

The Increasing Relevance of Tax for the CEO and the Board



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The international business press, NGOs, politicians and others now discuss tax extensively and often emotionally. Some very well known companies have been under public and political scrutiny in relation to their tax planning. In addition, some of these companies find themselves a subject of unlawful state aid investigation by the European Commission. Much of the focus is on whether companies are paying their “fair share”, a very troublesome concept, as it often has little or nothing to do with the applicable standards of the laws and regulations. In my 35 years as a tax professional, I have never seen tax so high on the corporate agenda. Tax was once a back office compliance function, far from the C-suite or boardroom. Tax has now become a highly relevant and important matter for most companies. What drove this change and what's next?

In my view, the root of the current focus on fair tax can be traced to three factors. The most recent of these is the global financial crisis and its lingering aftermath. Austerity efforts have focused many on why tax revenue is insufficient to fund the things governments have promised. While corporate income taxation has in the long term remained fairly constant as a percentage of total revenue, the notion has arisen that individuals pay the tax bill and companies have not contributed their fair share.

Secondly, many tax laws are badly out of date. The way business is conducted has changed constantly over the years and far faster than the changes, which have been enacted by countries to tax these new business models. In the 1920s and 1930s—when the international tax system took shape most taxation was of goods and localized services. These were relatively simple to tax. Income could be computed from the accounting records. The country

where the goods were made or services provided taxed them. Today, we deal with many more intangible elements of income, such as intellectual property and brand value, for which location is not easily defined. The value chain for most companies is complex to a degree unimaginable in the 1920s and 1930s. E-commerce has led to a further disconnect between the place where revenue is generated and corporate tax is paid.

A third factor is that countries are not all similarly situated in their ability to attract business investment and jobs, so historically they have used tax incentives to improve their positioning. This has led to lots of tax competition among states, which has made the factors described above even more acute.

These three factors have combined to result in some difficult publicity for more than a few companies, with reputation with customers at the center of the concern for most of them. Apparent trust in the tax system and in “big business” has declined.

So what can be done about this? The OECD's BEPS project is a start. This massive undertaking will culminate in delivery of a full package of measures to the G20 in October 2015. Countries have extensively participated in these deliberations, working through a number of complex topics, some of which have no simple answer. Input from companies and tax professionals like my network to try to achieve workable solutions has been extensive.

BEPS will require meaningful law changes by many countries. This is not an easy process. Some countries have enacted new laws already, which hopefully will fit the new BEPS framework. The United States is a great example of a country which has an outdated system for the taxation of international operations. The US needs to change, but the political process is sure to be



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protracted. It may not lead to enacted legislation soon. Other countries have similar challenges. All of this leads to uncertainty for business, which is harmful to growth and investment. In addition, overlapping tax claims by countries have resulted in an increase in international tax disputes, for which no easy solution is in sight. Inconsistent implementation of BEPS may exacerbate these disputes.

Companies do not have the luxury of curtailing their operations while the countries of the world change their tax laws. Business goes on. Uncertain times call for CEO and Board involvement in decisions around investment and resource allocation. Because one of the factors in both investment decisions and resource allocation is tax, reasoned analysis must include tax matters and needs C-Suite and Board level involvement. These senior individuals need to consider long-term tax strategy, increased transparency, avoidance and management of disputes, various tax planning options and their sustainability in a post-BEPS world. A focus on reputational risk to the organization must be factored into the analysis. Communication about tax will become more important.

So where does this take us? I expect that tax law change will be a constant that will lag behind business change. The OECD BEPS program may bring more clarity, but will not resolve every possible issue and the timing of country legislation is uncertain. In this environment, tax planning needs to comply with the existing laws, must be based on actual business facts, and should have solid commercial rationale. Thoughtful intervention by CEOs and Boards is perhaps the best way to drive sustainable tax planning, done in a manner that respects the interests of all stakeholders. ●