

Inter-American Center of Tax Administrations – CIAT

45th CIAT GENERAL ASSEMBLY



“TAX MORALE AS DETERMINING FACTOR IN IMPROVING THE EFFECTIVENESS OF THE TAX ADMINISTRATION”

Subtopic 2.3:

“CREATING TAXPAYER AWARENESS: CORPORATE SOCIAL RESPONSIBILITY AND THE FORUMS FOR TAXPAYER- TAX ADMINISTRATION DIALOGUE”

Deborah Nolan

**Quito, Ecuador
April 4-7, 2011**

Introduction:

The challenge of tax administration of global companies has increased significantly over the recent years. Opportunities for change are increasingly abundant. Responsibilities and expectations of the tax authorities are heightened.

For companies operating in a global environment, the challenges of managing tax risk and controversy are tremendous. The rules and relationships are complex; the stakes are high.

There are several key factors that are driving change in the global tax controversy and risk management landscape: the accelerating pace of globalization, the shifting economy, the rapid succession of legislative and regulatory changes, and the changing model of tax administration.

Around the world, companies have been striving to achieve success in an increasingly competitive global marketplace, even as they address the challenges or economic turmoil.

Shifting flows of capital have re-balanced economic influence from west to east, giving rise to a new global economics. Companies around the world have had to re-frame their decision-making processes and look to emerging markets in their efforts to grow and become more efficient.

For each change that businesses have had to make, governments have had to consider how to react. They have adapted their tax policies and adjusted their administrative approach to more effectively compete for international business and investment while collecting the revenue they need to address growing deficits and increased spending needs. Tax administrators today face significant challenges in understanding the complexities of new business structures and transactions, as well as the dynamics created by an expanding global footprint for people and businesses. Governments are looking to their tax administrators to rise to these challenges and deliver fair tax administration to very complex global businesses in a time of significant change. In doing so, they are attempting to create more efficient dispute resolution tools; refining their risk assessment models; sharing and collaborating more; and focusing on enforcement as a way to make sure they collect the amount of taxes they consider are due.

The result: complexity, uncertainty and, increasingly, controversy. This is the reality that businesses and tax administrators face. The financial and reputational risks of ignoring new global realities have never been greater for corporations. The opportunities for tax authorities to approach tax administration of large global businesses, efficiently and effectively are abundant. Many tax administrations are adopting more business-like and cost-effective approaches to improve compliance through both service and enforcement. Though countries around the world are at differing stages in their development of new policies, procedures and tools, one thing is clear. They are communicating more and seeking ways to leverage one

another's experience in the global tax community to improve tax administration in their own country.

The topic for discussion raised for this forum relate to this issue of corporate social responsibility and the forums for taxpayer-tax administration dialogue. The concept of corporate responsibility and governance and the importance of a dialogue between the tax administrator and its stakeholders to achieve compliance and mutual interests will be discussed.

Corporate social responsibility and corporate governance

“Corporate social responsibility” is a concept of “corporate self regulation incorporated into business model.” It is also sometimes called, “corporate conscience, corporate citizenship, social performance, and sustainable responsible business.” There has been some debate over whether it is the corporation who has the conscience or its leadership who help set the tone and its culture. Typically, the term “corporate social responsibility” is spoken in relation to the environment, its ethical operations, the community, to its employees and to its stakeholders. Whether or not there it is specifically stated that corporations should “pay their fair share” of taxes in its statement of corporate social responsibility, there is an indirect link.

It is noteworthy that in the United States, a tax system that is reliant on voluntary compliance, the compliance levels of individuals is the highest of other segments. While it is certain that the information reporting and withholding has a significant impact on the level of compliance, the attitude of taxpayers has an impact on their willingness to comply.

The IRS Oversight Board, in its 2010 Taxpayer Attitude Survey showed the following results. When asked, “How much, if any, do you think is an acceptable amount to cheat on your income taxes?” The responses were:

A little here and there	8%
As much as possible	4%
Not at all	87%
DK/NA/NR	2%

For the following statements, respondents were asked about their level of agreement or disagreement, with the following five choices:

- Completely agree
- Mostly agree
- Mostly disagree
- Completely disagree
- DK/NA/NR

Question: % completely and mostly agree

It is every American's civic duty to pay their fair share of taxes	69 + 28 = 97
Everyone who cheats on their taxes should be held accountable	69 + 27 = 96
It is everyone's personal responsibility to report anyone who cheats on their taxes	30 + 32 = 62
Taxpayers should just have to pay what they feel is a fair amount	10 + 17 = 27
The more information and guidance the IRS provides, the more likely people are to correctly file their returns	45 + 40 = 85

For the following statements, respondents were asked how important it is "that the IRS does each of the following to ensure that all taxpayers honestly pay what they owe?" with the following five choices:

- Very important
- Somewhat important
- Not very important
- Not at all important
- DK/NA/NR

Statement: % Very and somewhat important

Ensures low-income taxpayers are reporting and paying their taxes honestly	69 + 24 = 93
Ensures small businesses are reporting and paying their taxes honestly	73 + 22 = 95
Ensures high-income taxpayers are reporting and paying their taxes honestly	78 + 17 = 95
Ensures corporations are reporting and paying their taxes honestly	85 + 13 = 98

When asked "How much influence does each of the following factors have on whether you report and pay your taxes honestly?" with the following five choices:

- Great deal of influence
- Somewhat of an influence
- Very little influence
- Not at all an influence
- DK/NA/NR

Factor: % Great deal or somewhat

Fear of an audit	35 + 29 = 64
Belief that your neighbors are reporting and paying honestly	21 + 23 = 44
Third parties reporting your income to the IRS	39 + 27 = 66
Your personal integrity	80 + 12 = 92

One might draw some conclusions from the following statements that:

- Individuals feel that it is their civic duty to pay their fair share of taxes
- Those who cheat on their taxes should be held accountable
- Tax administrators should be ensuring that corporations are reporting and paying their taxes honestly
- Integrity is a key factor in compliance with tax laws

What would be the public perception of a corporation that did not pay their “fair share”? Corporations are paying increased attention to issues that might have an impact on financial and reputational risk. Tax controversy poses one of those risks. Beyond the costs associated with tax controversies, the corresponding financial impact can be significant. A sizeable adjustment stemming from an audit could lead to millions of dollars in additional taxes. Add in potential fines and a single tax controversy can cause financial restatements, reduce future dividends or even cause the sale of an asset to pay the additional assessment.

Along with these financial risks come considerable reputational risks. Over the past several years, the press has taken a much keener interest in tax issues, with an emphasis on real or perceived corporate abuses. Media attention is often magnified by industry watchdogs and other stakeholder groups, which can expand a single event into ongoing scrutiny that can affect shareholder confidence and, ultimately, share price. Thus, the importance of risk management strategies and achieving certainty with the tax authorities to minimize or avoid controversy becomes increasingly important to a company and its leadership as a part of its overall responsibility.

Corporate governance, both from external sources as well as internal sources are focusing on tax risk management as a part of overall enterprise risk management that is addressed by company leadership, boards of directors, internal and external auditors and regulatory agencies. In the United States, the recent years have brought an increased focus on financial and tax risk. With the financial accounting scandals of the recent past, came the Sarbanes Oxley Act, followed by FIN 48 for the accounting for uncertain tax positions and the increased transparency and disclosure. The recent US requirement to disclose uncertain tax positions is yet another risk management tool for the tax administrator to bring a focus on areas of uncertainty. Recognizing that “uncertainty” related to tax positions can be driven by several factors, including the lack of clear guidance, complexity of the law or where there is a range of acceptable answers, it need for processes to resolve or avoid disputes with the tax authorities becomes increasingly important.

Tax authorities around the world have made significant efforts to elevate tax risk as a corporate governance issue. The goal of many is to put tax planning on the boardroom agenda as a social responsibility issue, thereby encouraging a more cautious and prudent approach. Several heads of tax administrations, including in the UK, Australia, the Netherlands and the United States have commented on the need for increased accountability by the board and the “C-suite” on issues related to tax risk, whether to ensure an appropriate framework for tax risk management, or to review specific transactions that might present risk

to the company. The OECD Forum on Tax Administration released an information note in July, 2009 entitled, “General Administrative Principles: Corporate governance and tax risk management,” to reinforce the belief that tax administrations have a vital role to play in ensuring that corporate boards understand that they are ultimately responsible for the business’s tax strategies and outcomes. The note looks at the experiences of three countries, Australia, Canada and Chile, in encouraging good corporate governance and enhancing relationships with large business.

Crossroads: Is there room for mutual interests and common ground?

As the tax administrators have the responsibility to administer the tax laws of their countries, they must do it in a way that is efficient and effective. Collecting the proper amount of tax due and dealing with the tax gap requires a multifaceted approach. For large global companies, the tax laws and cross border implications present additional complexities that lend themselves to increased uncertainty and risk, for the taxpayer as well as the tax administrator. If tax administrators are to be efficient and effective, they must be able to use scarce resources appropriately, making distinctions between taxpayers who want to comply and those who make conscious decisions not to comply. Many of the processes afforded to taxpayers to resolve disputes or achieve certainty require a relationship of collaboration and increased transparency and disclosure.

Tax administrations in different countries have evolving models for compliance assurance of large enterprises. Some are dealing with issues of integrity and internal controls and the basic infrastructure and needs to approach this segment of taxpayers. Others are more mature in their model to address service and enforcement approaches for global companies.

Companies with expanding global footprints make business decisions that consider but are not necessarily driven by the tax administration processes in those countries. However, they do have increasing expectations and interests that the tax administrator provide an opportunity for a fair and objective hearing of tax disputes and that there will be opportunities to resolve those disputes administratively, or even before a return is filed.

Regardless of the challenges faced by taxpayers and tax authorities, with the constant change that is required to keep pace with the changing business models, behaviors and compliance treatments for large corporations, creating forums for taxpayer-tax administrator dialogue has significant benefits and if done with proper protocols, little risk.

Forums for taxpayer – tax administrator dialogue

The United States Internal Revenue Service has embraced the concept of stakeholder relationship management for years. Following the restructuring of the IRS along taxpayer segments, the focus on “understanding the customer” strengthened. Various groups and approaches were used to seek the perspective of the public to be served as new processes, initiatives and approaches to compliance were formulated. Four overall goals of the Stakeholder Relationship Management (SRM) strategy:

- Leverage stakeholder relationship to help the IRS achieve its tax administration objectives
- Support the IRS Strategic Business Plan
- Add value to external stakeholders
- Assist stakeholders and improve the overall consistency and quality for stakeholder interactions

The dialogue to improve tax administration through the balance of service and enforcement can take many forms. The protocols to ensure appropriate access and influence are in place through public law and internal procedures.

Through the enactment of the Federal Advisory Committee Act (FACA) of 1972, the U.S. Congress formally recognized the merits of seeking the advice and assistance of our Nation's citizens. At the same time, the Congress also sought to assure that advisory committees:

- Provide advice that is relevant, objective and open to the public
- Act promptly to complete their work; and
- Comply with reasonable cost controls and record keeping requirements

With the expertise from advisory committee members, the tax authorities have access to information and advice on a broad range of issues affecting federal policies and programs. The public, in return, is afforded an opportunity to participate actively in the federal government's decision making process.

With regards to large corporations, the IRS has an advisory council (IRSAC) with a subgroup focusing on issues related to that segment, advising the Large Business and International division commissioner. There is also an Information Reporting Program Advisory Committee (IRPAC) and an Electronic Tax Administration Advisory Committee (ETACC) which are covered in this category. The IRS Commissioner and his leadership team are actively engaged with these groups and personally committed to ensure that their purpose is achieved.

There are other key stakeholder groups of large corporate taxpayers and their service providers whose input is actively sought to improve tax administration through an enhanced understanding such things as of the implications of new processes, need for guidance, ways to improve compliance with reduced burden, the practical implementation of strategic initiatives and leadership direction and the changing business models and transactions that have tax implications. Engaging in a dialogue with these taxpayer and their intermediaries can also provide the leaders of the tax administration to hear directly from taxpayers as well as send key messages that are important for the segment to hear. Examples of key stakeholder groups include the Tax Executives Institute (TEI), American Bar Association (ABA), American Institute of Certified Public Accountants (AICPA), Organization for Foreign Investment (OFII), and industry groups. Tax authorities can learn about specific taxpayer

problems and concerns from these groups that can provide a “taxpayer’s point of view”. Such an approach is very much in keeping with a guiding principle of “understanding and solving problems from the taxpayer’s perspective” and “walking in their shoes”.

The OECD Tax Intermediaries addressed the role of the relationship among tax authority, taxpayer and the intermediary. “The key issue was the recognition of the mutual benefits to all parties from revenue bodies using modern risk-management concepts. In turn, to underpin the risk management approach, two further essential elements were noted: (a) an enhanced relationship between revenue bodies, taxpayers and tax intermediaries, and (b) the use of effective operational tools and techniques.” The message in the study was that mutual interests can be met if taxpayers are transparent and collaborative, with timely disclosures.

Taxpayers wanted to have tax matters resolved quickly, quietly, fairly and with finality. The five things that the study team’s consultation has suggested revenue bodies need to demonstrate in order to give taxpayers the incentive to engage in the enhanced relationship are:

- Commercial awareness
- An impartial approach
- Proportionality
- Disclosure and transparency
- Responsiveness

The concept of seeking a business perspective is embraced, not only for tax authorities and taxpayers, but in it’s owns operations as a global forum for tax policy and administration by recognizing the Business and Industry Advisory Committee to the OECD (BIAC). The BIAC is an independent international business association devoted to advising government policymakers at the OECD and related fora on the many diversified issues of globalization and the world economy. Officially recognized in 1962 as being representative of the OECD business community, BIAC promotes the interests of business by engaging, understanding and advising policy makers on a broad range of issues with the overarching objectives of:

- Positively influencing the direction of OECD policy initiatives;
- Ensuring business and industry needs are adequately addressed in OECD policy decision instruments, which influence national legislation;
- Providing members with timely information on OECD policies and their implications for business and industry.

This group also serves to provide input to the OECD on specific issues and have working groups to focus on those collaboratively.

Conclusion

In times of unprecedented change for business and tax authorities, the dialogue between taxpayer and tax authority becomes even more essential. As corporate governance and regulatory requirements over large businesses are strengthened, the desire for proactive tax risk management becomes a business imperative. More companies are seeking to build collaborative relationships with the tax authorities to resolve disputes but also to be a positive influence on effective and efficient tax administration.

The public can best be served when they know that they have a voice. The tax administration is the owner of the tax administration processes and has the clear authority and responsibility to embrace or disregard the input of the stakeholder. Establishing a forum for the dialogue, seeking and valuing input, can reap significant benefits in establishing and improving practices for efficiency and effectiveness. Creating a culture that values the external stakeholder input and manages it appropriately assist with today's challenges and prepare for the future.