CHANGING ATTITUDES TO TAX REPUTATION RISK

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In recent years, it seems that any discussion of tax includes mention of the moral obligation taxpayers have to "pay their fair share." Many believe this theme began to get traction in 2011 when Warren Buffett realized that he was paying proportionately less taxes than his staff. Even though Mr. Buffett is an extremely wealthy business magnate, he did not keep this observation to himself. On the contrary, he publicly stated that he believed the system should tax the "super-rich" at higher effective rates than the average worker (the "Buffett Rule"). Since that time, the "fair share" tax debate has been on the agenda of media and politics around the world.

In the US, the *Paying a Fair Share Act* – aimed at achieving at least a 30% effective tax rate on multimillion dollar earners – was tabled in 2012 but, in truth, never really got out of the starting blocks. Notwithstanding that, the issue doesn't seem to be going away as the "Buffett Rule" has recently reappeared in President Obama's 2016 budget proposal.

In Europe and Australia, the media coverage, as well as the public and political debate, on this issue seems to be even more vociferous than in the US. Most "developed" countries are vigorously addressing fair payment of tax, with the UK, France, Germany and Australia being at the forefront.

Historically, companies have focused their performance metrics to deliver growth in profits **before** tax. In other words, tax was an afterthought as far as measuring corporate performance was concerned. Has the change in public attitude to tax planning resulted in a world where such planning can actually affect business and profits?

Two Pronged Approach: Domestic Legislation and International Coordination

Getting large corporate enterprises to change their behavior can be challenging, particularly if the targeted behavior is difficult to measure or identify, perceived to be a mechanism by which shareholder value is maximized, or takes place across multiple jurisdictions. As a response to these challenges, it seems many jurisdictions have decided to take a two pronged approach by implementing legislation domestically, while at the same time coordinating compliance efforts on an international basis. With the support of many non-governmental organizations seeking to "out" companies that use aggressive tax planning techniques, it seems that governments across the world are happy to encourage the public to see blurred lines between tax mitigation and tax evasion, put senior executives in front of parliamentary or Congressional committees to explain their actions and, occasionally, comment publically on the tax affairs of individuals and companies.

As a result of these deliberate public relations campaigns, it is clear that attitudes to tax reputational risk have and will continue to change.

Changing the Rules of the Game

Various governments have proposed and implemented plans to make existing tax planning structures less effective. These changes can be seen at national government, EU and global levels.

Most prominently, the UK's introduction of the "diverted profits tax" aims to tax profits that companies shift out of the UK by channeling their sales through low tax jurisdictions. Combine this with the public relations campaign promise to publically "name and shame" serial users of tax avoidance schemes and you can clearly see the two pronged approach in action. The UK also recently issued a "consultation document" to obtain input on "measures intended to improve large business tax compliance". The measures would include items to address: (i) a requirement that large businesses publicly disclose their tax strategy, (ii) establishment of a "Code of Practice" to define acceptable tax behaviors, and (iii) a defined way to deal with businesses that persistently undertake aggressive tax planning.

In Ireland, the Revenue is phasing out the "double Irish" structure that had been a tax planning favorite. Additional pressure is being applied by the EU Commission's ongoing investigation of transfer pricing arrangements of Apple, Starbucks and, for good measure, Fiat in several EU member states for compliance with EU rules on state aid.

On an international level, the OECD's BEPS initiative is currently drafting the legislative blueprint to combat legal, but allegedly unfair, profit shifting to low tax jurisdictions where there is no or little economic activity. Stakeholder input and public consultations are ensuring there will be an internationally broad level of agreement regarding the measures to be implemented domestically. In addition and for the first time ever in tax matters, non-OECD/G20 countries are being involved on equal footing in the construction of the OECD's blueprint.

Of massive significance is the OECD's proposal to implement country-by-country reporting requirements, which are intended to add greater transparency to multinational groups' profit allocations. This is a big step towards a coordinated effort to reduce the incidence and effectiveness of international tax planning structures. Critically, the question remains as to what information will enter the public domain that can then be used to fuel the public relations campaign against perceived tax evasion.

The first set of OECD reports was released in September 2014. Combined with the work to be completed in 2015, the intent is to give countries the tools they need to ensure profits are taxed where the economic activities generating the profits are performed and where value is created. At the same time, implementation of these proposals in the local jurisdictions is intended to give business greater certainty by reducing disputes and tax leakage due to uncoordinated application of international tax rules between involved countries. These 2014 outputs will be consolidated with the remaining 2015 deliverables to ensure a coherent package will be delivered to the G20 Finance Ministers in October 2015, together with a plan for the follow-up work and a timetable for implementation.

With Pressure Mounting, How is Business Responding?

Two fundamental observations can be made in terms of changing attitudes to tax planning. First, aggressive tax planning means taking a business risk in today's transparent world. Second, being technically tax compliant with the letter of the law doesn't seem to be good enough anymore.

Several global corporations – and a few celebrities – are starting to see their reputation being publicly tainted by accusations of not paying their "fair share" of tax. For consumer brands, it's their most influential stakeholders, i.e., their customers or potential customers, who are being influenced by negative press. In the past, the dispute between businesses and tax authorities was about whether or not a certain tax plan was permissible under the law. Now the debate has crossed-over into what media reports and the public believe is fair. It's a simple truth that public opinion, even if based on inaccurate information, can be very powerful. If reputational damage adversely impacts profits or earnings, tax ceases to be an afterthought. It becomes a business risk that needs to be actively managed and monitored.

Initial responses in this context have been Starbuck's "voluntary tax" commitment in the UK by way of refraining from tax deduction claims for royalties and intercompany charges – despite being legally permissible. More recently, Amazon announced it would report its UK, Germany, Italy and Spain revenues domestically in each of those jurisdictions, thereby potentially increasing the tax base and tax revenues in these countries. Vodafone has gone even further and adopted a detailed 14 page tax code of conduct renouncing "artificial tax arrangements" defined as follows:

> *The use of such arrangements would be "artificial" where there is otherwise no commercial purpose for the activities or if the attribution of profits or other benefits to a jurisdiction were not based on the actual activities and capabilities but merely on a contractual description of rights for which no capability exists. Other artificial arrangements could include the provision of debt where there is no commercial rationale, provision of goods and services where there is no benefit to the recipient, the routing of transactions either financially (for withholding tax) or physically (for VAT) through companies which play no part in the underlying commercial arrangements.*

Currently, non-consumer facing brands may be largely spared from public outcry, but will nonetheless be subject to stricter tax legislation and enforcement following BEPS implementation or purely domestic measures. Nothing seems to be more attractive to the tax authorities around the world than the US$2.1 trillion kept overseas by US companies (as recently reported by Bloomberg) and whether those funds have been adequately taxed.

Should Businesses Prepare for a Turn of the Tide?

As a result of developments in the last years, it is becoming increasingly important that multinational corporate groups adopt a comprehensible and justifiable policy in relation to tax planning. Since tax planning may now significantly affect business, top management needs to not only be aware of potential tax planning risks and its effect on business and operations, but also to be in a position to explain the company's tax policy to the public if necessary.

The following questions may be helpful in guiding internal discussions related to this emerging business risk:

- Can our tax planning taint our public image?
- Can our tax planning affect our business and profits?
- Can our tax planning become a competitive disadvantage?
- Are our competitors doing better than we are in managing their tax reputation?
- Do our customers value good corporate citizenship?
- Would going above and beyond the call of duty with respect to our tax strategies boost our business and image?
- Could we use responsible tax planning to our competitive advantage?
- Are the tax planning methods we use artificial or too aggressive?
- What are the real and long-term cash benefits of our tax planning?
- How do the real benefits compare to the potential business risk?
- Does top management understand our tax planning methods?
- Can top management explain our tax planning methods in front of an aggressive committee hearing?
- Do we need a code of conduct for tax?
- Do we need a tax compliance officer?
- Are there ways to mitigate tax planning risk?
- What would be required to unwind a tax structure or mitigate tax planning risk?
- Are we prepared for negative press related to our tax strategies?
- Are we able and ready to act promptly in case our tax strategies are questioned?
- Do we need independent opinion and advice?

It has become clear in the last few years that the landscape in which companies are now required to undertake tax planning has changed forever. Much of the general public has a perception that large multinationals are not paying their fair share of tax and any efforts by a company to minimize their global tax paid may very well be seen as tax evasion, rather than adding to shareholder value. Companies will need to consider their planning options in this new light in order to determine whether a net benefit to the company results. Perhaps public opinion will prove to be a more effective control on corporate tax minimization than any rule of law.

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