Good Tax Governance in Transition

Transcending the tax debate to CSR

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OIKOS
het kan anders

Colophon

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Foreword

This publication is the result of a joint project of Oikos and the VBDO that started more than two years ago. We felt that, after the turmoil that the tax behaviour of several companies created in the UK, it was time to bring a new angle into this discussion. The resulting negative impact on the reputation of these companies was destroying value. Meanwhile, the European Parliament agreed that the tax policy was part of the corporate social responsibility of a company. But what does this mean? To what extent is transparency necessary? How do we bring back the trust in some of these companies? How to deal with the ethical element in this discussion? What is a fair tax, and how do we deal with these requirements in a rapidly changing and uncertain environment? To what extent do companies have to take the opinions and interests of various stakeholder groups into account?

This publication cannot supply an answer to all of these questions, but makes a first attempt to structuring the discussion and start a dialogue. after depicting the changing legal and societal environment, a number of tax governance principles are being suggested. The exact level of implementation will vary per company, and should be the result of a discussion with all stakeholders. It is a prerequisite that the responsibility for the policy, the quality of the implementation and the level of reporting should be in the hands of the board, not merely in the hands of the fiscal experts.

This publication looks at the issue of responsible tax from various angles, due to the rather unusual cooperation between NGOs, investors, and the consulting industry. We hope that others will join this cooperation.

We want to thank PwC for their extensive input and support during this process and ICCO for their financial support. As this is but a first step in a long process, we are looking forward to hear the feedback of all stakeholders, one of them being you, the reader. We will certainly appreciate all your comments and suggestions.

Gerhard van der Schuil *Executive Director Oikos*
Giuseppe van der Helm *Executive Director VBDO*

Executive summary

The way of doing business is in transition. A shift in the importance of natural and social capital has led to a new perspective on the role of stakeholders. Companies are engaged in a dialogue with multiple stakeholders to define what corporate social responsibility means for their business.

In this publication we address the topic of 'tax'. Tax is often regarded as an obligatory burden for a company's profits. Yet, this perspective does not seem to help restoring trust with stakeholders. In the era of transparency companies are a visible part of society, and as such have a responsibility to contribute to it. Therefore, we think that defining a responsible tax strategy is part of corporate social responsibility. We hope to contribute to a balanced debate on what good tax governance means for companies.

In our study we found that some companies already make efforts in their reporting on tax. A general cohesive approach on good tax governance from a strategic, risk management and CSR perspective is still lacking. CSR is about creating shared value. If tax is part of CSR it should also be seen as an instrument to create shared value and not just as a cost. We believe that the discussion about good tax governance is one that should benefit all and could also help as a yardstick for acting in an ever more transparent fiscal world. With understanding each stakeholder position we hope to help to create a common language on what good tax governance could be and to create more understanding between multinational operating companies, tax administrations, advisors and the public. We therefore 'crafted' six principle-based guidelines on what we think good tax governance could be.

1. **Companies should define and communicate a clear strategy on Tax governance**
2. **Tax must be aligned with the business and it is not a profit centre by itself**
3. **Respect the spirit of the law. Tax compliant behaviour is the norm**
4. **Know and manage tax risks**
5. **Monitor and test tax controls**
6. **Provide tax assurance**

Tax as CSR deserves serious boardroom and government attention. We hope this publication will stimulate that objective.

1 Introduction

Nowadays sustainability and corporate social responsibility (CSR) have become important issues for almost every business. Most listed companies make an effort to define a CSR policy; they have a sustainability department and sustainability is part of the criteria for remuneration of board members. Some CSR themes, such as environmental measurement and management, have been developed and operationalized in an advanced stage. Others, however, are slowly emerging on the CSR agenda. Tax is one of them.

Over the last years, tax policy and tax avoidance schemes have drawn the attention of media and politics, often resulting in negative publicity and harmed reputations.

In *Good Tax Governance in Transition. Transcending the tax debate to CSR* we will try to open the debate on how tax could be regarded as part of a company's corporate social responsibility strategy.

Approaches to corporate tax policy have traditionally been very practical and operational. In order to develop good tax governance today, we feel that more than just operational excellence should be taken into account. A clear vision on tax (e.g. why do we pay it at all?) and ethics are important indeed.

By means of this publication we intend to give a positive twist to a subject that has turned into a match between those who are guided by ethical principles alone and those who cling to the letter of the law in order to justify their tax behaviour.

In chapter two we will explain the relevance of tax as integrated part of a company's CSR policy. In the following chapter we will describe the current status of tax as part of corporate responsibility. We will analyse current policies of Dutch companies, and give some examples of relevant practices. Chapter four will focus on integrated reporting and tax. We point out that we need to change our perspective on reporting and the language we use in our reports. In the final chapter we provide a concept of guiding principles for good tax governance and a holistic approach on tax to facilitate the discussion. Following these principles we will end with some food for thought and describe dilemmas companies and competent authorities face.

Tax is hardly ever part of the core business of a company. Usually tax reporting is assigned to (in- and external-) tax experts and left outside the boardroom. However, with recent attention of the press regarding tax issues and the many transparency- and anti-avoidance initiatives[1], we are convinced that tax should be part of the corporate responsibility strategy of companies and should as such be integrated throughout the business. That is the reason why we joined forces in writing this publication, as we hope for a wide audience

[1] For example Base Erosion and Profit Shifting (BEPS) initiated by the OECD or Country by Country Reporting in the European Union.

2 Importance of corporate social responsibility on tax

2.1 "Tax is where the environment was 10 years ago"

In 2004 it was Jeffrey Owens, former director, Centre for Tax Policy and Administration at the OECD, who said: "tax is where the environment was 10 years ago"[2]. Ten years later there is little concrete news to report. This statement still provides an important perspective on today's debate on tax and corporate social responsibility. It leads to the question what we can learn about good tax governance if we take a good look at how organizations have dealt with the pressure of stakeholders concerning their environmental and social impacts. When it comes to classic CSR themes, we see that many companies tend to invest more in reducing their environmental or social footprint than the international law prescribes. How different was Friedman's view on CSR in 1970: "There is one and only one social responsibility of business - to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game."[3] This vision no longer applies to most activities businesses engage in. For instance leading companies in the Dutch textile industry have signed a voluntary agreement to invest in human rights in their supply chain, reaching out to e.g. Bangladesh to reduce negative social impacts (such as the Rana Plaza Disaster in Bangladesh). If human rights and environment have emerged on the corporate social responsibility agenda, then why should this not be the case for tax?

2.2 Why we pay taxes

Although citizens and businesses consider taxes alike as a cost, Arjo van Eijsden (Partner at E&Y) points out that: *"Tax is a distribution of profits. That puts tax in the same category as dividend - a return to stakeholders in the enterprise. This reflects the fact that companies do not make profit merely by using investor's capital, they also use the societies in which they operate, whether that is the physical structure, the people the state has educated or the legal infrastructure."* [4] In his critically acclaimed book 'A Theory of Justice' John

[2] Financial Times (2004) "The tax avoidance story as a morality tale" November 22, 2004

[3] Friedman, M. (1970) New York Times Magazine, September 1970

[4] Eijsen, A. van (2013) "The Relationship between Corporate Social Responsibilities and Tax: Unkown and unloved" EC Tax Review, 2013-1

Rawls describes societies as a cooperative venture for mutual advantage whose commitments demand reciprocity.[5] In broad terms, a tax payment should therefore not be seen as costs that need to be avoided, but as a legitimate payment from wealth created to communities that contributed to the wealth creation in the first place.[6]

An issue that has been addressed by NGOs is the negative impact aggressive tax avoidance can have on societies, especially in developing countries. In 2010 Global Financial Integrity calculated that between 2002 and 2007 developing countries lost around 107 billion dollars in tax revenue, due to transfer mispricing.[7] On the one hand, developing countries struggle to receive tax revenue in order to increase the national budget, while on the other hand, they aim to attract investments. We observe that the outflow of capital in developing countries exceeds the inflow of capital, with the largest outflow of capital being an illicit one.[8] As Norad, a Norwegian NGO puts it: "the African continent is rich in natural resources and many countries in Africa are experiencing healthy economic growth. Nonetheless little of this growth is benefiting the poor. Due to tax exemptions and evasion, the tax contribution of many companies and individuals is close to negligible. This means that entire societies lose out on vast revenues which could have been used in areas such as infrastructure, education and health care".[9]

As the UK Co-operative Bank states: "One of the most effective ways that businesses can contribute to poverty reduction is to pay income tax in developing countries." Several studies have shown that there is a positive correlation between tax and development[10][11]. Not only will revenues increase, taxation will also lead to redistribution and it supports the implicit social contract and legitimacy of the state, that way creating more stability[12].

But also in the rest of the world, while being faced with austerity cuts, the general public has become highly critical of companies that employ aggressive tax avoidance tactics and by doing so shift the fiscal burden to the rest of society.[13] The *Eurobarometer* survey ascertained that 89% of the general public in Europe wants stricter regulation against tax

5 Rawls, J. (1971) "*A Theory of Justice*"

6 Sustainalytics (2013) "*It's Time to Call for More Responsibility: Multinational Corporations and Tax Transparency: A Guide for Responsible Investors"*

7 Global Financial Integrity (2010) "*The implied tax revenue losses from trade mispricing*" p. 14

8 Baker, RW (2005) "*Capitalism's Achilles Heel*"

9 Norad (2013) www.norad.no/en

10 Goodspeed, T., Martinez-Vazquez, J., & Zhang, L. (2011) "*Public Policies and FDI Location: Differences between Developing and Developed Countries*" FinanzArchiv: Public Finance Analysis, 67(2), 171-191

11 James, S. (2009) "*Incentives and investments: Evidence and Policy Implications*" Washington, DC: World Bank

12 Cobham, A. (2005b) "*Taxation policy and development*" Economy Analysis No. 2

13 SOMO (2013) "*Avoiding Tax in Times of Austerity. Energias de Portugal (EDP) and the Role of the Netherlands in Tax Avoidance in Europe*"

avoidance.[14] Andrew Witty, CEO of GlaxoSmithKline made the following observation: "*I really believe one of the reasons we've seen an erosion of trust, broadly, in big companies is they've allowed themselves to be seen as being detached from society and they will float in and out of societies according to what the tax regime is. I think that's completely wrong*" [15]. Public frustration over the fair share debate has showcased tax as a moral phenomenon.

A purely legal technical approach to the issue will not protect companies from charges of irresponsibility and associated reputational damage and eroding brand value.[16]

2.3 "The thickness of a prison wall"

Broadly speaking CSR can be considered as a corporate's impact on society. ActionAid[17] shows in their 2011 report on Tax Responsibility that a definition of corporate responsibility needs to be drawn more widely than 'moral' considerations only, and includes both:

- *the consideration of a business's impact on society and the environment, beyond its obligation to comply with the letter of the law*
- *the consideration of the potential impact of environmental and social issues on a business's long-term performance*

CSR therefore also means a socially responsible view on law. Tax practitioners and corporations often point out that tax evasion is illegal while tax optimization is legal and compliant with the law. However, in practice, the boundary between tax evasion and tax avoidance is up for interpretation and the difference, as it has been famously said, is the "thickness of a prison wall".[18] 'Because of this grey area of law, actual behaviour becomes a factor of importance when making decisions on tax planning schemes. Sustainalytics identified a spectrum of tax behaviour ranging from evasion to mitigation.[19] Besides the contrast between legal and illegal, we should make a difference between responsible and irresponsible tax planning.

[14] The Eurobarometer is published on http://ec.europa.eu

[15] The Guardian (2011) "*Andrew Wittey of GSK: Big firms have allowed themselves to be seen as detached from society*" March 20th 2011

[16] ChristianAid (2011) "*Tax and sustainability. A framework for businesses and socially responsible investors*" p3

[17] ActionAid (2011) "*Tax responsibility. The business case for making tax a corporate responsibility issue*" p1

[18] Denis Healey, former UK Chancellor of the Exchequer, as quoted in Elliffe, C. (2011) "*The Thickness of a Prison Wall - When Does Tax Avoidance Become a Criminal Offence?*" New Zealand Business Law Quarterly, Vol. 17, no. 4, pp. 441-466, December 2011

[19] Sustainalytics (2013) "*It's Time to Call for More Responsibility: Multinational Corporations and Tax Transparency: A Guide for Responsible Investors*"

2.4 Political developments

The above paragraph illustrates that law alone cannot bring business and society back together. However, a number of political declarations were made and (non-) legislative actions were taken to close the gaps in the international tax system. At a global level the current BEPS action plan at the OECD is the most important process. The core pillars of this action plan are the coherence of corporate tax at an international level, realignment of taxation, and substance and transparency, coupled with certainty and predictability. To put it concretely, this will include model treaty provisions concerning the substance of companies that want to use treaty benefits, a proposal for country-by-country reporting and transfer pricing guidelines.

Furthermore, in February 2014 the OECD proposed its action plan for automatic information exchange, which focuses on transparency between tax authorities and will replace the current system of information on request. An initiative by the OECD, Tax Inspectors without Borders, supports developing nations to close tax loopholes and improve the effectiveness of their tax regimes.

Within the EU a number of proposals have been introduced. After stricter transparency regulations have been adopted for the extractive and logging industry[20] and the banking sector [21], the European Commission is keen on introducing country-by-country reporting for all sectors. The Mother-Subsidiary Directive is momentarily also up for revision, with a proposal including national anti-abuse clauses and an initiative to tackle hybrid loans.

2.5 'Shared value'

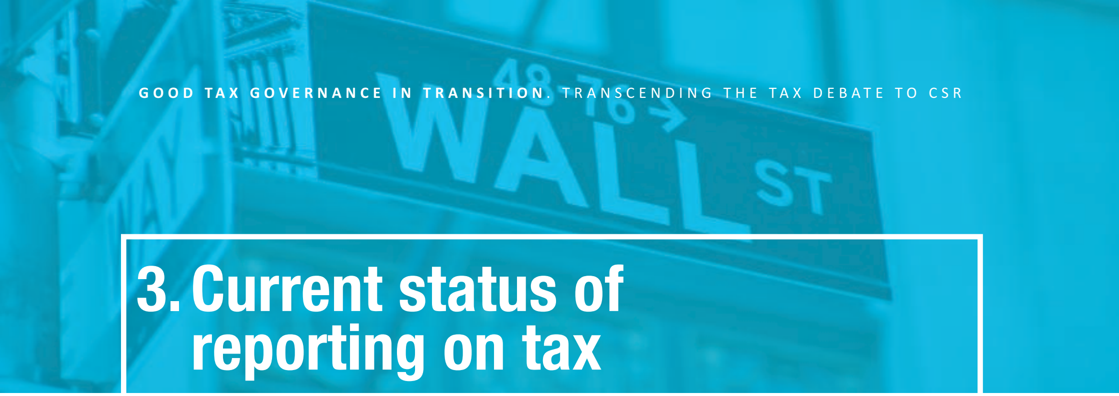
What is clearly illustrated in the fair tax debate is that the number of key stakeholders has grown rapidly. The tax inspector is no longer the only key stakeholder, as almost every citizen in the country seems to be part of a growing group of stakeholders. This has incited companies to redefine the purpose of their corporation and to learn how to legitimize their business again. As Michael Porter and Mark Kramer wrote in 2011: "*Companies must take the lead in bringing business and society back together. The solution lies in the principle of creating shared value, which involves creating economic value in a way that also creates value for society by addressing its needs and challenges. The purpose of the corporation*

[20] The European Transparency Directive and the Accounting Directive

[21] The Capital Requirements Directive

must be redefined as creating shared value, not just profit per se. This will drive the next wave of innovation and productivity growth..."[22] These citations from Porter's article seem to be a valuable contribution to the fair tax debate. Porter implicitly argues that companies can create economic value by addressing the existing frustrations in society around fair tax. As tax is a shared value and shared value is the core business of CSR, tax planning can no longer be considered to be outside the scope of the CSR agenda.

[22] Porter, M. and Kramer M. (2011) "*Creating Shared Value*" Harvard Business Review, January/February 2011



3. Current status of reporting on tax

To gain a general understanding of the current status of how companies report on tax regarding the above issues, we have looked into publicly available information provided by various listed companies in the Netherlands.

3.1 Tax strategy

Tax strategy and corporate reputation are more and more seen as a business issue[23]. For this reason, we were interested to find out if and to what extent companies report their tax strategy. VBDO has done research on whether companies have communicated their tax strategy for financial year 2012 [24]. Sixty-nine companies were included in their review. Of these companies, seven have published their tax strategy in their annual report and/ or on the corporate website. Four companies have mentioned their tax policy briefly in the risk paragraph. In total, 16% of the companies included in the review communicate their tax strategy. However, the thoroughness in which they communicate their tax strategy is arguable. Although tax is gaining an interest among different stakeholders, the number of companies actually communicating their tax strategy seems quite low.

3.2 Tax as a CSR issue in company reporting

Of the sixty-nine companies included in the VBDO review[25], only four (6%) companies specify tax as a CSR issue. Looking at the extensive debate on tax we have witnessed during recent years, this number indicates that this discussion not yet reflects a real change in the mind-set of companies when it comes to tax. Of the four companies that regard tax as an aspect of CSR, three do this on a fairly high-level by acknowledging that paying taxes contributes to the development of countries. Unilever has a more extensive approach and is thus mentioned by VBDO as a best practice example for linking tax policy to CSR.

3.3 Tax risk management

As tax is an inextricable part of doing business, it is interesting to see whether or not companies include tax in their broader risk management approach. We have reviewed

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23 PwC (2013) "*Tax Strategy and Corporate reputation: a business issue. 16th annual Global CEO Survey*"

24 VBDO (2013) "*Duurzaamheid bij beursgenoteerde bedrijven in de versnelling: Rapportage aandeelhoudersvergaderingen 2013*" For more detailed information on the data included, we refer to this report. We note that VBDO has added some companies to their dataset after publication date.

25 Idem.

the financial year 2012 of the 25 companies listed on the Dutch AEX index with respect to their reporting on tax risks and tax risk management.

In total, eight companies have not included any tax related risks. Nine companies mentioned tax risks, but in a general manner and mostly as an enumeration of items. Of the reviewed companies, eight have included a (company) specific tax risk for which some have included risk mitigating factors.

The risk associated with corporate responsibility in relation to tax can be broadly summarized in three categories[26]:

1. Reputational risk; we have found several companies specifically articulating the risks resulting from non-compliance with local tax legislation. In some cases, risk mitigating factors are included, like consulting external tax advisors and having a Tax Control Framework.
2. Regime or regulatory risk; several companies mention that operating globally means they are subject to taxation in many different countries and that tax laws in those countries can be amended or differently interpreted. Several companies mention that changing tax legislation (rising taxes) could have an adverse effect on the companies' performance. Some companies also report the risk of double taxation and risks relating to transfer pricing.
3. Financial or investor risk; in this category we have found companies reporting on tax accounting risks relating to the inability to utilise deferred tax assets and/or relating to the value of loss carried forward.

3.4 Taxes paid, country by country reporting

Of the 66 companies (three companies only have activities in the Netherlands) included in the VBDO survey[27], only 8% reports some sort of country-by-country information on tax. Or, as VBDO states, it can be argued that almost no company seriously and completely reports tax on a country-by-country basis. Only one company (Corio) shows a complete division of tax paid per country. Four other companies give some insight on a regional or country level of taxes paid, but it is still unclear whether it is validated with their stakeholders.

[26] ActionAid (2013) "*Tax responsibility, An investor Guide*"
[27] VBDO (2013) "*Duurzaamheid bij beursgenoteerde bedrijven in de versnelling: Rapportage aandeelhoudersvergaderingen 2013*"

3.5 Tax governance: roles and responsibilities

To gain an understanding of the importance of tax on the corporate agenda, we looked into the roles and responsibilities in organisations with respect to tax. As starting point of this research we reviewed the financial year 2012 annual reports of the AEX listed companies. When tax governance was not included in the annual report we did a search on the corporate website, especially looking at the Audit Committee Charter.

In general, we classified the companies in three categories:

1. Companies that only incorporate the responsibility of the supervisory board with respect to tax[28] in the Audit Committee Charter on their website. Tax governance is not included in the annual report. Seven of the companies included in our review fall with this category.
2. Companies that have included tax in an enumeration of items the audit committee supervised on. No additional information on tax roles and responsibilities is provided in the annual report. Fifteen companies in our review fall within this category.
3. Companies that included a more detailed list of tax items the supervisory board looked at, or companies that included tax in the company overview and/ or roles and responsibilities of a member of the Executive Board. In our review, we found three companies that provide more information on tax roles and responsibilities.

Overall impression

We see some companies making an effort in their reporting on tax. Still, a real co-hesive approach for tax from a strategic, risk management and CSR perspective is lacking. Developments like BEPS and country-by-country reporting will require companies to develop a broader view on tax transparency to enable them to articulate the story behind the numbers. Or, as a PwC UK study on tax transparency states: "*Tax reporting that is limited to historical corporate income tax numbers is unlikely to be enough*".[29]

[28] Paragraph III.5.4, Dutch Corporate Governance Code
[29] PwC (2013) "*Tax Transparency Building Public Trust, How companies are explaining their tax affairs*"

4 A new business language for the 21st century

4.1 Why do we need a new business language?

As we have set out in the chapters above, companies started to change their perspective on their corporate responsibility. This has led to global multi-stakeholder initiatives, which still continues under the heading of integrated reporting as a first step towards a new common business language.

Why did this initiative gain such momentum in 2011? Referring to interviews with eighteen opinion leaders within the Dutch financial system about their perspective on the future of reporting[30], not one opinion leader opposed integrated reporting. Yes, the world has changed and reporting must change too. Board members and other decision makers are still confronted with complex issues, such as biodiversity, human rights, climate change, obesities, and other mega trends. And on top of all that, fair tax and good tax governance. How can you explain your performance with regard to such complex issues to your stakeholders? This shows the need for a *new common language*, which enables decision makers to make better informed decisions related to all those complex issues and to communicate them to the diversified group of stakeholders.

4.2 Measuring and managing total impact: A *new common language* for business/tax decisions

We have argued that tax impact not only deserves just as much attention as economic, environmental and social impact, but also with the same rigour as these topics and using the same business language. We have found no literature which tries to explain a new business language which parallels the people, planet and profit impact with tax impact. And why should we not try to benefit from the lessons learnt in those other domains? The tax domain is a world which requires more than tax specialists in order to look at tax impact in an integrated manner. The following diagrams provide insight into this notion:

[30] Roelofsen, E. and Laan, R. van der (2013) "*Voorkauwen of vaag houden*" Eburon, 2013

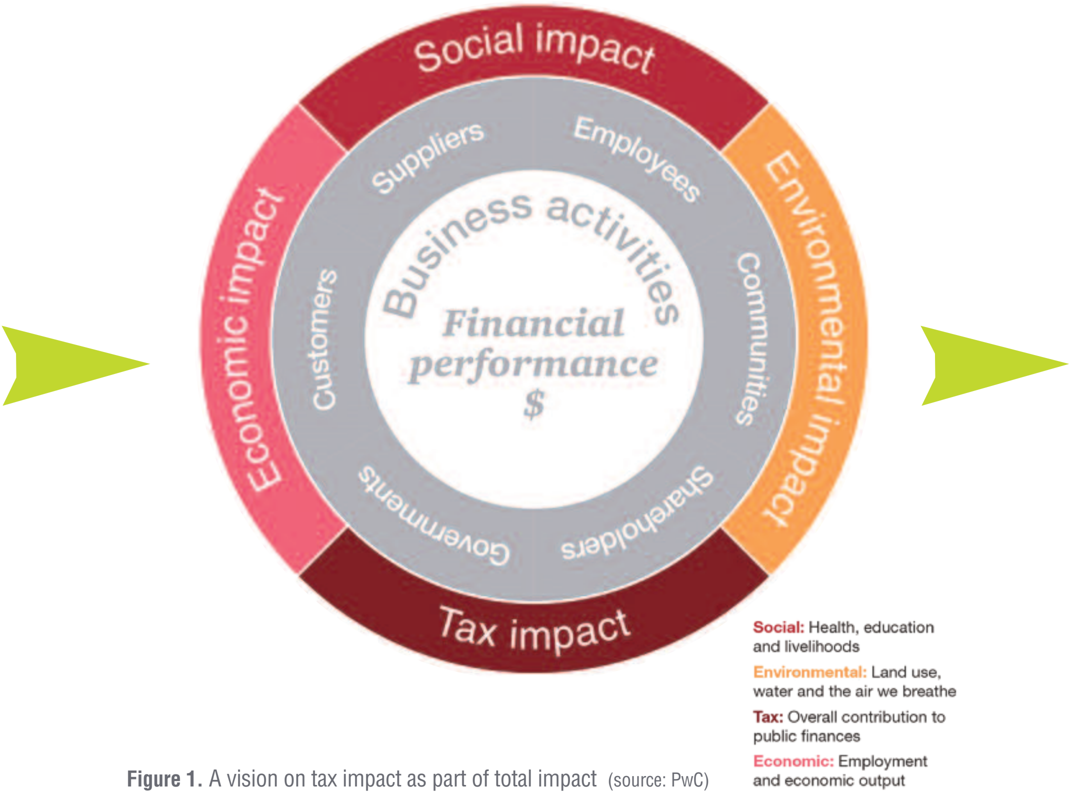

Figure 1. A vision on tax impact as part of total impact (source: PwC)

As Mervyn King, the world's most famous advocate of integrated reporting, stated: *"… the world's iconic companies have realized that the impacts of their activities on their stakeholders and generally on society, the environment and the economy, are critical… Integrated thinking requires all these [complex] factors to be considered in a holistic manner, so that the company can understand, and make decisions based on the overall impact it has on all its stakeholders. Total impact measurement and management is a new language to assist companies in understanding the overall impact of their activities… and to assist them in moving towards integrated reporting."*[31]

[31] PwC (2013) "*Measuring and managing total impact: A new language for business decisions*" www.pwc.nl/integratedreporting

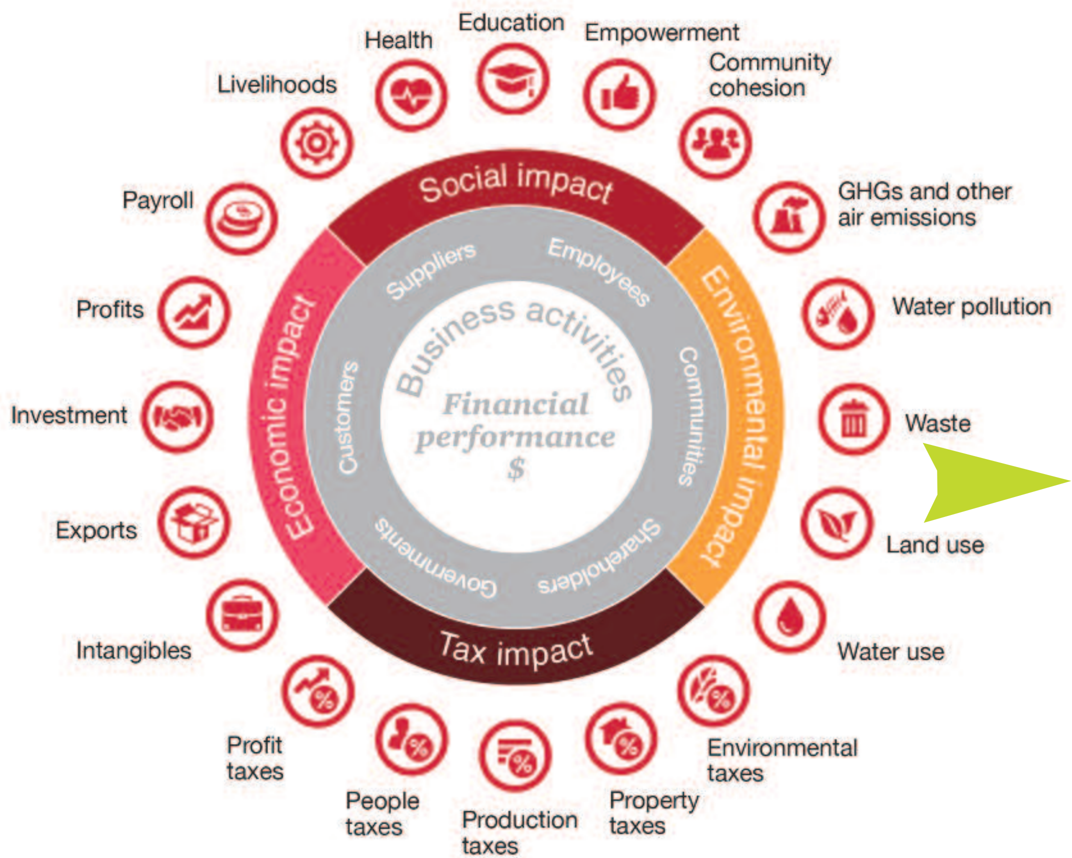

Figure 2. Total Impact diagram with concrete examples (source: PwC)

Three fundamental concepts are at stake here; materiality analysis, value creation and measuring impact. These three concepts have been fully embedded in the (integrated and sustainability) reporting guidelines that have been launched in 2013[32]. Based upon our experience on how companies follow the roadmap towards integrated reporting, we could also depict the roadmap towards good tax governance:

[32] The international <IR> framework, 2013, www.theiirc.org; G4 Sustainability Reporting Guidelines, www.globalreporting.org, 2013

Figure 3. The continuous learning cycle towards good tax governance, step-by-step and focusing on material aspects (source: PwC)

What will we learn from following this learning cycle? We do not yet know how we can develop a new common business language from this learning cycle. Yet, working along this learning curve will result in developing that new common business language. In connection with this we refer to the Barley Case in appendix 1[33].

It is beyond the scope of this report to further explore the new language for the 21st century in order to explain the complex tax impact. However, we believe that by continuously going through the learning cycle, new principles for good tax governance will emerge. In the next chapter we will further examine this subject.

[33] PwC (2013) "*Measuring and managing total impact: A new language for business decisions*" www.pwc.nl/integratedreporting

5 Exploring guiding principles for good tax governance

With the arrival of the age of transparency, it was just a matter of time until tax came into view of a public outside the traditional community of tax specialists, such as tax inspectors, tax managers and tax advisers. As mentioned earlier in this report, the public debate on good tax governance brought about a shift from a biased legal approach on tax ('if it is possible within the boundaries of the law, it is ok') towards a discussion on ethical tax behaviour ('does it fall within the spirit of the law'). This trend was fuelled by the economic crisis and the subsequent stream of articles in the press about tax behaviour. People looked in amazement at their own tax bill and simultaneously at the tax position of some multinationals and non-compliant behaviour in some countries[34].

In the wake of these events came the questions of the public, politicians and NGOs. The debate got into a 'j'accuse' mode and solutions were not right around the corner. We recognize the following dilemmas that multinationals are facing when discussing tax behaviour:

Dilemmas
Multinationals operate 'internationally' / Tax Administrations 'nationally'
Tax regimes providing tax incentives / 'Fair share' discussion
More transparency of multinationals / More aggressive Tax Administrations
International reporting standards / Local tax legislation
Accountability shareholders / Social and political accountability
Intricate (international) tax environment / Building audit capacity

A first step towards good tax governance is tax compliance management. We see various tax transparency initiatives emerge[35] and tax administrations implement or experiment with compliance strategies based on co-operation and transparency supported by the Forum on Tax Administration (OECD).[36] What these models usually have in common is that they are built on the pillars of 'justified trust' and transparency. Tax Compliance models

[34] For example Greece. The Dutch minister of finance answered questions of parliament. "*Verzoek om reactie op het bericht dat rijke Grieken 54 miljard naar het buitenland sluizen*" Kenmerk: BFB 2014-132M

[35] Such as the country-by-country reporting initiatives at the levels of the US, the EU, etc.

[36] See for example: OECD (2013) "*Co-operative Compliance: A Framework*"

based on 'justified trust' and transparency can only exist if the tax function of a company is at a sufficient level of maturity. A company can be trusted when they are able to provide correct information, i.e. when they are 'in control'.

Furthermore, most tax administrations only want to engage in co-operative compliance arrangements with taxpayers who refrain from 'aggressive tax planning'. However, what is deemed 'unwanted behaviour' by one tax inspector could be perfectly acceptable to the other tax inspector.

As we progress, companies will develop specific principles for good tax governance for their organisation. They will start reporting on it and we think that slowly but surely these principles will converge, at least per industry. In order to stimulate discussion we have developed a set of guiding principles for good tax governance. We believe that the discussion on good tax governance is one that should benefit all and could also help as a yardstick for operating in an ever more transparent fiscal world. With a common understanding we hope to help create a common language on what good tax governance could be. At the same time we hope this will create more understanding between multinational operating companies, tax administrations and the public.

5.1 Guiding principles for good tax governance

Principles and a code of conduct are only useful if you can measure their acceptance within an organisation. Therefore some principles contain a reporting and a testing element. Although the principles speak for themselves and appear to be stating the most obvious, we hope that they provide some guidance in the discussion on good tax governance.

1. DEFINE AND COMMUNICATE A CLEAR STRATEGY	
A proper tax strategy should be transparent and clearly contain a company's vision and objectives with respect to its tax policy. Tax should be part of a companies CSR policy.	
I.	The strategy takes stakeholders interests into consideration and is clearly communicated (transparency).
II.	Long term Key Performance Indicators (KPIs) are set that do not only deal with managing the effective corporate tax rate (ETR). Tax should be aligned with the business.
III.	A paragraph on tax ethics contains the company's vision on tax planning strategies. It clearly stipulates the company's risk appetite.
IV.	The organisation describes its policy towards tax administrations (co-operative compliant or other).
V.	Roles and responsibilities are defined. The Board and Audit Committee support the tax strategy.

2. TAX MUST BE ALIGNED WITH THE BUSINESS AND IS NOT A PROFIT CENTER BY ITSELF	
It should be understood that tax is an integrated part of doing business. Tax is not merely the exclusive domain of the tax department. The main purpose of business is to create value for stakeholders before tax, not after. As a principle a company pays tax in every country where it employs business activities. A company must be able to extract tax information when needed. This implies that:	
I.	Tax processes and procedures are well documented and maintained.
II.	A proper tax IT infrastructure is available.
III.	Required skills are available within the organization.
IV.	The organization must be able to demonstrate how tax is aligned with the business.

3. RESPECT THE SPIRIT OF THE LAW. TAX COMPLIANT BEHAVIOUR IS THE NORM

Ultimately, managing tax is about filing the correct returns on time, irrespective of the company's tax planning strategy. Being compliant with tax laws and regulations, statutory financial obligations and international accounting standards is the core responsibility of our tax function.

I.	The organization can demonstrate it files its tax returns on time. This refers to: • Corporate tax compliance; • Employee tax compliance; • VAT; • Customs; • Other tax compliance.
II.	A statement on compliance readiness will be published with the tax position in the annual report.

4. KNOW AND MANAGE TAX RISKS

Tax risk management is a pro-active process that is demonstrably embedded within the risk management and internal control function of the company.

I.	Tax risk assessment and control activities are reported on a regular basis to the CFO. A tax risk report is presented to the Audit Committee at least once a year.
II.	Tax risks are financial risks (penalties, legal interest, re-assessments, and potential conflicts) or non-financial risks (reputational: public, tax administration, government).
III.	Tax risk management processes and policies are well documented and will be assessed on an annual basis by the external auditor.

5. MONITOR AND TEST TAX CONTROLS

Manuals, policies and controls are paper tigers if not properly executed.

I.	The company will develop an internal monitoring and testing methodology on the execution of its tax strategy (including ethics) and controls. This methodology includes: • Remediation plan in case of noticed errors; • Escalation plan; • Communication plan.
II.	Monitoring and testing will take place on a regular basis. Monitoring and testing results will be documented and stored appropriately. An annual monitoring and testing report is presented to the external auditors and Audit Committee at least once a year.

6. PROVIDE TAX ASSURANCE

In principle, the organization is prepared to provide third party tax assurance should regulators or competent authorities require a certain level of comfort. A company will decide on an appropriate way of reporting to the public and its stakeholders and will also explain why with (expected) international regulation. A company will report to the public and its stakeholders those aspects that are material to them and will also be compliant with (expected) international regulations.

Food for Thought

1. **Is fair tax a political issue or is it part of Corporate Social Responsibility?**
2. **Is tax a cost or is tax the creation of shared value for stakeholders?**
3. **Is it more important to focus on transparency objectives or is it about measuring the impact of transparency, like increased compliance and less corruption?**
4. **Should a company follow international regulation if it conflicts with national legislation?**
5. **To what extent should a company follow the specific needs of any single stakeholder group?**

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Description organizations

Oikos

At Oikos we believe that everyone has the right to live free from poverty and to have the chance to develop and participate in society. The aim of all our activities is to involve Dutch stakeholders in the vital task of achieving sustainable development for all. We do this by organising conferences and producing informative material, campaigning and lobbying backed up by research into the root causes of poverty.

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VBDO

The Dutch Association of Investors for Sustainable Development (VBDO) works to create a sustainable capital market, a market that considers not only the financial criteria but also the non-financial, social and environmental criteria. VBDO's vision is to increase sustainability awareness among companies and investors.

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Appendix 1

The Barley Case; a new common language (source: PwC)

Hypothetical example*:* To illustrate how Total Impact Measurement & Management (TIMM) works we have prepared this over-simplified hypothetical example. We recognise that in actual practice there will be numerous trade-offs and considerations to be made, but to keep things simple, we explore just two of those in this example.

Business type and geography: Brewer in Africa

Key strategic question*:* Should barley be imported or should an alternative, locally grown crop be grown for the brewery?

Description of strategic context: Procurement decisions include capital and revenue expenditure (including overheads), as well as potential risks such as regulatory change. Often they do not take account of wider impacts (e.g. environmental or social) or the more intangible implications for business (e.g. reputation or changes in consumer attitudes).

In this case, the brewer wants a balanced, holistic analysis to support its decision. An approach that includes comparing the total long-term impact of using barley with that of a locally grown alternative will provide the basis for transparent decision making on sourcing. This new total impact perspective could also help address, for example, security of supply and foreign exchange exposures. In addition, it would allow the brewer to develop a clearer long-term strategy for the business and help engage with stakeholders on the basis of a more credible analysis of the impacts of business decisions.

How TIMM could be used *(examples of analysis)*

The brewer has two options: it can import barley from Country A (Option 1) or it can grow an alternative crop locally in Country B (Option 2). Each option has different social, tax, economic and environmental implications as well as, of course, financial ones. TIMM can be used to measure and value not only the business financial performance, but also the societal costs and benefits of each option on both a global and a national basis. A simplified analysis of the pros and cons of each strategy are set out below.

Summary outputs of the TIMM analysis

Figure 4 summarises the results of the TIMM analysis for the two options. Each bar represents a positive (green) or negative (red) impact. The inner circle represents the expected return to shareholders. The different impacts can be compared and aggregated.

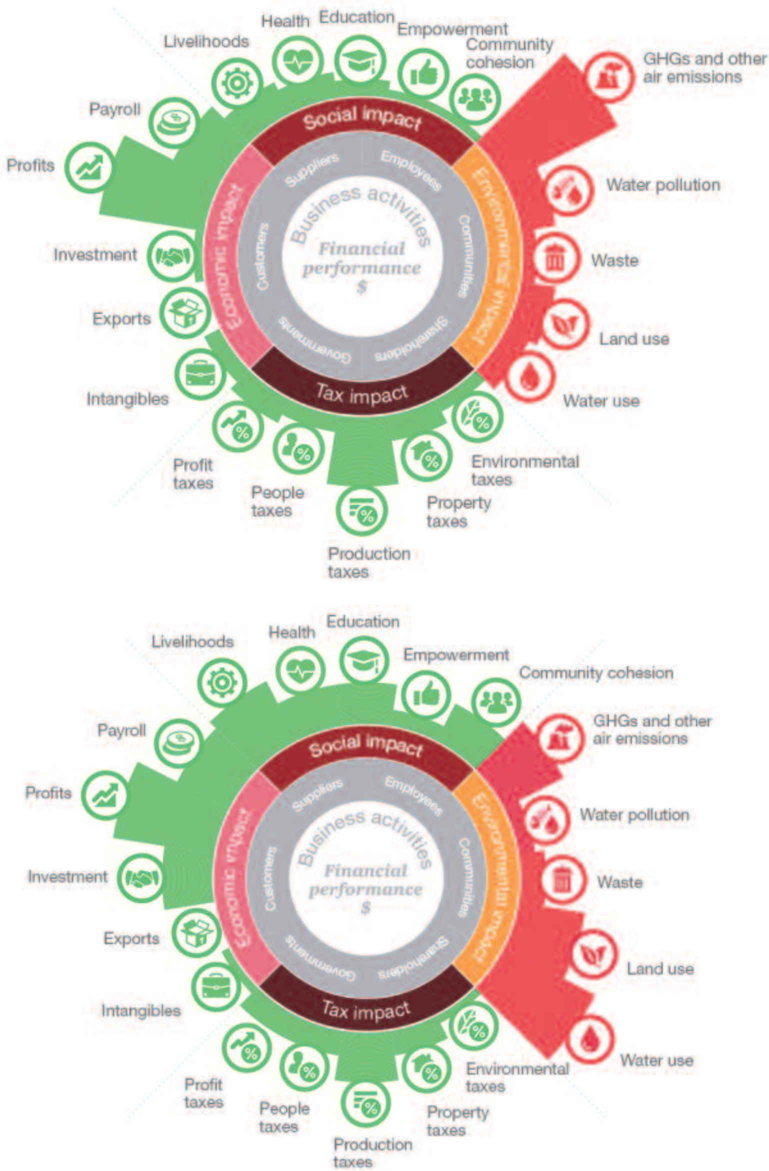


Figure 4: Using TIMM to weigh up the options (source: PwC)

Business financial performance:

- Local sourcing in Option 2 reduces the brewer's costs and risks due to lower distribution costs and reduced foreign exchange exposure.
- Local sourcing in Option 2 enhances the brewer's reputation with local consumers which is reflected in stronger demand and customer loyalty; in Option 1, the brewer's reputation in barley-growing countries is weakened, but only marginally.
- However, Option 2 has higher set-up and running costs, including supply chain development, community investment and increased local staff and offices.
- Trade-off: Will reduced operating costs of Option 1 outweigh the benefits and set-up costs of Option 2?

Environment:

- Option 2 generates lower greenhouse gas emissions as transport demands are lower and creates less water pollution, because more traditional growing techniques are utilised which use natural fertilisers.
- On the other hand, Option 2 has some higher environmental costs due to less advanced waste management and the loss of valuable ecosystems which may have been cleared for agricultural purposes.
- Even though the alternative crop that was chosen requires less water than barley, Country B has greater water scarcity which makes it more valuable in comparison to Country A.
- Trade off: Which is better... reduced global greenhouse gas emissions or better water availability in Country B?

Economic:

- More mechanised barley production in Country A means that more physical capital is employed in Option 1.
- Local procurement under Option 2 has more widespread economic impacts along the brewer's supply chain. Although, given the higher value added activities across the supply chain for Option 1 (i.e. higher use of technology), this generates overall higher profits.
- Additional investment is needed under Option 2 to establish the infrastructure required for local production which will have a positive economic impact.
- At a global level, there is no net effect on exports so the impact of both options is zero.
- Even though Option 2 will require more local employees, these generate lower value added per employee so the overall impacts for the two options are similar.
- Trade-off: It can be observed that the impact on the economies of the two countries is very different under the two scenarios.

Social:

- Under Option 2, local farmers benefit from access to a (more) secure market and the support of the brewer in developing business infrastructure such as co-operatives, training and health services. This is reflected in more secure livelihoods, greater self-confidence and enhanced cohesion of the agricultural communities.
- Under Option 1, barley is bought on the international market with no established direct supply chain relationship. This means the brewer's influence on the social outcomes in exporting communities is weaker.
- Volumes of beer consumption are largely unaffected by the choice of option.
- Trade-off: There would appear to be a clear social impact benefit of Option 2.

Tax:

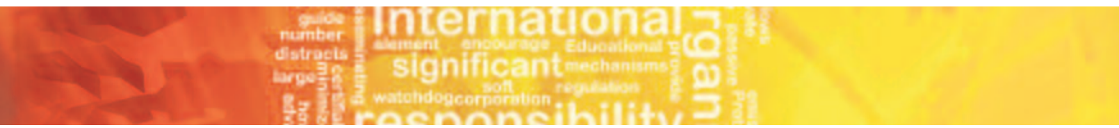
- Under Option 2 the brewer is expected to be more profitable in the long term and, hence, liable to greater profits tax. However, in the short term, the costs of establishing the local supply chain will reduce profits tax.
- Under Option 1, duty would be payable on imports of barley; this would not be offset by the taxes payable by local farmers.
- Trade-off: In reality, tax considerations would be considerably more complex. The point here to make is that the tax impact, which is a material issue in this industry, is part of total impact. The way it is presented (in the picture above) will enable the company to start a dialogue about the positive tax impact which may be lower, relatively or in any particular year. Yet, this should be seen in the context of a higher positive impact or lower negative impact in other domains.

Summary

In this hypothetical example, in the absence of total impact thinking, the decision would have been made largely using financial analysis with some qualitative overlays. TIMM provides a new perspective. Using TIMM and putting a value on the qualitative overlays clarifies the total impact of each decision and makes the many trade-offs between Options 1 and 2 easy to identify. It is immediately obvious that there are two key trade-offs that need to be considered:

- **reduced greenhouse gas emissions vs. increased water usage in a more water scarce location**
- **improved societal outcomes vs. an increased use of an already scarce water resource in those same communities**
- **a possible third key trade-off could be lower local profits tax in the short term vs. higher profits tax in the longer run. Just as the other trade-offs, this one should also be seen in the light of the other key trade-offs.**

TIMM may not be able to provide an empirical answer, but it provides management with significantly more information with which to make a more informed decision, and a framework to communicate the rationale for that decision with their multiple stakeholders.



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