A new mountain to climb

Tax reputation risk, growing transparency demands and the importance of data readiness

2014-15 Tax risk and controversy survey series
Foreword

In the time since the height of the global financial crisis, the tax world has changed significantly. And the transformation is not yet over.

A convergence of complex trends and forces is forcing company tax leaders to confront new and imminent challenges. Among them: architecture of cross-border taxation is being redrawn; disputes are rising as governments deal with a legacy of fiscal deficits around the world; and demands for more tax transparency are rising in tandem with public scrutiny – and judgment – about how much tax businesses pay.

As a result, companies face more tax risk than ever. Tax now has a far higher profile, elevated to senior company management and the board and beyond include news media, shareholders, regulators, investors, policymakers and the general public.

The first report in EY’s 2014-15 Tax risk and controversy survey series, Bridging the divide, provided survey highlights and identified key risks that companies faced in the current environment. The second, Managing operational tax risk, detailed how the right people, processes and technology can help companies manage the risks identified in the first report.

This third report provides some answers to a question that has vexed corporate tax departments in recent years: How can businesses prepare for, and proactively manage tax risk and the increased reputational risks posed by the ongoing “fair share of tax” debate? It concludes tax executives need to prepare their enterprise to meet imminent demands for greater tax transparency in a world where the information shared with one tax administration will be shared automatically with all of them.

I encourage you to engage the fair share of tax debate and the paradigm shift in thinking about reputation risk it requires. And I urge you to assess your organization’s readiness to gather, analyze and communicate the information needed to be effective in presenting a consistent, complete, and accurate profile about your tax operations around the world. Tax executives that do these things will increase confidence in their organization and keep business focused on its strategic goals.

Sincerely,

Jay Nibbe
Global Vice Chair – Tax

Contents

Tough conditions on the climb 1
Evaluating the landscape 3
Preparing for the climb 11
A long climb ahead 20
Tools and insights 22
Tough conditions on the climb

This third installment in our Tax risk and controversy series explores another driver of tax risk that has emerged in recent years: public opinion, its potential to damage a company’s reputation and the impact it has had on the demand for more tax transparency.

For many tax professionals, reacting to the “fair share of tax” debate as experienced in headlines, online and in legislative hearings, has been an unfamiliar and frequently challenging experience.

The intense focus on the tax affairs of multinational corporations is in part a legacy of the global financial crisis, with much of it rooted in opposition to austerity measures taken by governments to counter rising budget deficits. Protests over executive pay at companies that received taxpayer bailouts and over companies’ accumulation of cash on their balance sheets transformed over time into an increased focus on whether and to what extent multinational companies could be shifting profits and underpaying taxes. And thus, the “fair share” of tax debate was born.

Growing calls for transparency

As the debate has evolved, many stakeholders have concluded that more tax transparency is one of the many answers to this complex issue. But these stakeholders have different interpretations of what that means in practice. They also disagree about the appropriate level of transparency necessary to assure all stakeholders that companies are following the tax laws – as written, and as intended.

The stakeholder camps include social justice tax activists, who generally demand full global and public disclosure. Some governments, such as Australia and Norway, also favor public disclosure, while others including the United States have warned that broad public disclosure of corporate tax information could be counterproductive. The Organisation for Economic Co-operation and Development (OECD) and European Commission are both driving multilateral developments around transparency. Among businesses, our Tax risk and controversy survey series shows that the appetite for public disclosure of tax data diverges widely according to local market dynamics.

While a mounting number of transparency obligations will affect the majority of multinational companies, these same businesses now have to decide for themselves where they sit on the voluntary transparency spectrum.
What companies can do

As we noted in our first publication, successful expeditions require a fully integrated approach to preparation, physical fitness, knowledge of current and future conditions, the deployment and use of the most reliable, modern tools and an experienced guide. That need for significant preparation is particularly important when it comes to tax transparency. Here, the message is clear: there are choices to be made, whoever receives your disclosures. **Preparation, communication and flexibility are key.**

In this publication, we suggest ways to increase overall levels of transparency readiness that are grounded in good processes, robust documentation and audit trail, and class-leading data management.

With this readiness in place, new reporting obligations can be met with less disruption to ongoing business activity and the appropriate communication tools can be developed, if desired, to help mitigate reputation risk. Such readiness will also help companies to communicate more effectively internally as well as externally.
The importance and complexity of transparency is heavily underscored by the way the media – news media in particular – tries to piece together often incomplete information that exists in securities filings, court papers and leaked documents. This has helped drive news coverage, often putting companies on the back foot, forcing them to react to allegations rather than facts or having the opportunity to describe their tax policies and approaches.

Tax hits the front page

Executives are rightly concerned when their business makes the news for the wrong reasons or is publicly criticized by lawmakers or regulators. Consumer boycotts, shareholder backlash, brand erosion and damaged relationships with governments can take a toll, particularly if a company is reliant on public contracts or its relationship with the public. Institutional investors may also grow skeptical, concerned that certain tax planning strategies may be unsustainable contributors to profit.

Companies are paying attention to this issue; eighty-nine percent of the largest global companies surveyed by EY – those with revenues in excess of US$5 billion – recently said they were somewhat or significantly concerned about news media coverage of how much companies pay in tax or their seemingly low effective tax rates.¹ This is up significantly from 2011, when fewer than half of companies said they were similarly concerned. But perhaps more troubling is the fact that more than 6 in 10 companies believe that engaging with the media is a “no-win” situation.

¹ EY’s 2014-15 Tax risk and controversy survey.
The global debate on tax transparency: key events

**2003–4**
- June 2003: Extractive Industries Transparency Initiative (EITI) launched
- 2004: United Kingdom introduces Disclosure of Tax Avoidance Schemes (DOTAS)

**2009**
- 1 September 2009: OECD Secretary-General Angel Gurría proclaims a “revolution” in transparency and exchange of tax information

**2010**
- 18 March 2010: Foreign Account Tax Compliance Act (FATCA) signed into law
- May 2010: A Protocol amending the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters provides for the opening of the Convention to all countries, not just OECD and Council of Europe Member States
- 21 July 2010: Dodd-Frank Wall Street Reform and Consumer Protection Act signed into federal law
- 24 September 2010: US Internal Revenue Service (IRS) releases final schedule and instructions for certain taxpayers to use in reporting their uncertain tax positions in their tax returns (Schedule UTP)

**2013**
- 29 May 2013: Australia introduces a tax bill requiring the Australian Taxation Office (ATO) to publicly report, in relation to companies with annual income of A$100 million or more, details of gross income, taxable income and tax payable thereon
- 13 June 2013: “Fair Tax Mark” launched in the United Kingdom
- June 2013: European Commission asks for information about tax ruling practice in seven countries (Cyprus, Gibraltar, Malta, the United Kingdom, the Netherlands, Ireland and Luxembourg)
- June 2013: Information request about IP regimes from the 10 Member States with such a regime (Belgium, Cyprus, France, Hungary, Luxembourg, Malta, the Netherlands, Portugal, Spain and the United Kingdom)
- 31 December 2013: Deadline for EU Member States to transpose country-by-country reporting obligation for banks under Capital Requirements Directive (CRD IV) into domestic law
- 1 September 2009: OECD Secretary-General Angel Gurría proclaims a “revolution” in transparency and exchange of tax information
- 18 March 2010: Foreign Account Tax Compliance Act (FATCA) signed into law
- May 2010: A Protocol amending the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters provides for the opening of the Convention to all countries, not just OECD and Council of Europe Member States
- 21 July 2010: Dodd-Frank Wall Street Reform and Consumer Protection Act signed into federal law
- 24 September 2010: US Internal Revenue Service (IRS) releases final schedule and instructions for certain taxpayers to use in reporting their uncertain tax positions in their tax returns (Schedule UTP)
3 February 2015
European Commission opens in-depth investigation into the Belgian excess profit ruling system

9 February 2015
OECD issues implementation guidelines for country-by-country reporting under BEPS Action 13

24 February 2015
Seychelles becomes the 85th signatory of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters

18 March 2015
European Commission publishes proposals for a Tax Transparency Package, including proposal to introduce quarterly, automatic exchange of information between Member States of their cross-border tax rulings, including advance pricing agreements (APAs) as well as the obligation to make a one-off exchange of cross-border tax rulings made within the last 10 years, where such rulings remain active at the point a revised Directive on Administrative Cooperation is adopted

19 March 2015
European Commission concludes negotiations with Switzerland on landmark tax transparency agreement

31 March 2015
OECD publishes a discussion draft on BEPS Action 12: Mandatory Disclosure Rules

30 January 2014
OECD Discussion Draft on BEPS Action 13 – Re-examine transfer pricing documentation

13 February 2014
OECD releases Common Reporting Standard

11 June 2014
European Commission announces the opening of state aid investigations of the transfer pricing agreements on corporate taxation of specific multinational corporations (MNCs) located in Ireland, the Netherlands and Luxembourg

13 August 2014
OECD issues Standard for Automatic Exchange of Information in Tax Matters

16 September 2014
OECD publishes Report on BEPS Action 5: Countering Harmful Tax Practices more Effectively, Taking into Account Transparency and Substance

17 December 2014
European Commission extends information enquiry on tax ruling practice to all Member States

September 2015
OECD BEPS Action 12: Disclosure of aggressive tax planning arrangements to be published

1 January 2016
Exchange of cross-border tax rulings and APAs to commence under revised European Union Directive on Administrative Cooperation

2016
Early adopting countries begin automatic exchange of tax information using the OECD Common Reporting Standard (CRS)

2017
First exchange of information under country-by-country reporting, using FY2016 data
The appropriate response for each company depends on a variety of factors, including whether it is a business-to-consumer or business-to-business enterprise, whether it has crisis communications capabilities, which industry sector it resides in and its overall brand visibility and reputation.

Different companies, different reactions

Multinational corporations have reacted in different ways to the increased scrutiny of their tax affairs, and with varying degrees of effectiveness. Some have tried to ignore aggressive news coverage before rebutting printed allegations on their own websites. Some have cooperated with journalists in an effort to try and better educate them about the company’s tax affairs. Some have proactively detailed each type of tax they pay around the world in an effort to broaden the debate beyond corporate income tax or accusations of profit shifting. Some have agreed to voluntarily pay more while some companies are starting to include annual report language to the effect that they may face higher future tax bills as a result of the BEPS project and other initiatives. By attempting to provide transparency and early communication of this message, these companies are trying to pre-empt any future negative reaction from the investor community. Others have chosen not to be actively involved in the debate.

The appropriate response for each company depends on a variety of factors, including whether it is a business-to-consumer or business-to-business enterprise, whether it has resources dedicated to corporate communications, which industry sector it resides in and its overall brand visibility and reputation.

Beyond relations with the media, our survey also found that leading companies are rapidly changing the way they communicate about tax risk and controversy to other stakeholders, both internal and external.

Growing coverage of tax issues drives calls for transparency

Whether or not media coverage is fair and balanced, the fair share of tax debate has led to growing calls for more business taxpayer transparency. At its heart, this “transparency” refers firstly to the information that governments feel should be shared in relation to cross-border transactions and secondly to the agreements that other governments have come to with large companies.

In the first instance, tax authorities around the world are stressing the need for more, and more readily accessible, information from companies in order to get a clearer picture of how their profits are taxed globally. Tax authorities now want to know more about the whole supply chain, not just the next step. They also want to know how much tax a company is paying in other jurisdictions, to allow them to gauge whether the company is paying enough in their jurisdiction.

In the second instance, both the OECD and European Commission feel that tax rulings granted by individual countries should be shared among all countries, to increase transparency about what companies are being granted. Significant differences in scope exist between these two organizations, however.

Together, these two demands for transparency have led to numerous rapid developments that are now altering the global tax landscape. They include the OECD’s BEPS Action 13 (Re-examine
Many companies feel that the need for greater transparency and more information is about constructive and productive taxpayer to tax authority dialogue, not something that should play out on the public stage.

Business’ viewpoint on the potential impacts of more transparency is clear: according to a recent EY webinar, 52% of respondents to a webinar polling question expect an increase in controversy in Western Europe because of developments related to BEPS Action 8 (Transfer pricing for intangibles) and Action 13 (Re-examine transfer pricing documentation).

A massive 94% of the largest companies having an opinion on the matter think that global disclosure and transparency requirements will continue to grow in the next two years. They are probably correct to think that; In the United Kingdom, for example, ahead of the May 7 general election, the manifestos of both the Conservative and Labour parties mentioned the possibility of making country by country reporting information publicly available. “We will seek international agreement to make country-by-country reporting information publicly available” reads the Labour manifesto, while the Conservative party state that “we will consider the case for making the information publicly available on a multilateral basis.”

Not for the public stage

Whether or not they are ready to do so, companies responding to the same EY survey say they have little desire to publically disclose more details about their business models or taxes paid. Just 21% agreed or strongly agreed with the statement: “We believe that voluntarily publishing to the public the amount of taxes we pay where we operate is a prudent step to take.” In contrast, 46% disagreed or strongly disagreed. Among Americas-based companies (many of which have been the most frequent targets of criticism), the resistance to voluntarily disclosing taxes paid is even more dramatic: just 3% said they agreed it would be prudent to do so and none strongly agreed. That compares to 54% that disagreed or strongly disagreed.

Many companies think that the need for greater transparency and more information is about constructive and productive taxpayer to tax authority dialogue, not something that should play out on the public stage. And many business leaders feel that too much information isn’t always informative, especially when a commentator is looking for a simple answer to a complicated question. Too much information is also susceptible to misinterpretation and can also be commercially sensitive.
Moving toward transparency readiness

Nothing is clear cut where tax transparency is concerned, other than the fact that many new obligations must be met. A variety of drivers influence individual companies, dependent on both geographical and sector profiles, leading to different choices being made. They include a company’s risk appetite, local legal obligations, local market dynamics, quality of enterprise-wide financial data and the availability of processes, skills and competencies to extract and report data in the format in which it is needed.

Business can do more and be more proactive to prepare for new reporting obligations and, as one proposed step, to have the right data ready to publish, either proactively or defensively. Whatever choices a business makes, developing and sustaining the ability to source accurate data, in the right format and in a timely manner will be a critical factor for all large businesses in the years ahead.

This is particularly critical as more tax authorities explore how real-time audit of financial systems can be undertaken, both in-country and on a cross-border basis.

---

OECD BEPS Action 13: Transfer Pricing documentation, 2017 implementation, covering 2016 fiscal year

OECD BEPS Action 12: Disclosure of aggressive tax planning arrangements; report due September 2015, implementation date unknown

European Commission Tax Transparency Package proposal, scheduled to be adopted 1 January 2016

- Extractives Industry Transparency Initiative (EITI)
- Dodd-Frank Act

National-level transparency initiatives (e.g., Schedule UTP (US); Reportable Tax Positions (Australia); Tax reporting for companies w/>$100m revenues (Australia); and Disclosure of Tax Avoidance Schemes (DOTAS) (UK)

- 85 signatories
- Multilateral in nature
- Wide scope of taxes covered
- Country where the information originates has to agree that revenue authorities 1, 2 and 3 may be granted access
The global engines of transparency
How multiple transparency initiatives are driving an increase in business tax information exchange
A new mountain to climb
Preparing for the climb

Transparency is set to become the new normal, and at record speed. Multiple new reporting obligations, coupled with the move to global and automatic exchange of tax information mean that businesses must now assume that any reporting in one country will be available to tax administrators in other countries.

Tax administrations will therefore be able to identify in greater detail than ever before individual transactions and structures, pairing that view with a “wide-angle” lens approach that shows them a multinational enterprise’s entire global picture. That microscopic scrutiny, both local and cross-border, will also increase in future years, with the yet-to-be finalized BEPS Action 12 (Require taxpayers to disclose their aggressive tax planning arrangements) expected to result in a whole new range of data being made available to revenue authorities. The extensive availability of financial reporting information on the internet, meanwhile, provides media and non-government sectors with increased access to data – but not always the full picture.

One simple adage rings true: you cannot have quality information without quality data. And to get quality data, there are many challenges that must be overcome: day-to-day transactions booked in any given country may not be properly sensitized for tax purposes; accounts may not be used in exactly the way they were designed to be; or changes may go uncommunicated. The difference in tax treatment between a normal everyday accrual and a major restructuring reserve can be immense. And that’s before the multitude of IT systems challenges that may prevail in the quest to comply and provide an accurate picture are considered.
There is no “silver bullet” solution to transparency readiness. Many companies understand that interim solutions will probably need to be implemented in advance of more complex, tailored integration, workflow and data warehousing solutions.

How to enable transparency readiness

Today, transparency readiness is a significant and often underestimated need of companies, whether the end goal is compliance with enacted disclosure and reporting requirements or proactivity in the development of a snapshot of data that publically explains a companies’ total social and economic contribution. Companies must answer three key questions: What data do we need to have readily available? What do we need to have in place to make it readily available? And how should we present it?

Companies need to not only understand the tax technical implications of what they provide to either government or public, but also have to develop processes that will allow new obligations to be met without major upheaval each time. That typically means modeling out the results in advance through joint tax and finance function efforts and learning the challenges in store for both the collection of the data (where additional interaction with the IT department will typically be required) and its subsequent analysis and transmission. With this learning, it is possible to identify the practical, real-life challenges each company will face.

The full range of data points that must be captured will vary by company, jurisdiction, sector and by how proactive a company wishes to be in terms of public disclosure. Coming up with a definitive list will be challenging, both because of the challenges presented by qualitative analysis and the difficulties related to systems readiness and accessibility. But there are actions that can be taken by virtually all companies that will help to put them in the best position to respond to these increased challenges moving forward.

How to source the relevant information

The rapid flow of new reporting and disclosure requirements — whether at the OECD, European Commission, sector or national level (such as Mexico’s new requirement to report significant transactions) have left tax departments and software houses rushing to catch up.

There is no “silver bullet” solution to transparency readiness. Many companies understand that interim solutions will probably need to be implemented in advance of more complex, tailored integration, workflow and data warehousing solutions that will be specifically designed for the task at hand.

Current experiences show that even some of the most well-known global companies are reacting to the changing landscape with manual processes that rely on email, spreadsheet-based data capture and storage of a snapshot of data outside traditional ERP systems or data warehouses.

Most will eventually upgrade to automated data collection, fit-for-purpose data warehousing and sophisticated data analytics capabilities. But it’s worth noting that even in advance of full end-to-end processes that deliver an integrated, large automated solution, the immediate availability and ease of use of some data analytics platforms should not be neglected.

Applied correctly – even to spreadsheets – these platforms provide a visually attractive, insightful view of global facts and circumstances. Outliers, anomalies or other variances in tax and financial data can be easily and quickly identified and, if necessary, remedied in advance of formal submission. This applies equally to legally required and voluntarily provided disclosure of tax information.
Are all data elements that the company is required to report currently tracked and stored in its financial systems? Is the data in multiple ERP systems, and if so, are there methods that can be employed to automate its collection?

Moving from year 1 to sustainability

Time has a habit of flying by when you are under pressure and the importance of immediate preparation and assessment cannot be overstated. The most recent country-by-country reporting implementation guidance from the OECD recommends that the first Country-by-Country Report (CbC Report) be required to be filed for, and contain information with respect to, an MNC group’s first fiscal year beginning on or after 1 January 2016.

For MNC groups with fiscal years ending on 31 December, the first CbC Report would be required to be filed by 31 December 2017. With so many ongoing obligations ahead in 2015 (not to mention substantial parts of the BEPS project remaining as yet unrevealed) businesses will need to establish whether to drive hard and put in place robust processes and systems for year 1 reporting or whether to continue relying on largely manual data collection processes.

To upgrade, an IT infrastructure discussion needs to occur sooner rather than later. Unfortunately, a recent EY survey indicates that only just over half (55%) of global respondents say they have a “high” or “good” level of confidence in the willingness and ability of the IT function or resources in their company to improve the suitability of technology tools and systems to benefit the finance and tax function.

That specific challenge aside, a number of different questions can help guide a current state transparency readiness assessment and give companies the opportunity to put in place plans for progress and improvement:

- What are the data requirements the company either wants or needs to report? What constitutes a tax payment, either as required by obligation or under our plans for voluntary disclosure?
- Are all data elements that the company is required to report currently tracked and stored in their financial systems? Is the data in multiple ERP systems, and if so are there methods that can be employed to automate its collection?
- Does the company have entities without integrated accounting systems, and if so, how will they be incorporated into overall plans? Do these new obligations provide the company with a catalyst to make a business case for increasing our investment in tax systems?
- Does the company have any instances where the group does not control an entity? For example, does the company structure include any associate entities that may be considered to be part of the group under OECD guidelines?
- How does the company manage the possibility that financial year ends may be different in different countries? Will local statutory accounts be available by the required deadlines for transparency reporting or will the company need to rely on other accounts including potentially non-audited data in order to comply with CbC reporting requirements? And if so, does the company need to consider creating additional controls and processes to make sure the reported data does not unnecessarily increase risks?
- How will the company address the fact that financial data may be stored in different currencies?
- Is the data reliable? And if there are doubts in that area, what types of checks and remediation can the company develop to improve overall reliability?
- If the company is able to capture significant amounts of data, how can they store it (now and in the future), so that they can access it, review it, compare it to prior years and run data analytics across it to check for anomalies?
- If required, can all reported data be easily and quickly reconciled to a reliable source?
- Whatever model (obligation versus voluntary reporting) is chosen, does the company need new resources, skills or budget to meet new reporting obligations?

Some companies are choosing to disclose more than just information of taxes paid and other related financial data. In some cases, companies are choosing to be more proactive in publishing information on the philosophy and approach in the areas of corporate governance and tax policies, including making public statements regarding their approach to tax planning.

In that vein, any transparency readiness strategy must ensure that these documents are not only available, but fit for purpose in the current environment and fit for sharing with the public. An approach this extensive will require broad-based support across the company, from tax function to executive management, board and audit committee.

---

3 EY 2015 Global Compliance and Reporting Survey of middle market companies
How to assess the data

Having the ability to source the data is one thing. Detecting risk anomalies in the data that may draw attention from tax authorities is another. This is especially true as more and more revenue authorities are able to access data in the ERP system directly. Here, it is not only the growth of the SAF-T standard in Europe that companies should be aware of. As far apart as Australia and Brazil, tax administrators believe that direct ERP access represents a next phase of risk assessment.

As noted, the risk assessment of financial and tax data varies depending on a number of different factors and no two situations are the same. But some general conclusions can be drawn.

The reporting obligations under the OECD’s BEPS Action 13 (though not the only new reporting obligations for taxpayers) provide a robust illustration of some of the types of questions that business leaders should ask themselves when risk assessing the information they may submit.

- Where is revenue earned in the group and where are the profits being derived from in the group?
- Can the company disclose financial information and allocation schedules on a per-country basis?
- How does the company balance providing sufficient information against the time and cost involved in producing the reports?
- Can the supply chain be diagrammed and can the company provide a functional analysis of each of the nodes of the supply chain for the top five products and/or all products with more than 5% of sales?
- Can the company explain its transfer pricing compliance succinctly and consistently?
- How can the company avoid misinterpretation of data, such as reporting ordinary profits in addition to profits after extraordinary items?
- Does the company have specific types of related-party payments and does the company earn consistent returns on similar transactions?
- Does the company have significant transactions with a low tax jurisdiction or are the functions, assets and risks of the company aligned with its economic substance and reward?
- Has the company experienced a business restructuring, and if so, what impact on financial and tax data does it have?
- Does the company have excessive debt in comparison to its peers?
- What percentage of transactions does the company currently cover in documentation, and is such documentation of sufficient quality?
- Have any transfers of intellectual property (IP) been made to related parties?
- Are the value-driving processes of the company relating to IP aligned with its economic substance and reward?
Tax reputation risk, growing transparency demands and the importance of data readiness
Transparency readiness can help mitigate reputation risk

Once companies find their footing in terms of transparency readiness, they are better prepared to determine how and if they want to engage in the debate. Those that can quickly and clearly explain their tax transactions and strategies – to executives, to their employees and to external stakeholders such as legislators, regulators, shareholders, customers and the media – are better positioned to manage reputation risks.

For companies that choose to be proactive, we think there are six distinct actions to consider when forming a reputation risk strategy that centers on developing a more holistic and transparent way of thinking and communicating about your company’s tax strategies and the broader role your enterprise plays in global, national and local economies.

1. Actively monitor the changing landscape

Tax function leaders should regularly monitor the level of public interest in their company’s tax profile. This includes closely monitoring media coverage of their company and tracking social media channels that previously may not have been of interest to the tax function. This often requires closer collaboration with communications and PR functions within the enterprise.

Companies should also closely monitor legislative and regulatory developments in the transparency and disclosure area in order to understand the likelihood of new and increased tax disclosure requirements. While many new requirements are already being demanded of companies, more are likely to follow. The European Commission may expand existing financial services disclosure and reporting requirements and, as noted, BEPS Action 12 will “Require taxpayers to disclose their aggressive tax planning arrangements,” among other obligations. These are not likely to be the only new reporting obligations for companies in the future.

2. Assess readiness (and desire) to respond

The assessment of a company’s readiness to respond to a reputation risk threat can be measured by the ability to answer the following questions:

▶ Does the company have complete visibility of its tax structures and taxes paid in each jurisdiction in which it operates?
▶ Are the taxes paid in all jurisdictions in line with business results?
▶ Does the company have complete visibility of all disputes or litigation in each jurisdiction?
▶ Does the company have a board-agreed strategy and plan of action for what it would do if a negative story regarding the company’s tax affairs appeared in the news media tomorrow?
▶ Does the tax function have regular and clear input into business strategy, and is it consistently aware of all major transactions?
3 Enhance communication with internal and external stakeholders

Communicating effectively about the company’s total tax picture, tax policies and overall tax profile is the next critical step to successfully managing tax reputation risks. Generally, companies will need a communications strategy and protocols for reaching internal and, if necessary, external stakeholders.

Internally, the tax function should validate the desired approach to the C-suite and other oversight functions, including the audit committee, risk officers, general counsel, public affairs and boards of directors. This is part of the tax director’s growing responsibility to take a more proactive role in general business strategy. The goal should be to secure agreement on the potential impact of reputation risk at the management level and to develop a common, strategic view of issues related to tax transparency.

Informing company leadership about tax reputation risk concerns will help them appropriately rank tax among other risk factors and help embed sensitivity around tax-related reputation risk in other business activities such as mergers or acquisitions. Because critics and the news media now look for a tax angle in nearly everything a company does, companies need to anticipate those inquiries and be prepared to respond.

Companies should also establish and sustain a dialogue between their tax and corporate communications functions. This is important both to familiarize public relations representatives with the details of material tax items before they are disclosed in public filings, and also to engage effectively with investors and the company’s own personnel. These professionals are best positioned to proactively frame the company’s messaging around tax matters before it is framed by others.

There are four questions that this broad-based dialogue should answer:

- On an ongoing basis, are there sensitive tax items that are being disclosed in public filings?
- Does the company want to proactively publish or reactively respond to any criticism?
- Does the company want to publish information on tax policies but not any deeper tax data? Will doing so create or mitigate reputation risk?
- Who will be the key spokesperson should a tax issue arise?
The development and sustenance of an accurate total tax picture often sits at the heart of a tax reputation risk strategy.

The total tax picture of a company incorporates much more than a mere listing of taxes paid around the world. Rather, it incorporates deeper insights on why a company operates where it does, why it is structured in the way it is and how it manages its tax department. It addresses not only what the company’s total tax contribution is across different classes of tax, but how its very existence benefits an economy as a whole. Finally (and importantly) a total tax picture analysis carefully views all of the above through the lens of public perception.

Generating broad and deep data that covers all tax, financial and social contributions is a challenge even for the most disciplined company. Establishing a closer relationship between tax and accounting functions — especially related to finance transformation initiatives and ERP-related projects — will help ensure changes to systems and processes take current and potential future tax reporting needs into account. In fact, many of the elements causing reputation risk today are the same elements that will be required to be reported under the OECD’s transparency initiatives prescribed in Action 13 of the BEPS project.

Developing the company’s total tax picture may in turn lead to discussions about whether to restructure transactions, relocate certain operations or intangible assets, or change a business model altogether. Leading companies will integrate what they learn from developing their total tax picture into their broader response to the BEPS Action Plan and also their general tax risk management strategy. The same companies will take a holistic view, leveraging whatever their data tells them.

### Four key components

Four key components make up a company’s total tax picture. Each quadrant details a number of different areas. Together, these elements help develop a company’s tax story.

The **Location** quadrant should trigger discussion and analysis of the various places in which your company operates, the reasons you operate in those jurisdictions, the structures through which you operate in each location and the business evolution that brought you to your existing operating model.

The **Investment** quadrant identifies a way to talk about how your company adds value to the economy. Deeper analysis can help you demonstrate your economic contribution. The range of data points to include can vary widely, depending on corporate fact patterns such as industry sector or location but may typically include:

- Direct effects (taxes, employment, employee compensation resulting from company sales)
- Indirect effects (same elements that result from the company’s purchases from suppliers)
- Induced effects (resulting from spending by the company and supplier employees at other businesses)
- Social contributions (R&D spending, sustainability efforts, support for other local businesses, community outreach)
- Tax collected on behalf of government (VAT, GST, social security, etc.)

The **Taxes paid** quadrant is designed to help identify a concrete number representing the total amount of taxes the company pays. Developing this quadrant may take significant analysis and can include factors such as your company’s direct tax contributions, taxes collected from customers, taxes paid by employees and suppliers, and induced tax contributions resulting from spending by your company’s employees and suppliers.

The **Governance** quadrant looks at the policies a company has in place and how the company’s tax function operates. This section is designed to trigger discussion of a company’s global risk management, tax resolution processes, audit function and tax performance processes.

<table>
<thead>
<tr>
<th>Why you operate where you do</th>
<th>How you manage your tax function</th>
<th>How you benefit the economy</th>
<th>Your total tax contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business and tax reasons</td>
<td>Internal policies, processes and controls</td>
<td>Economic contributions</td>
<td>Federal, state and local taxes paid</td>
</tr>
<tr>
<td>Evaluate and explain existing tax structures</td>
<td>Resolution options</td>
<td>Social contributions</td>
<td>Taxes paid by suppliers</td>
</tr>
<tr>
<td></td>
<td>Monitoring tax developments (including legislation)</td>
<td>Supply chain</td>
<td>Taxes paid by employees</td>
</tr>
<tr>
<td></td>
<td>Technology solutions</td>
<td>Employee spending</td>
<td>Employees of suppliers</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Location</th>
<th>Investment</th>
<th>Governance</th>
<th>Taxes paid</th>
<th>Total tax picture</th>
</tr>
</thead>
</table>

If appropriate, go through the steps that are necessary to prepare the total tax picture.
5 Decide with whom the company wishes to communicate

Increasingly, corporate executives say questions about tax are taking up more and more time on investor calls. Institutional investors in particular want to know whether the company will be affected by tax reforms underway around the world now or future changes that may come about as a result of the BEPS project. When a company faces specific accusations of tax avoidance, they want to know whether the questioned tax positions are sustainable. The tax director must work with the C-suite and communications function to anticipate and answer these types of questions.

It is difficult to overstate the importance of communicating with employees when a company is under scrutiny for its tax practices — especially when the company is involved in direct engagement with consumers. Most executives understand how difficult it is to recruit and retain the best people; unanswered allegations of tax avoidance may damage morale and catalyze employee attrition over time.

Finally, the decision of whether or not to proactively engage with the media (as opposed to reacting to a published story) is perhaps the most difficult of all. Some may argue that doing so mitigates the risk; others may believe that it is akin to waving a red flag at a bull. Each company must decide its own strategy, based upon facts and circumstances.

6 Embed reputation risk thinking into core business strategy

Assessing and preparing a response about how the company manages ongoing tax operations is one thing. Creating a whole new risk-focused mindset and culture within the function is another. Ensuring that non-tax professionals — particularly those in upper-level management — proactively consider tax risks when considering a merger or acquisition takes that philosophy one step further. That kind of dialogue must be initiated, revisited and sustained if the tax function is to properly and actively assess the tax reputation risks of ongoing business decisions.
A long climb ahead

Corporate taxes have been in the public spotlight before. In the past, they've attracted attention as part of government tax reforms or as part of litigation with tax authorities. But those news cycles were typically localized and typically ended quickly.

Today, the picture is different. Transparency is quickly becoming the new normal, reputation risk driven by the media appears to be a permanent risk and the way tax administrations will analyze new tax data remains an unknown.

All things considered, the importance of a robust transparency readiness process to ensure that data can be sourced and presented in an effective, efficient and clear manner cannot be understated. Companies now have the full picture of what is required under BEPS Action 13 thanks to a final CbC reporting template that is now in place as well as a full year to prepare. Readiness processes should confirm a number of critical factors:

- Whether the data are accessible, and by which means – and if not, what level of investment needs to occur to secure the situation
- Whether there are anomalies in the data that should be assessed and remedied prior to formal submission
- Whether an appropriate feedback loop exists to ensure that record-to-report processes are functioning as they should
- What year-on-year compliance burden and additional costs (both fiscal and headcount/services provider) the company should expect to incur

While BEPS Action 13 is clearly front and center for all companies with revenues over €750 million (or a near equivalent amount in domestic currency), it is not the only new obligation that companies will be required to meet. Indeed, according to respondents to EY’s 2014-15 Tax risk and controversy survey, 94% of the largest companies having an opinion on the matter think that global disclosure and transparency requirements will continue to grow in the next two years. That means that transparency readiness has never been as important as it is now. Conversations with company management, finance and IT leaders should begin immediately, if not already underway.

As revolutionary as the transparency journey has been, it also demonstrates that many businesses must now deal with a completely disparate set of information reporting requirements. There is, therefore, an important and urgent role for businesses to also play in the ongoing debate with government and regulators to ensure that the compliance burden does not become unmanageable.

Greater transparency between taxpayer and tax authority can build trust and it would be ideal if there was one single set of requirements for companies to meet. It could lead to fewer disputes between taxpayer and tax authority, create greater mutual understanding and foster a relationship based upon cooperative compliance.

We think it is important that all concerned are ready to engage in the next stage of increased transparency and to continue to help all stakeholders and the public better understand the complexities of the tax debate. Only then will we all get a better footing on the mountain.
Between November 2013 and January 2014, EY surveyed 962 tax and finance executives representing more than 20 industries in 27 jurisdictions. The results demonstrate that the risks are growing and that managing tax risk and controversy is more important than ever to business. For example:

- 81% of companies surveyed expect already heightened tax risks to accelerate in the next two years, up from 57% in 2011 when the survey was last conducted.
- The news media has been an even bigger driver of tax-related reputation risk. Eighty-nine percent of the largest companies are concerned about news media coverage of taxes, up from 60% in 2011.
- The OECD’s BEPS project is having a galvanizing effect on tax enforcement, with 74% of the largest companies indicating that they feel tax administrators are now challenging existing structures due to changes in the law or changes in their enforcement approach.

In 2014, we produced a series of shorter reports that focused on the key issues identified in the survey. The first report, Bridging the divide: highlights from the 2014 Tax risk and controversy survey, notes the most significant survey findings and sets the stage for deeper exploration of key topics in the subsequent editions, including:

- Reputation risk
- BEPS and legislative risk
- Enforcement risk
- Operational risk

Survey findings show that many companies may wish to consider enhancing their preparations and tools to bridge the divide between current and future tax risk management models.

Managing operational tax risk: Finding the right people, processes and technology to manage record-to-report risks

In our second in report in EY’s Tax risk and controversy series, we used the survey results, inputs from tax function leaders and EY professionals to provide a deeper exploration of the many sources of “operational” tax risk – those risks arising inside the organization from the interaction of people, policies, processes and technology.

In our report, we examined what companies are doing with the resources they have now, as well as how they build flexibility and resilience. We also investigated the divide that some companies may have to cross as they move from current to future tax risk management models.

ey.com/taxriskseries
EY’s Tax risk and controversy series materials are available on a dedicated microsite, which will continue to be populated with new resources as they become available.

**Benchmarking yourself against your peers**

An innovative benchmarking tool allows you to answer 20 selected questions from EY’s 2014-15 *Tax risk and controversy survey*. You then can compare and contrast your views against survey responses for companies in your jurisdiction and company size. Your responses will not be stored by EY.

**Listen to podcasts**

All of our reports are available for online streaming or offline podcasting. You can download report chapters or listen to the report in one single podcast.

**Download infographics**

All of the infographics appearing in EY’s 2014-15 *Tax risk and controversy survey* series of reports can be downloaded and used in presentations, articles and white papers.

[ey.com/taxriskseries](http://ey.com/taxriskseries)
About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

About EY’s Tax Services
Your business will only succeed if you build it on a strong foundations and grow it in a sustainable way. At EY, we believe that managing your tax obligations responsibly and proactively can make a critical difference. Our 38,000 talented tax professionals, in more than 140 countries, give you technical knowledge, business experience, consistency and an unwavering commitment to quality service – wherever you are and whatever tax services you need.

© 2015 EYGM Limited. All Rights Reserved.

EYG no. DL1256
1402-1201171

ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com