Tax in the Boardroom

Executive Summary

Tax has never been so topical.

Recent media scrutiny into the tax affairs of well known multinationals has pushed tax to the forefront of board room discussions. Large, household names have faced intense criticism over the tax planning policies they have used. Tax planning has become more complex with increasingly elaborate mechanisms being used to diminish tax liabilities.

This trend has arisen as multinationals have imposed generic goals which they and their advisors have worked towards. These have included moving profits to where they are taxed at a lower rate, shifting expenses to where they are relieved at a higher rate or making use of existing tax attributes (e.g. tax credits, losses etc). Companies have been driving these goals to minimise their tax burden, albeit within the letter of the law.

The world of tax is seeing unprecedented interest and has to embark upon a period of change

The recently published report of the Public Accounts Committee (PAC) "Tax Avoidance: The Role of the large Accountancy Firms", has attracted much attention, as did the same Committee's inquiry into the corporate tax affairs of large multinationals. It was during this inquiry that the Big Four accountancy practices agreed that international tax rules are out of date and need changing in order to reflect the complexities of modern business. Coupled with the Organisation for Economic Co-operation and Development's (OECD) recent report in relation to Base Erosion and Profit Shifting (BEPS), the world of tax is seeing unprecedented interest and has to embark upon a period of change.

The G20 requested that the OECD produce a report following suggestions that multinationals may be engaging in BEPS. Accordingly, in February 2013 the OECD presented its report on BEPS to G20 Finance Ministers and Central Bank Governors. In responding to the growing concern that substantial tax revenue is being lost through organisations shifting profit to more favourable tax locations, the key observations reported by the OECD were;

- There is an increased segregation between the locations where actual business activities and investments take place and where taxable profits are reported.
- Current technology permits non resident tax payers to derive substantial profits from transactions with customers located in other jurisdictions. It is questionable whether the fair allocation of taxing rights on business profits is ensured.
- The international tax regime has not kept pace with changing business environments. Most domestic rules for

international tax remain characterised by a historic lower degree of economic integration across borders.

- Planning opportunities may result in profits not being taxed in any jurisdiction whatsoever, through hybrid mismatch arrangements. Corporations can establish branches in foreign jurisdictions with low or zero rate income tax and then use financial instruments and arrangements to move profits, avoiding any tax.

- Whilst the OECD's transfer pricing guidelines have been revised a number of times, corporations are able to artificially split the ownership of assets between legal entities within a group and thereby shift risks and intangibles to low tax jurisdictions which may contribute to BEPS.

- Leveraging high tax group companies with intra-group debt is a very simple way of achieving tax savings at group level.

- In practice there are strategies which may be used to circumvent the application of anti-avoidance rules through channelling financing through independent third parties or the use of derivatives.

The OECD is proposing a more stringent focus on the issue of BEPS through an action plan including;

- Neutralizing or limiting the effects of international mismatches (double non-taxation)

- Clarification on transfer pricing rules (including intangibles)

- Treaty concepts in relation to digital delivery of goods and services

- Treatment of intra-group financial transactions

- More effective anti-avoidance measures

- Countering harmful regimes more effectively

Whilst it is acknowledged that any significant changes in tax legislation from a global perspective will take time to implement, large corporations and their advisors wait in anticipation as to how the issue of BEPS will be tackled.

From a UK perspective, the Public Accounts Committee has made a number of recommendations to address the controversy of corporation tax paid by multinationals in the UK. These focus on a radical overhaul to simplify the UK tax system, in addition to greater transparency over companies' tax affairs. A consistent recommendation by the PAC has been to provide additional resourcing to the HMRC to deal with the issue of tax avoidance in order to ensure the HMRC is better equipped in dealing with such issues.

In light of the views expressed by the Public Accounts Committee and the approach being taken by the OECD, it is increasingly evident that tax is at the forefront of most boardroom discussions, particularly regarding strategic considerations.

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