increasingly rigorous regulation and growing pressure from a variety of stakeholders, internal and external, to demonstrate that they're well run, responsible organizations. As a result, the fields of corporate governance and social responsibility have moved to centre stage.

The management of tax has become one of the criteria by which corporate governance is judged by investors and important non-owning stakeholders such as regulators, tax authorities and the media.

The challenge for companies is how to comply with increasing regulation and more vocal stakeholder expectations while remaining competitive and flexible. KPMG's recently published discussion paper, *The Governance of Tax*, available at [www.kpmg.ca](http://www.kpmg.ca), explains how companies can turn their tax policies into competitive advantages by good tax management and adopting clear, carefully thought-through communication of its tax affairs.

## The "responsible" taxpayer

Political developments, demographic trends and demands for high-quality services in developing countries have led to growing pressure on public finances all over the world. This in turn has led to increased scrutiny of the business conduct of multinationals. There have also been concerted efforts to add a dimension of corporate social responsibility to tax management by questioning the "fairness" of tax planning.

An increasingly heated debate, fuelled in part by pressure groups, about what is "acceptable" tax behaviour has put boards in a quandary. Despite the legal obligations of directors to endeavour to minimize costs and maximize shareholder value, there is evidence of a creeping conservatism on tax at many large companies as a result of this uncertainty.

*Often tax is regarded as a specialist area and thus may not be adequately addressed at the board level.*

There appears to be a belief among tax authorities that many businesses are somehow shirking their tax responsibilities, even though many companies believe they have good tax compliance records and low risk profiles with the tax authorities. Despite this, companies will probably have to accept greater transparency if they are to close the “trust gap” between taxpayer and tax authorities.

### **Is tax on the board’s agenda?**

Although boards have made real progress toward recognizing tax as a key issue, tax has become simultaneously more complex and demanding—and thus harder to grasp. This has led some companies to continue to regard tax as a specialist area, indigestible at the board level. The consequences can include lost opportunities, poor communication of material tax issues, ill-informed boards, and tax departments exposed to undue risk.

### **Corporate sustainability includes tax**

The reputation of a company emerges from its results over time, and a key component of a good reputation for investors, analysts and regulators alike is a lack of surprises. Sustainability, the ability to sustain performance at a given level over a period of time, will therefore be a major target in any corporate strategy.

Logically, this “sustainability” requirement must include tax. Companies should therefore think about whether their tax reports to external stakeholders are contributing to the general impression that they project sustainability. So far, this requirement is usually interpreted as the company’s ability to maintain a steady rate of tax in the published accounts. Other disclosures, for example, losses available to offset against future profits and the status of tax authority investigations, are also relevant. The challenge is to know what stakeholders expect to hear, to recognize that these expectations are evolving and to manage communications accordingly.

Clear and open reporting improves transparency, but it does not by itself deliver sustainability. One must delve deeper and analyze how tax is managed as well as reported.

### **Good tax management can create value**

The inclusion of tax management as an important component of corporate governance gives companies an opportunity to gain a competitive advantage by spelling out their tax policies and their attitudes to tax risk clearly and consistently to external stakeholders.

Leading organizations in the tax field typically

- have a clear, defensible position on how tax and risk are managed
- have a well-documented, board-approved tax strategy
- have an enterprise resource planning system able to provide useful tax information
- present tax information in a clear, meaningful way to both internal and external stakeholders
- seek influence in the tax debate between taxpayers and the tax authority.

### **Clear communication is key**

Good management of tax is only part of the task. Clear, credible communication has to be at the heart of a company's approach to tax. Companies may want to consider an "outside in" approach that starts with various stakeholders' requirements for information, which drive the board's need for knowledge on tax matters, which in turn drives the organization and resourcing of the tax department.

The starting point for any communications plan is to know your audience. Most corporations' external audience falls into four broad categories:

- investors, including investment analysts and the financial press
- tax authorities, governments, local authorities, and regulators
- suppliers and customers
- non-governmental organizations, and pressure and community groups concerned with a wide range of public interest issues.

Once a company has a picture of its prospective audience, it needs to decide what "transparency" means for it in communicating with these groups. This meaning can vary depending on the stakeholder involved, the board's attitudes to disclosure and communication in general, and relevant regulatory requirements. Information should be useful and relevant to the particular stakeholder to avoid "over-reporting."

Once the company has decided what it wants to say to external stakeholders, it should consider what the board needs to know to transmit the right messages. The board's information requirements should be reviewed regularly to ensure they are up-to-date. Board briefing material will normally include information on strategy, risk profile, principles, current tax risks in each market and business, and controls and updates of financial information in appropriate detail.

*Communication of tax policies and attitudes can create competitive advantage.*

## Align responsibility to reporting

Clearly, a tax department needs to be able to implement the strategy the board has agreed to. The tax department has to be able to provide the board with information it needs to monitor progress, make decisions, and set targets. Responsibility should align to reporting. An example of how this might look in practice is shown below.



Although tax management involves numerous issues, it is possible to plot a sensible course between wholesale and gradual change within a coherent, high-level strategy. If companies focus, as we suggest, on what the market and other external stakeholders expect, they can achieve a great deal through a series of incremental steps, with limited disruption.

It's important for the board to remain fully informed throughout of the risks and opportunities of the various options, so that it can reach a properly informed judgment about what's appropriate for the organization.

## Conclusion

Companies that are fully in control of their tax affairs, know what is possible within the organization's particular constraints, and communicate this information effectively to their stakeholders are likely to be better regarded in the market than their competitors.

Further, companies that are too cautious in their approach to tax can risk losing out to competitors who see good tax management and transparency as a way to generate value. Thus, companies have much to gain by embracing greater transparency in tax affairs and investing in the necessary management expertise to run tax matters more effectively.

## Implications for the audit committee

The Audit Committee Institute believes that the audit committee has an important role in good tax management and communication. In its oversight role, the audit committee should have a good understanding and level of comfort with the company's process for identifying, managing, and reporting its tax affairs.

The following are three ideas the audit committee should consider in meeting these objectives:

1. Obtain a list of the major tax uncertainties facing the business and discuss their status with management. The list should include income taxes, transfer pricing issues, sales and local tax, foreign jurisdictions, etc.
2. Discuss the company's tolerance to tax risk with management. Involve the tax department, the CFO and CEO, and others making decisions impacting the company's tax position. Evaluate whether everyone is "on the same page".
3. Review the company's public disclosure of tax and tax uncertainties, ensuring it covers all major areas in a clear, meaningful way.

*Oversight of tax management and communication also rests with the audit committee.*

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative.  
© 2007 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. 3563