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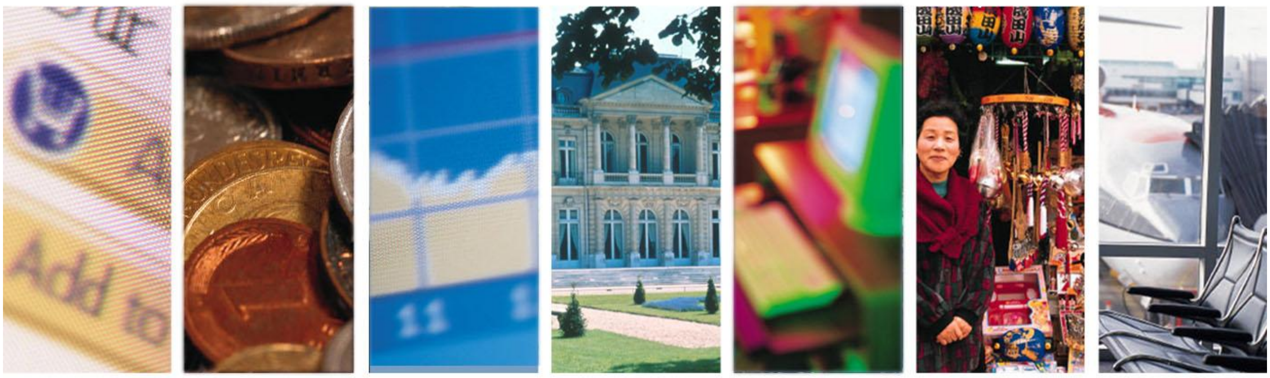

FORUM ON TAX ADMINISTRATION

Information Note

General Administrative Principles:

Corporate governance and tax risk management

July 2009

CENTRE FOR TAX POLICY AND ADMINISTRATION

Tax guidance series

Corporate governance and tax risk management

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ABOUT THIS DOCUMENT

Purpose

This information note deals with the topic of corporate governance and tax risk management. It shares and builds on the experiences and lessons of three countries, Australia, Canada and Chile in encouraging good corporate governance and continuing to develop approaches to sound tax risk management. Despite these countries' diverse regulatory environments and experiences they suggest a number of common benefits, challenges, and best practice considerations.

Background to the Forum on Tax Administration

Since its establishment in July 2002, the Forum on Tax Administration (FTA), a subsidiary body of the OECD's Committee on Fiscal Affairs (CFA), has operated with the broadly stated mandate "… *to develop effective responses to current administrative issues in a collaborative way, and engage in exploratory dialogue on the strategic issues that may emerge in the medium to long term …"*. To carry out this mandate, the FTA's work is directly supported by two specialist Sub-groups—Compliance and Taxpayer Services—that each carry out a program of work agreed by member countries. The Compliance Sub-group exists to provide a forum for members to:

- periodically monitor and report on trends in compliance approaches, strategies and activities;
- consider and compare member compliance objectives, the strategies to achieve those objectives and the underlying behavioural compliance models and assumptions being used;
- consider and compare member compliance structures, systems and management, and staff skills and training; and
- develop and maintain papers describing good country practices as well as develop discussion papers on emerging trends and innovative approaches.

Caveats

National revenue bodies face a varied environment within which they administer their taxation system and jurisdictions differ in respect of their policy and legislative environment and their administrative practice and culture. Similarly, a standard approach to tax administration may be neither practical nor desirable in a particular instance. The documents forming the OECD tax guidance series need to be interpreted with this in mind. Care should always be taken when considering a country's practices to fully appreciate the complex factors that have shaped a particular approach.

Inquiries and further information

Inquiries concerning any matters raised in this information note should be directed to Elizabeth Goli (CTPA Tax Administration and Consumption Taxes Division) at e-mail (Elizabeth.Goli@oecd.org).

EXECUTIVE SUMMARY

Key points:

1. Corporate Boards are accountable to their shareholders for ensuring appropriate corporate governance practices.

2. Good corporate governance is fundamental to good business. The importance of good corporate governance and greater transparency is highlighted by the current global financial crisis.

3. How a large business manages tax risk can affect its financial performance and reputation. CEOs and Boards of large businesses are increasingly considering tax risk management as part of their overall corporate governance.

4. Tax administrations have a vital role to play in ensuring that corporate boards understand that they are ultimately responsible for their business's tax strategies and outcomes. Tax administrations are increasingly focussing on encouraging good corporate governance and enhancing relationships with large businesses.

5. This information note looks at the experiences of three countries, Australia, Canada and Chile in encouraging good corporate governance and enhancing relationships with large business. Despite these countries' diverse regulatory environments and experiences, they suggest a number of common benefits, challenges and best practice considerations.

6. These experiences suggest that large businesses that have good corporate governance and more transparent relationships with tax administrations can expect fewer audit interventions and hence greater certainty.

7. The purpose of this information note is to share the three countries' experiences to assist tax administrations to engage Boards and CEOs of large businesses in dialogue about corporate governance and tax risk management.

PART 1: INTRODUCTION

8. This information note is part of the Organisation for Economic Co-Operation and Development's (OECD's) Tax Guidance Series of strategic management papers focussing on General Administrative Principles.

9. The information note deals with the topic of corporate governance and tax risk management. It was developed in consultation with a number of OECD members following the Fourth meeting of the OECD Forum on Tax Administration (FTA) in Cape Town South Africa in January 2008 that built on the FTA's 'The Seoul Declaration'[1] in relation to achieving an enhanced relationship between tax administrations and large business taxpayers.

10. Enhancing relationships between tax administrations, taxpayers and tax intermediaries and encouraging good corporate governance is a vital issue for both tax administrations and large business. The Seoul Declaration refers to:

"Encouraging management and audit committees of large enterprises (e.g. CEOs and boards of directors) to take greater interest in, and responsibility for, their tax strategies."

11. The Cape Town Communiqué[2] notes as "the way forward":

"…We also noted the work in progress to explore opportunities for the application of the OECD's Principles of Corporate Governance in the area of taxation and will continue to share experiences in undertaking dialogue with the Chairs and Boards of listed companies about the approach they take to managing taxation risks… ."

"…we will continue to encourage a global dialogue with large corporate taxpayers and their advisers…."

12. This information note shares and builds on the experiences and lessons from Australia, Canada and Chile in continuing to develop approaches to tax risk management that encourage good corporate governance and enhanced relationships with large business.

13. The case studies of the three countries' experiences suggest a common set of best practice considerations that may assist other tax administrations to encourage dialogue with large businesses about good corporate governance and tax risk management.

[1] OECD Forum on Tax Administration 2006 Meeting.

[2] OECD Cape Town Communiqué 11 January 2008

PART 2: BACKGROUND AND RECENT DEVELOPMENTS

The importance of good corporate governance

14. Corporate governance deals with the rights and responsibilities of a business's board, senior executives, management and employees, shareholders and other stakeholders. How well a business is run affects its performance and market confidence.

15. Good corporate governance is essential for businesses that want access to capital and for governments that want to stimulate private sector investment. Poor corporate governance on the other hand weakens a business's potential and at worst can pave the way for financial difficulties and even fraud[3].

16. The current global financial crisis reinforces the importance of good corporate governance. To some extent the current decline was driven by poor governance and reduced transparency in some businesses and markets. This makes it more difficult to see the true extent of risks and harder to form a view about business and market integrity, which in turn contributes to less informed business decisions and risk of financial collapse.

17. Good corporate governance is central to the integrity of business, financial institutions and markets. It underpins decision-making including how a business manages risk and how it chooses to implement or not implement transactions and business strategies.

18. How a large business manages its tax risk can have a significant impact on its financial performance and reputation. CEOs and Boards of large businesses are increasingly considering tax risk management as part of their overall corporate governance approach. In a speech to the tax Executives Institute Conference in Washington DC Jeffrey Owens, Director OECD, Centre for Tax Policy and Administration observed:

"Tax has ceased to be something that just interests tax directors. The press is taking an increasing interest in tax issues. Newspapers such as the Financial Times and the Wall Street Journal now run front page headlines on the way some companies have been targeted over tax avoidance, the intention of a company to shift its headquarters offshore."[4]

19. Tax risk is generally attributable to uncertainty about the interpretation of tax law in relation to particular transactions and the business's view about whether a tax administration could have a different view to its own or the view of its advisors.

20. The experience of Australia, Canada and Chile suggest that enhanced relationships with large business go a long way towards reducing uncertainty. An Australian large business suggested that early and transparent consultations with the tax administration results in fewer audit interventions and is improving certainty.

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[3] OECD Directorate for Financial and Enterprise Affairs, Corporate Governance Principles, Frequently asked questions about the OECD Principles of Corporate Governance.

[4] Tax Executives Institute Conference, Washington DC, Speech by Jeffrey Owens - Director OECD, Centre for Tax Policy and Administration, 19 March 2007

Recent developments

21. Many large businesses have changed the way they approach corporate governance, compliance, and business ethics. This largely reflects an environment of heightened community sensitivity to corporate governance and social responsibility.

22. Countries are introducing legislation and standards that require large business to provide greater transparency in their financial reporting. Notably the Sarbanes-Oxley ('SOX') legislation in the United States of America established new standards for all U.S.A. public company boards, management and public accounting firms[5]. For example, SOX 404 requires that policies for key strategies and risks need to be documented and reported.

23. The importance of tax in this space is highlighted by the observation that in the first year of SOX the tax function accounted for around one third of 'material weaknesses' that were reported – and this trend seems to be continuing.[6]

24. Also in the United States of America FIN 48 now requires an analysis of material tax positions in financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes.*[7]

25. FIN 48 and SOX are not only relevant to U.S.A. based multinationals. They can also apply to U.S.A. subsidiaries of foreign based large business and other non U.S.A. entities that are registered with the U.S.A. Securities and Exchange Commission.

26. Leading practice boards in many countries are mandating that tax risk be managed like any other enterprise risk. Recent international surveys by major accounting firms indicate that tax risk management is increasingly gaining acceptance at board level[8]. Findings include that senior executives are increasingly looking for better insights into tax because of its potential material impact on financial statements and that the tax function can no longer focus solely on tax compliance and managing the effective tax rate. CEOs and boards are asking more complex questions about how their organisation manages its tax risk exposure.

27. There is now a greater awareness of tax in the boardroom. As Jeffrey Owens observed:

"What is clear is that the recent spate of corporate scandals, the success of a number of tax administrations in challenging aggressive tax schemes and the general change in attitudes towards tax planning, will all combine to produce a greater awareness in the Boardroom of the importance of tax issues." [9]

The importance of enhancing relationships

28. There is a general move by tax administrations towards more collaborative approaches that are built on mutual respect, trust and transparency. This was recognised by Deputy Secretary General, OECD Pier Carlo Padoan, during his opening statement at the fourth meeting of the FTA:

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[5] Sarbanes-Oxley Act of 2002, United States of America.
[6] Tax Risk Management, Ernst and Young, LexisNexis Butterworths 2007.

[7] The Financial Accounting Standards Board (FASB) issued interpretation no. 48, *Accounting for Uncertainty in Income Taxes- an interpretation of FASB Statement No. 109* (FIN 48).

[8] Tax risk: External change, Internal Challenge - the Australian Perspective: Global Tax Risk Survey 2006-2007, Ernst & Young 2007.
[9] Good Corporate Governance: the Tax Dimension – OECD Forum on Tax Administration- September 2006.

"When I look around the OECD and beyond I am struck by the number of countries that are currently reviewing how they interact with taxpayers and looking for new ways to achieve better tax compliance."[10]

29. The Communiqué which issued following the fourth meeting of the FTA summarised the benefits of enhanced relationships between tax administrations and taxpayers:

"An enhanced relationship offers benefits for revenue bodies as well as taxpayers…taxpayers who behave transparently can expect greater certainty and an earlier resolution of tax issues with less extensive audits and lower compliance costs. An enhanced relationship between revenue bodies and tax intermediaries would also yield significant benefits."[11]

30. Both tax administrations and large businesses want greater certainty. Tax administrations look for certainty around voluntary compliance with tax laws and large businesses having good governance arrangements in place. Large businesses look for certainty about which of their behaviours and transactions the tax administration is likely to see as risky, and how the administration is likely to respond to those risks.

31. Several tax administrations have introduced and are further developing initiatives that encourage large businesses to consider good corporate governance and enhanced relationships that support tax risk management. The following parts of this information note discuss the experiences and lessons from Australia, Canada and Chile in this increasingly important area of tax administration.

[10] Opening Statement by Deputy Secretary General, OECD, Pier Carlo Padoan, Forum on Tax Administration Meeting, Cape Town, South Africa, 10-11 January 2008

11 OECD Forum on Tax Administration Cape Town Communiqué January 2008.

PART 3: LESSONS FROM THREE COUNTRY'S EXPERIENCES

32. Despite different business and regulatory environments in Australia, Canada and Chile, our diverse experiences have identified a number of common benefits, challenges, and suggested best practice considerations.

Benefits

33. Tax administrations are an integral part of the changing environment in which large business operates. This requires an approach to managing tax compliance that is dynamic. By moving to a more consultative and collaborative relationship, the tax administration can better understand the business and its environment. The administration is therefore better placed to identify risk and help business to improve certainty through ongoing open dialogue.

34. By appropriately considering and working to reduce significant tax risks, boards of large businesses can increase the standard of their corporate governance and their awareness of the implications of major transactions. The standard of corporate governance has a direct bearing on whether a company has a high, moderate or low tax risk level.

35. Tax administrations focus the majority of their large company compliance resources on high risks, particularly where taxpayers are not transparent, open and compliant. Large businesses that have good corporate governance practices and enhanced relationships with the tax administration will generally experience fewer audit interventions. This contributes to greater certainty and the potential of reduced tax compliance costs.

36. Dialogue between the tax administration and large business about tax risks in 'real time' – or as close as possible to the time of the transaction if not earlier, can reduce the incidence of tax shortfalls and administrative penalties. There are also significant benefits for the large business as it can address any concerns that the tax administration has whilst the details are fresh in the 'corporate memory'.

Challenges

37. The following challenges may arise for tax administrations in promoting good corporate governance and enhanced relationships with large business:

- Building a relationship of trust with some large businesses may be challenging where there is a history of audit interventions by the tax administration.
- How to build an environment that supports more collaborative and differentiated approaches - including the administration's legislative and administrative framework and its organisational culture.
- How to develop and articulate clear procedures and other support mechanisms that help large business and tax administration staff implement collaborative approaches.
- The requirement to have professional and well qualified staff that have good relationship management skills.

- The need to be responsive. Tax administrations must be aware of their capability to assist a number of large businesses in a satisfactory and timely way. This may require different organisational arrangements and ways of prioritizing work to ensure responsiveness.

Suggested best practice considerations

38. The following considerations may assist other tax administrations to encourage good corporate governance and enhanced relationships with large business.

39. It is essential to work towards a relationship of trust between business and the tax administration. In order to build trust, tax administrations should consider starting with the assumption (unless there are indications to the contrary) that large businesses:

- Closely manage and scrutinise their material risks and issues.
- Minimise their compliance risks through effective internal controls.
- Seek to properly apply the law.

40. By starting with these assumptions, tax administrators can focus on developing relationships built on mutual respect, transparency and openness.

41. Engaging large businesses early in the design of initiatives or approaches to improve tax risk management can also be effective in building trust.

42. Tax administrations could consider initiating direct dialogue with CEOs, directors and boards about the administration’s expectation that they to recognise their role in ensuring that the business has good corporate governance approach to managing tax risks.

43. A good governance approach in relation to tax might include the following features:

- A sound framework to manage tax risks and comply with tax obligations.
- A well resourced in-house tax capability.
- Reporting requirements that ensure that significant tax risks are elevated to decision makers such as the CFO, CEO, the Board or its Audit Committee.
- Appropriate review and sign off procedures for material transactions.
- An effective tax risk mitigation capability including the business’s relationship with the applicable tax jurisdictions.
- Capacity to regularly evaluate the effectiveness of tax governance systems.

44. Where large business directors and senior management ask for practical advice about steps they might consider to better understand their business’s level of tax risk, the tax administration could suggest that they:

- Have a broad understanding, at least from a financial and business perspective, of the major tax issues that arise in the normal ongoing operations of the business.

- Make enquiries about or establish reporting procedures to identify material risks so as to provide a level of confidence that corporate processes promote tax compliance.

- Consider, from a financial and business perspective, the tax implications of major transactions, business structures and strategies.

- Oversee the overall amounts of different taxes paid by the business; be aware of whether these amounts are increasing or decreasing, and how the tax administration is likely to perceive these trends.

- Be aware of the relationship the business has with tax jurisdictions, the level of scrutiny of its affairs and the stance that it and its advisers adopt in relation to tax compliance and tax planning.

45. Attachment A gives a more detailed example of questions that boards and senior managers may want to consider to ensure that they understand the level of tax risk. These questions are based on the Australian Taxation Office Corporate Governance Guide for board members and directors.[12]

Other supporting strategies

46. Tax administrations could consider the following strategies:

- Collaboration with relevant associations and institutes to ensure tax risk management is included in the curriculum for corporate governance certification programs and related workshops.

- Active communication with large businesses, intermediaries, accounting, industry and law associations in order to increase their awareness of its compliance strategies, activities and perceived risks.

- In accordance with the recommendations of the recently released OECD study - work with tax intermediaries to enhance their role in promoting good governance and compliance. For example, consider how they can help to reduce the tax risk of their clients.

- Engage bar associations, accounting associations and the professional tax communities to educate about the importance of good governance.

47. The three countries' experience indicates that having the following features in their large business compliance programs has helped to encourage good corporate governance and enhanced relationships:

- A robust risk-assessing approach that identifies non-compliance and poor governance as early as possible.

- Early and direct communication with CEOs, boards and senior managers about concerns the tax administration has about a business's governance and tax compliance.

[12] www.ato.gov.au/content/downloads/LBI82560.pdf

- A professional workforce with adequate resourcing to resolve compliance issues and respond to businesses in a timely manner.

- Appropriate legislative tools to ensure compliance.

- In relation to cross-border issues, good collaboration with other jurisdictions through treaties and exchange of information agreements.

- Special diligence and strong deterrence where there is evidence of the inappropriate use of tax avoidance or tax havens.

- Where poor governance is widespread consider legislative solutions that place responsibility on senior executives and boards.

PART 4: CASE STUDIES

48. This part comprises case studies from Australia, Canada and Chile that describe different experiences in promoting good corporate governance and enhancing relationships with large businesses. The Australian case study includes a perspective provided by a large business describing features of how they manage themselves, their tax risk governance and interaction with the Tax Office.

Australia – Australian Tax Office perspective

49. Capital raising in Australia is primarily conducted through the Australian Securities Exchange (‘ASX’). At June 2008, there were 2226 businesses listed on the ASX with a domestic market capitalisation of A$1.29 trillion. The ASX has issued principles and best practice guidance for corporate governance and managing risk.

50. Other key corporate regulators include the Australian Securities and Investment Commission which ensures that Australia’s financial markets are fair and transparent, and the Australian Prudential Regulation Authority which is the prudential regulator of the Australian financial services industry. The Australian Taxation Office (‘Tax Office’) is the principal revenue collection agency.

51. Australia’s approach to managing large corporate tax compliance is explained in its 2006 *Large business and tax compliance booklet* (‘the booklet’)[13]. This publication, which was designed in collaboration with large business, outlines what the Tax Office sees as good governance and its expectations of large business.

52. The Commissioner of Taxation has written twice to the boards of Australia’s largest public businesses about good governance and the board’s role and responsibility in relation to taxation. He suggests that the board has the ultimate responsibility for corporate tax risk, including deciding how much risk the company is prepared to accept. To help board members manage this responsibility the Tax Office published a *Governance guide for board members and directors*. The Commissioner continues to elaborate these themes in speeches and key publications to the business community.

53. In 2006, the Tax Office established a program of relationship management meetings with the largest 100 Australian businesses. These meetings are a key part of the Tax Office’s strategy of building a relationship based on trust. They provide an opportunity for senior business and senior Tax Office executives to discuss risk management and governance approaches, for example what works and what doesn’t, what they are seeing and its impact, etc.

54. In May 2008, the Tax Office introduced the Annual Compliance Arrangement (‘ACA’) for the top 50 businesses. The ACA gives practical certainty for large businesses that have good corporate governance and are willing to work collaboratively with the Tax Office. The ACA requires the business’s CEO to give a written assurance that the company meets the Tax Office’s corporate governance guidelines (refer attachment A) and that it has a genuine commitment to disclosing material tax risks. Large businesses that choose to have an ACA are able to manage their tax risks and compliance from a position of greater certainty.

[13] www.ato.gov.au/content/downloads/77898_N8675-08-2006_w.pdf

Australia – A large business perspective

55. We recently asked a large Australian multinational business for its perspective on what good governance in relation to tax risk management looks like. This is summarised as follows:

- Robust day to day accounting & control mechanisms.
- Strong internal control mechanisms.
- Independent external audit committee.
- Separation of the role of external auditor and external tax advisor.
- Tax operating standard/code of conduct and assurance processes to confirm adherence.
- Clear accountabilities in relation to tax decisions.
- At least half yearly letters of assurance to internal audit/CFO in relation to tax expense, deferred and current tax provisions, provision for tax uncertain positions.
- Adequate resourcing of the tax function.
- Use of the Tax Office rulings system for material transactions.
- Openness and transparency with tax officers.
- Board & senior management have a line of sight on tax risk management - they are aware of the risks & issues & know what transactions the revenue authority is likely to view as risky.
- Good relationship, i.e. clear expectations, clear contact & escalation points, ongoing dialogue with the Tax Office.
- Responsive to changes in the environment, law etc.
- Tax is considered as part of the decision making process for major transactions.

Canada

56. Canada has a relatively small capital market. There is a high concentration of closely held businesses with over 25% of the largest 300 listed businesses having a controlling shareholder. More that 50% of the market capitalization is inter-listed on U.S.A. stock exchanges.

57. Securities regulation falls under the responsibility of the Provinces and Territories, each having their own legislation and securities regulatory authority. The Canadian Securities Association harmonises the securities regulatory approach across the country. The Criminal Code, a federal statute, applies across provincial and territorial boundaries and provides sanctions for corporate transgressions.

58. The Canadian system can be generally described as a principle-based self regulatory approach. As such, the response to recent events in the corporate world has not been as swift or as comprehensive as the U.S.A. Sarbanes-Oxley Act but there have been changes.

59. To further restrict insider trading and to protect corporate whistle-blowing, the Criminal Code was modified to implement tougher penalties for those convicted of corporate crimes.

60. Several new independent oversight bodies were created to improve public confidence in the system. These include the Canadian Public Accountability Board, the Accounting Standards Board and the Auditing and Assurance Standards Oversight Council.

61. It is expected that the *Canadian Generally Accepted Accounting Principles* will be phased out in favour of International Financial Reporting Standards.

62. The Accounting Standards Board (Chartered Accountants of Canada) and Provincial securities regulators have implemented new standards for disclosures. Ontario has implemented a “liability-for-disclosure” regime that facilitates lawsuits by security holders. Most provinces and territorial securities regulators have adopted new rules governing audit committees and certification of financial statements.

63. The Canada Revenue Agency (‘CRA’) is revising its audit program to recognize the differences among large businesses with respect to the strength of their governance and their willingness to deal with CRA in an open and transparent manner. In brief, audits will be eliminated or targeted to specific issues where there is evidence of strong governance and a willingness to work with CRA on an open and transparent basis. Agency resources that are saved from this reduction in auditing will be re-focused to address taxpayers whose governance is weak, or purposely risk tolerant, as well as taxpayers who do not operate in an open and transparent manner. An important feature of this approach will be that CRA will advise the taxpayer of how the Agency perceives their governance, openness and transparency, along with other risk factors and accordingly, the compliance approach that will be utilized.

Chile

64. Chile has a small capital market. As of December 2008, 1994 companies are included in the list of the Large Businesses Unit of the Chilean tax administration (‘SII’). More than 50% of the total tax revenue is paid by these large taxpayers.

65. Chile has made recent important progress in improving rules regarding corporate governance. These include among others, stronger rules and penalties against insider trading, improvement of information to be made available to the market, audit committees, information regarding trading made by Directors, Managers, controlling shareholders and other related parties.

66. As of December 2008, the SII has not formally addressed large corporations as to what is expected towards corporate governance as a specific issue regarding large taxpayers. However, currently the SII is developing some strategies to enhance tax risk management as an important aspect of a major strategic “segmentation” plan, where good corporate governance may be included as a positive attribution factor of the large corporations segment. In exploring and developing those strategies, the SII experience and its vision towards corporate governance and tax risk control for large corporations is based on transparency, truthfulness and openness.

67. The SII promotes the inclusion of tax risk control into corporate governance through the following approaches:

- Providing opportunities for large corporations to obtain more tax certainty in a transparent and truthful context through real time auditing.

- Implementing a tax audit function based on tax risk assessment processes.

- Giving timely responses and facilitating closing of pending cases. SII is carrying out a great effort to respond timely according to real businesses terms, providing a higher tax certainty to specific transactions.

- Providing business with real-time assistance in specific transactions or elements of their auditing processes. This mechanism allows performance of auditing functions simultaneously in real time for businesses in a transparent environment. Indeed, directors and senior executives of large enterprises should disclose all the information. SII therefore achieves a better understanding of the business and reduces risks and costs involved in future audits.

- Exploring opportunities for collaboration and transparency, for example seminars, direct communication with directors and senior executives, SII assistance in important transactions, greater certainty and quick responses solving pending controversies, among other measures.

68. These measures can be achieved more easily through:

- Multidisciplinary working teams formed by highly qualified tax officials, (hopefully with previous experience in the private sector), which creates greater willingness and a better affinity with the business community; and

- Direct channels of communication between the tax administration and the corporation's board, senior executives and their legal and tax advisors.

69. From the perspective of a developing country, two main problems arise when implementing these new tendencies:

- The lack of an exhaustive legal framework which provides flexible tools for tax authorities.

- The fact that these new tendencies are not widely spread enough, not only within the Tax Administration but also in the business environment.

CONCLUSION

70. Tax administrations have a vital role to play in ensuring that Corporate boards understand that they are ultimately responsible for their business's tax strategies and outcomes.

71. Whilst still work in progress, the diverse experiences of Australia, Canada, and Chile in encouraging good corporate governance and enhancing relationships with large businesses highlight a number of common benefits, challenges, and suggested best practice considerations that other tax administrations may find helpful.

ATTACHMENT

Key governance questions

The following governance questions are reproduced from the Australian Taxation Office's *Governance Guide for Board Members and Directors.*

These questions are addressed to board members and directors of large businesses and are intended to help them better understand and manage their business's tax obligations.

The questions look at corporate governance from 2 perspectives:

1. Ensuring that the company has the accounting and control mechanisms needed to handle day to day tax and reporting requirements.

2. Ensuring that tax is properly considered as part of board and corporate decision making processes for major financial transactions, overall corporate strategies and when seeking or considering tax advice.

The questions ask Board members and senior management to consider the business's overall tax performance and the tax consequences of its major transactions or strategies.

Overall tax performance

1. Are you confident that your records and control systems enable your group to meet its tax obligations properly?

2. Are the amounts of tax you are paying and your pattern of tax payments in line with your current and previous business results?

3. Is there anything to indicate that your group's business results and tax payments are lower than would be suggested by economic conditions and the performance of others in your sector?

4. If your group is consistently reporting losses, are these real economic losses and can they be satisfactorily explained in terms of the group's overall performance? Is there a material difference between the losses reported for accounting purposes and the losses claimed for tax purposes? If so, can the difference be satisfactorily explained?

5. Is your group making the necessary changes to its processes and giving proper consideration to major transactions and strategies to take account of changes in the tax laws?

6. Are you aware of any material timing or permanent differences in the group's tax effect accounting and, if so, are you comfortable with the reasons for those differences?

7. Are there any areas of major disagreement between your group and the tax authority? If so, are you satisfied with the way they are being handled? Have any additional tax liabilities been adequately provided for?

Major transactions and strategies

1. What commercial objectives are being sought by the proposed strategy or the ownership and financial structure being proposed for a major transaction? Is there a genuine and material financial benefit for your group apart from any effect on the group's tax position? Are the tax results at odds with the commercial results?

2. If the structure and financing for your group's business or a major transaction is complicated, is this because the business issues are complex? Is it more complex than necessary to achieve the commercial objectives? Are there additional steps designed primarily to reduce the taxes that would ordinarily be payable? Is the form of the transaction or strategy consistent with the substance of the arrangement?

3. What level of confidence do you have in the correctness of advice you have received?

4. How likely is it that the tax authority will take a different view of the application of the law and assess the company accordingly?

5. If the tax authority takes a different view and the matter proceeds to litigation, what is the risk of the court deciding the matter in favour of the tax administration?

6. What is the potential downside if the company is unsuccessful in litigation with the tax administration?

7. If there is a dispute with the tax authority, what is the likelihood of the tax administration being prepared to settle the dispute and, if so, on what terms?

8. How likely is it that the tax authority will identify the tax issues arising from the proposed course of action? Allied with that, to what extent will embarking on the proposed course of action increase the tax risk profile of the company and the possibility of audit scrutiny?

9. Depending on the potential risk, and your need for certainty, would it be desirable to approach the tax authority for guidance?

10. Where a position has been taken on a tax issue, would it be desirable to be upfront with the tax administration by identifying the issues before or when lodging the tax return?

11. Is the advice based on the actual transaction or on an expectation of how the transaction will be implemented? Tax liabilities will arise from the actual transaction implemented and not any proposed or intended transaction on which taxation advice may have been sought at an earlier point. In such cases consideration will need to be given to the implications of any material changes that occur, or have occurred, in implementing the transaction.

12. Are you satisfied that the factual basis for the tax advice has been properly checked? The factual basis of a transaction or strategy critically influences the tax consequence. Senior decision makers may feel it prudent in assessing the tax risk to seek assurances on the accuracy of the facts. For example, were they independently verified or were statements of intention or other people's understanding of the relevant facts relied on? Does the factual basis stated for the transaction or strategy accord with your understanding of the matter? If the advice is based on any assumptions, are they reasonable and what would happen if they did not eventuate?

REFERENCES

Actualización del plan de prevención Del fraude fiscal
Spain's Agencia Tributaria is currently implementing a project focused on collaborating with large companies as part of a wider strategy for prevention of fiscal fraud. More information is available at: www.agenciatributaria.es/AEAT/Contenidos_Comunes/La_Agencia_Tributaria/Informacion_institucional/Campanias/Plan_prevencion_del_fraude_fiscal/actualizaFraude.pdf

Revenue Ireland The cooperative approach to tax compliance: Revenue working with large business, unpublished.

Revenue Ireland discusses large market corporate governance issues. The paper is not available online but can be sourced from Revenue Ireland (email Liam Gallager at ligallag@revenue.ie).

OECD (2008) Using the OECD Principles of Corporate Governance- A Boardroom Perspective, OECD, Paris.

This publication offers practical advice for boards on how to implement the OECD Principles of corporate governance. It provides practical help for boards to navigate from principles to practice.

Interviews and discussions with business executives from around the world demonstrate that good boardroom practice requires more than law, regulation and codes of conduct. The OECD emphasises that it is often the essential qualities of effective leadership including judgement and integrity which make the difference.

Rather than provide a checklist of what the board of directors should do this publication aims to describe how businesses can practice good corporate governance in reality.

The involvement of business executives from around the world in the development of this publication also reflects the importance that the OECD places in engaging the private sector in implementing good corporate governance.

OECD (2008) Fourth Meeting of the OECD Forum on Tax Administration, Cape Town Communiqué OECD, Paris

This communiqué summarises the discussions at the OECD FTA meeting of Heads and Deputy Heads of 45 economies including global trends in business and wealth management, and achieving an enhanced relationship between revenue bodies, taxpayers and tax intermediaries.

OECD (2008): Study into the Role of Tax Intermediaries, OECD, Paris

This report which initially focussed on the role of tax intermediaries in aggressive tax planning has broadened its focus into a wider review of the tripartite relationship between revenue bodies, taxpayers and tax intermediaries. It acknowledges the diverse experience of a number of countries and its conclusions include that having an enhanced relationship offers benefits for revenue authorities as well as taxpayers.

Ernst and Young (2007): Tax Risk Management

Written by industry practitioners including Ernst & Young, Freehills, Corrs Revenue Group and Greenwoods, *Tax Risk Management* addresses how to build a tax risk management framework, tax disputes and audits, high risk areas such as mergers and acquisitions, and tax risk management from a corporate perspective.

Ernst and Young (2007) The Tipping Point - where tax risk and internal audit meet.

Drawing on the findings of their two Global Tax Risk Surveys in 2004 and 2006 Ernst and Young say that effective teaming of tax and internal audit could be the way forward in helping to manage tax risk across the enterprise:

"This is all part of a wider recognition by boards and audit committees that in order to have a complete picture of an organisations risk profile, there needs to be proper consideration of the tax consequences of doing business."

"From a financial statements perspective, without effective processes and controls in place around tax, there is a significant possibility that the tax numbers and related financial information disclosed in the business's annual accounts could be inaccurate or incomplete."

Ernst & Young believe that one way of managing this risk is to integrate tax into the business's enterprise wide internal audit program to ensure that all tax issues are identified and given appropriate scrutiny.

Ernst and Young report that their 2006 Global Tax risk survey indicates that 35% of businesses are planning to increase internal audit involvement in the review of tax processes and controls over the next 12 months. They advocate that this approach will help to reduce the overall tax risk profile of the business and potentially increase its competitive advantage.

Tax Executives Institute Conference, Washington DC, Keynote speech by Jeffrey Owens, Director-Centre for Tax Policy & Administration, OECD (19 March 2007)

This speech gives an international perspective on the debate over tax and governance and raises the key question of how governments around the world can work together to resolve these issues and how the tax community can be part of that dialogue.

KPMG Discussion Paper: The Governance of Tax (2007)

KPMG believe that recent changes in the tax environment require the increased transparency within businesses to be extended to the relationships they have with external stakeholders including tax authorities.

KPMG say that tax authorities are moving more towards risk-based approaches to compliance. The note that Australia and the U.K. have already adopted this by allocating resources to those taxpayers considered to be at a higher risk of non compliance when benchmarked against a number of different risk factors. KPMG expect that other OECD countries will follow suit. They comment that some taxpayers are beginning to respond to this by assessing their own tax risk profiles as part of an overall review of the tax function:

"KPMG welcome these discussions as heralding a higher level engagement between authority and taxpayer."

A recent KPMG survey in the UK found that the number of businesses with board-approved tax strategies has increased - 84 percent of respondents said that tax governance was rising up the board agenda.

KPMG consider that this is driven by a desire for 'no surprises' and a recent emphasis on improving tax reporting through new accounting rules, such as the U.S. FIN48, and Sarbanes Oxley.

KPMG conclude that although each company will approach the modernisation of its tax function in its own way, the overriding requirement when making decisions about how tax will be managed is that the board are kept fully informed of both tax risks and opportunities.

KPMG (2007) Tax Governance Institute: The role of the audit committee in the management of enterprise tax risk

This web cast brought together a panel of U.S. tax professionals including Kitty Dindo - Vice President and Chief Risk Officer First Energy Company, Maurice Agresta - Vice President Tax UPS, and Larry Bradley - KPMG Lead Audit Partner.

Dindo highlights that tax risk should be viewed as part of the board and the audit committee's broad enterprise risk management and that nothing else apart from income recognition has greater influence on net income than income taxes.

Bradly adds that tax is not only an audit committee issue but is the responsibility of the board. Agresta comments that a more significant tax risk could potentially harm a business's reputation: "You can always borrow money to pay a penalty or an assessment but you can't borrow a reputation."

Bradly comments that in his experience as an external auditor he has observed income tax material weaknesses where there has been a failure of communication between corporate functions. He said that issues are likely to result where tax is viewed only as a compliance function: "How often is a tax director the last person to be informed about an impending business decision such as shutting down a factory, that may have certain tax implications?"

Agresta suggests the following items should be put before the audit committee:

- The corporate tax department's mission and strategy, tolerance for risk and performance measures.
- Details of tax personnel, how many, level of expertise, responsibilities and how do they interact with consultants?
- What are the significant tax strategies, major issues and initiatives?
- The business's effective tax rate and comparisons with similar entities.

KPMG (2007) The Rising Tide – regulation and stakeholder pressure on tax departments worldwide

KPMG presents the findings of two surveys of 753 tax professionals in major businesses and multi-nationals in 19 countries. The key findings included:

- As evidence of the increasing focus on tax risk management and the tax function, nearly half (45 percent) of respondents said shareholders now expect to receive more information on their business's tax policy than they have in the past.
- Increasingly, investors, corporate executives and board members are demanding better insight into tax because of its material impact on financial statements. In the United States, for example, hundreds of businesses in the past two years have reported tax-related material weaknesses to the SEC under SOX 404.
- Despite this, only a minority (48 percent) of respondents have a formal tax risk management strategy and even fewer (40 percent) say it is a rising priority.
- When asked if they believe their business's tax risk management strategy is "well understood'' throughout the organization, only 14 percent of respondents agreed.
- Boards and tax executives should address the tax risk assumed by their businesses before they become aware of it for the wrong reasons. An assumption that tax risks are under control will not provide the transparency demanded in these times of heightened sensitivity to corporate governance and social responsibility.

International Network for Tax Research - Good Corporate Governance – The Tax Dimension

This paper was prepared by Jeffrey Owens from the OECD Centre for Tax Policy and Administration for the Symposium on Tax and Corporate Governance held in Munich on December 8-9, 2006, and co-organized by the International Network for Tax Research (INTR), the Max Planck Institute for Intellectual Property, Competition and Tax Law and the German IFA branch. The paper addresses the link of tax and corporate governance by highlighting several important interconnections.

International Network for Tax Research - Taxation and Corporate Governance: An Economic Approach

This paper was prepared by Mihir A. Desai of Harvard Business School and Dhammika Dharmapala of the Universities of Connecticut and Michigan for the Symposium on Tax and Corporate Governance, held in Munich on December 8-9, 2006, and co-organized by the International Network for Tax Research (INTR), the Max Planck Institute for Intellectual Property, Competition and Tax Law and the German IFA branch. The paper analyses from an economic viewpoint how the tax system and corporate governance arrangements interact. In particular, it explores how agency problems create such interactions and, conversely, how taxation can interact with the various mechanisms that have arisen to ameliorate the corporate governance problem.

Ernst & Young (2006-2007) External change, Internal Challenge - the Australian Perspective: Global Tax Risk Survey

Ernst and Young's 2006 global tax risk survey demonstrates that businesses have increased their investment in tax risk management and that risk continues to be a key measurement of tax performance.

Ernst and Young asked tax directors to highlight the challenges facing their tax departments, where they focus their efforts, how they're measured, staffing issues, and how they address internal and external influences. They also asked a smaller group of senior financial executives to share their views on the governance challenges they face in relation to tax.

According to Ernst and Young the survey shows:

- High levels of awareness and communication between the tax function and senior executives, and a reasonable level of confidence about the influence and profile of the tax function.
- An effective tax risk framework must be aligned with the business's risk philosophy and must be developed in conjunction with senior management and perhaps internal audit – taking into account a rounded view of risk.
- Tax planning opportunities related to commercial dealings need to be carefully evaluated in the light of the business's risk profile.
- Leading organisations ensure that their tax risk frameworks are monitored and are coherent and flexible, and that they are capable of being updated to deal with emerging risks.
- Tax authorities are increasingly taking a business operational view of risk and a company tax function that fails to do the same thing could be missing areas of concern.

UK HM Revenue and Customs (February 2006): Business Tax on the Boardroom agenda – The views of business

HMRC published the results of a survey that canvassed the views of over 500 Chairmen of UK based large businesses.

The survey findings in respect of tax risk management and corporate governance included:

- Boards want greater senior level communication with HMRC- strategic and policy matters were at the top of the list, however, nearly half of the respondents felt that tax risk management, costs of compliance, legislative change are of high importance.
- 86% of boards identified management of the tax function as their greatest risk. Over half cited reputation, corporate governance, and tax authority challenge as risks of equal importance.

- Most boards said they were reluctant to share audit and corporate governance documentation with tax authorities unless there are clear benefits such as reduction in compliance costs and greater understanding of tax risks.

HRMC highlights that tax and corporate governance was discussed at a joint conference they held with the Chartered Institute of Taxation in October 2005 where Loughlin Hickey, KPMG's Global Managing Tax Partner, said that global issues were driving tax onto boardroom agendas. He urged the UK to lead the debate:

"…a corporate's relationship with Government matters, and an emerging challenge will be to establish the role of HMRC in boardroom relations."

Hickey emphasised that the level of trust will determine the quality of that relationship. Emphasising the importance of mutual understanding and respect, he suggested that both Government and business should develop the ability to empathise but remain tough.

KPMG (2004) Discussion Paper: Tax in the Boardroom

KPMG comment that in order to meet the expectations of stakeholders such as Governments and the public, company boards are coming under growing pressure to oversee tax affairs. KPMG say there is a growing belief at director level that tax needs greater board level attention:

"Our discussions with senior managers suggest they too are beginning to see tax as a board issue. The penny started to drop that tax was a big number on the balance sheet, as one survey respondent put it."

KPMG observes that in the UK, Australia and the US, efforts are being made to align tax regulation with modern corporate governance legislation and guidance.

This report concludes:

"A constructive debate amongst interested parties can help provide the compass Boards need to find their way….The compass may already exist within the tenets of good corporate governance, but tax raises its own distinctive issues which have yet to be assimilated into the governance framework. A specific debate about tax, embracing a wide range of the business community, is in everyone's best interest."

OECD (2004) Principles of Corporate Governance, OECD, Paris

The OECD Principles of Corporate Governance provide a set of corporate governance standards and guidelines. These principles have broad support across major markets and are regarded as an international benchmark for policy makers, investors, businesses and other stakeholders.

The OECD describes the basic elements of an effective corporate governance framework:

- Promoting transparent and efficient markets.

- Protecting and facilitating the exercise of shareholders' rights.

- Ensuring the equitable treatment of all shareholders.

- Recognising the rights of stakeholders and encouraging active co-operation between businesses and stakeholders.

- Ensuring that timely and accurate disclosure is made on all material matters including the business's' financial situation, performance, ownership and governance.

- Ensuring the strategic guidance, the effective monitoring of management by the board, and the board's accountability to the company and shareholders.