Australasian Tax Teachers Conference 2008

Abstract

Tax Risk Management: A review of recent developments in tax risk management and an analysis of the impact of tax risk management on the tax function within a large corporation.

Business decisions of a corporation include matters relating to taxation and are made by management whilst the financial impact of those business decisions, to a large extent, are borne by the shareholders. Corporate governance practices seek to provide a mechanism whereby the interests of management are aligned with those of the shareholders. Current expectations of good corporate governance now include tax risk management and this paper will outline the relevant obligations on a corporation such as Principle 7 of Australian Stock Exchange Principles of Good Corporate Governance and Sarbanes-Oxley Section 404 in the US.

Tax risk management by large corporations has recently been the focus of the Australian Taxation Commissioner’s statements on appropriate tax compliance policies. Other tax authorities around the world have also raised tax risk management as integral to a company’s tax compliance strategy. This paper will look at pressures in Australia and around the world on large corporations to address tax risk as part of a corporate governance strategy and how corporate attitudes and practice towards managing tax risk have evolved. This paper also looks at the impact of the tax risk management through a review of surveys carried out by a number of organisations including international chartered accounting firms.
The separation of ownership and control of a company means that the directors who make the tax decisions will not necessarily bear the consequences of those decisions even if there is a tax adjustment. Importantly not all directors of a corporation will be made aware of the tax position a company takes as tax departments within a corporation and external advisers are often responsible for the tax position yet are not necessarily accountable for any tax adjustment. To the extent the interests of the owners of the corporation differ from the persons who control the company there may be conflicts with respect to a variety of issues including taxation.

The Australian Taxation Office (ATO) and other revenue authorities around the world have highlighted, in an effort to improve corporate tax compliance that directors of a corporation must ensure that they are aware of the tax position that the corporation takes in meeting their director’s duties\(^1\). Good corporate governance practices, the ATO emphasises, require systems within the organisation to exist so that directors are informed and make the final decisions with respect to the tax risk approach taken. Arguably the ATO is shifting the audit of corporate tax compliance back to the corporation itself by requiring directors to review tax risks as part of a good corporate governance program.

**Corporate Governance**

An understanding of the meaning of corporate governance is required before looking at the extent to which tax is part of good corporate governance practice however there appears to be a lack of a universally accepted definition of the term.

At its simplest corporate governance is concerned with the way in which companies are directed and controlled.\(^2\) Further the term ‘corporate governance’ is often used to describe the way in which a company’s internal arrangements, taking into account external factors such as legislation, commercial or market pressure,

\(^1\) Michael Carmody, Commissioner of Taxation,
“Large Business and Tax Compliance; A Corporate Governance Issue” Leaders’ Luncheon 10 June 2003
“Corporate Governance and its Role in Tax” 2005 Taxation Institute National Convention 17 March 2005
“Large Business and Tax Compliance” Speech to the International CFO Forum, Sydney 13 October 2005
Micheal D’Ascenzo Commissioner of Taxation,
“Top end tax risk management-the journey continues” Speech to the PricewaterhouseCoopers Boardroom Dinner, Brisbane 28 June 2006
“Increasing certainty in uncertain times” Deloitte Academy Melbourne 16 April 2007
Jim Killaly Deputy Commissioner of Taxation Large Business and International,
“Tax risk governance: the corporate and personal dimensions” Australian Institute of Company Directors Sydney 18 July 2007
“Recent Developments in Tax Administration” Australian Taxation Summit 2004
“Analysing Recent Developments in Large Business Compliance” Australian Taxation Summit 15-17 February 2006
“Managing tax risks by analysing the Tax Office’s stance on compliance” Australian Taxation Summit, Sydney 5-7 February 2007
“… provide,
• for responsibility for decision making to be divided between the company’s members, its board and its executive management
• for decisions to be taken and implemented
• for the exercise by decision-makers of their powers to be monitored and reviewed
• incentives for decision-makers to act in the interests of the company and disincentives to act in a manner that harms the company”

As corporate governance concerns the management of the company and the extent to which stakeholders’ interests are respected and protected it derives very much from the separation of ownership and control in a corporate structure. Fundamental in developing corporate governance practices within a corporation there needs to be an identification of who the stakeholders are. In the Anglo-American model corporate governance focuses on the interests of the financial stakeholders, typically shareholders. In the European market model where stock markets are less liquid, and cross shareholdings occur between industrial groups and banks, governance is often extended to a broader range of stakeholders, including employees and customers.

The recent increased focus on corporate social responsibility will impact on corporate governance practices as the pool of stakeholders affected by a corporation’s outcomes increases.

Further the 20th century has seen a move away from companies that are owned and managed by the same group of people to companies with a diversified range of shareholders. There is an increased need for managers to be employed by the company to act on behalf of the shareholders and individual shareholders have little influence over the management of the company.

Corporate governance has been the focus of regulators and the subject of various reports and recommendations following the Enron and Worldcom collapse in the US in 2001 and HIH Insurance, One.tel and Harris Scarfe corporate collapses in Australia during 2001 and 2002. 4 The Economist Intelligence Unit (EIU)(sponsored by KPMG) published ‘white papers’ in 2002 and 2003 in which they reported information they had collected from surveys and interviews with corporate executives from around the world concerning corporate governance. 5 The EIU note that the responses on the whole reflect a substantive change with respect to corporate governance. The EIU observed that shareholders have become more active in their examination of companies and that companies are responding by becoming more transparent. In addition there is a feeling among respondents that there is a better understanding of the business within the

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3 Commercial Applications of Company Law 7th Edition CCH P Hanrahan, I Ramsay and G Stapledon Page 113
4 “Tax Risk Management” Ernst and Young LexisNexis Butterworths 2007 page 49
5 “Corporate governance: Business under scrutiny” A white paper from the Economist Intelligence Unit 2002 and 2003
company as a result of the focus on governance. Importantly the EIU also noted that the board of directors had “become a more potent force within the organisation”\(^6\)

Specifically risk management has been identified globally as a corporate governance issue and tax risk has been the subject of increased attention as part of a good corporate governance approach. The risk management strategy that the board of directors take is a balancing act as reducing one set of risks may have an impact on others. By way of example a board of directors that decides to take a more risk-averse approach to reduce the risks associated with its reputation may be accused of not taking sufficient risk to maximise tax savings.

The Australian Stock Exchange (ASX) formed the Corporate Governance Council (made up of 21 different business, shareholder and industry groups) in August 2002 in response to a call for clear guidelines concerning governance best practice. The business community and particularly the ASX were concerned that significant corporate failures in Australia and the US where financial problems were not identified until after the collapse would result in a loss in confidence in the stock market.

The Corporate Governance Council (the Council”) prepared and published “Principles of Good Corporate Governance and Best Practice Recommendations” in March 2003 in an effort to enhance corporate accountability of listed companies. As stated by the Council “any corporate governance regime needs to be flexible to cope with the constantly changing business environment and as a consequence the 10 core principles listed are principles not rules and each principle equally underlie good corporate governance.” Each of the core principles are supported by best practice recommendations. The Principles of Good Corporate Governance are not mandatory and ASX Listing Rule 4.10.3 requires a company to provide a statement in their annual report as to the extent to which they have complied with the governance principles and to the extent they have not followed the recommendations they must give reasons.

Principle 4 of Good Corporate Governance requires a board to be confident that financial reports present a true and fair view. Accordingly Principle 4 has application to the corporation’s material tax responsibilities in the financial reports and the ability of the board to be confident in those figures would require policies on tax risk oversight and management.

Principle 7 of Good Corporate Governance requires uncertainty and risk to be recognised and managed through effective oversight by the board of directors and internal controls. The board of directors must be aware of material risks, including tax risks in complying Principle 7.

Specifically best practice as recommended by the Council in Principle 7 requires the board of a listed company to recognise and manage risk through;

- Establishing policies on risk

\(^6\) “Corporate governance: Business under scrutiny” A white paper from the Economist Intelligence Unit 2003 page 2
Establishing risk management system
Review effectiveness

Further best practice states that the risk profile of the listed company should be made publicly available, for example through the corporate website, including a description of the risk management policies and internal compliance and control systems.

 Principle 4 and Principle 7 have application to tax risks but are not compulsory and only apply to listed companies under Listing Rule 4.10.3. Listed companies must provide a statement in their annual report in accordance with Listing Rule 4.10.3 disclosing the extent to which they have followed the Corporate Governance Best Practice recommendations and if they have not complied, why not.

After the publication of Principle 4 and 7 in March 2003 by the Council Michael Carmody the Commissioner of Taxation at the time, in a Leader’s Luncheon presentation on 10 June 2003 highlighted tax risk management as part of good corporate governance.

As stated by the Commissioner in that speech:
“Our expectation is that large businesses will ensure appropriate oversight and systems for management and integrity assurance relative to the importance of various tax issues. We expect close management and scrutiny of material issues. A failure to do that can have significant financial consequences for the revenue system, corporations and shareholders.”

Although Principle 4 and 7 applies to listed companies the Commissioner raises tax risk management as part of good corporate governance by all large corporate taxpayers.

Reflecting the theme of greater accountability for corporate decision makers the Australian Parliament passed the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (CLERP 9) which again was a response to corporate collapses in Australia. CLERP 9 focused on audit regulation and the enhancement of the corporate disclosure requirements for listed companies.

Sarbanes-Oxley (SOX) Act of 2002

The Enron collapse in the US in 2001 put corporate governance high on the business and political agenda in the US and one of the responses of the US Federal government was to introduce tough new legislation in the form of the Sarbanes-Oxley (SOX) Act of 2002. The key objective of SOX is shareholder protection through increased regulation of the audit profession, financial disclosure and appropriate corporate governance practices by

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7 Michael Carmody, Commissioner of Taxation “Large Business and Tax Compliance; A Corporate Governance Issue” Leaders’ Luncheon 10 June 2003
public companies listed on the US exchanges. US companies have reported huge costs in complying with SOX.

Most listed US corporations have been affected by Section 404 of the SOX Act that requires an annual report by management regarding internal controls, procedures for financial reporting and an attestation as to the accuracy of the internal control report by the company’s auditors. Any corporation that cannot attest to the effectiveness of internal controls must report the deficiency to its audit committee. The requirements in Section 404 impact on a corporation’s risk management systems including tax risk management, as directors are required to attest to the internal control systems that are in place. Before SOX it appears that accounting for income tax was handled differently to other financial statement amounts in that there was a less formal process and it was often the responsibility of one individual within a corporation.

The failure of the internal control systems within US listed corporations to deal with tax risk before the introduction of SOX is demonstrated in a review of the material weaknesses reported after the application of Section 404…

“In the first year of SOX section 404 internal controls reporting, the tax function accounted for one third of all ‘material weaknesses’ reported by enterprises. In the second year, the percentage of tax related ‘material weaknesses’ increased slightly as external auditors focus further on this previously unconsidered area. In the third year, the trend towards 30% continues”\(^8\).

The impact of SOX has also been felt in Australia, as Australian subsidiaries of US-registered reporting entities are obliged to comply with Section 404 for financial years ending after 15 November 2004. Also Australian entities issuing securities in the US must comply with Section 404 after 15 July 2006 or 2007 depending on the characteristics of the securities issued.

As a result of Section 404 there has been a focus on internal control systems in relation to tax risk and accounting for income taxes because of the formal requirement to report material weaknesses. As previously stated tax was one of the most common areas of internal control failure cited in adverse opinions filed after the introduction of SOX.

The profile of corporate tax has changed since 2002-2003 and is still evolving. Tax can no longer be isolated from other corporate decision-making and review. In the past it was argued that tax was too technical for the business mainstream and so was often left to the tax experts within the corporation with very little monitoring or control by the board.

Quimby and Pearce note that …

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\(^8\) Ibid 4 page 32
“Taxes were a ‘mystery’, often deemed more of an art than a science and a chief financial officer’s comfort over those accounts was probably gained more through dialogue than through review”\(^9\)

Corporate regulation around the world has focused on the need for greater corporate responsibility as demonstrated by SOX in the US, ASX Listing Rules in Australia, the Standard on Risk Management AS/NZS 4360:1999, UK The Combined Code on Corporate governance, provision C.2”.\(^10\) This trend has had an impact on the tax function within a corporation not just because there is a requirement under the law to address risk management, including tax but there has been a behavioural shift in acceptable governance practices around the world. If management does not address tax risks then why not would certainly appear to be the tax authorities response. Shareholders must also evaluate their investment considering the quality of governance practices and any shortcomings could impact on share value. Increasingly stakeholders including shareholders and tax authorities are looking at tax management in their evaluation of a corporation. SOX Section 404, ASX Good Governance Principles, ATO announcements linking governance and tax all mean that in Australia as in the rest of the world a company needs to develop tax risk policies.

No consensus has yet been reached about how companies should apply corporate governance principles to a corporation’s tax function and clearly what approach is appropriate to one company will not necessarily suit another. We have seen in Australia and globally the development and application of tax risk frameworks and tax management processes in large corporations to meet reporting obligations where relevant and to satisfy local tax authorities that tax risk has been addressed by corporate decision makers. The large chartered firms have in recent time targeted tax risk management as an area in which they can provide services to large business.\(^11\)

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\(^9\) Larry Quimby and Joseph Pearce “Lessons Learned From SOX 404” International Tax Review Supplement - Tax management in Companies 2006 Page 1

\(^10\) See also FIN 48 Accounting for Uncertainty in Income taxes, an interpretation of Statement of Financial Accounting Standard No109 (US)

France’s equivalent of SOX “The Financial Safety Act of 1 August 2003

Japan’s equivalent of SOX “The Financial Instruments and Exchange Law”

The European Union’s “8th Company Law Directive on statutory audit”

UK The Combined Code on Corporate Governance, provision C.2; the Turnbull Guidance on Internal Control, paragraphs 25-26 and Appendix on risk and control processes

Varney Report (UK) of December 2006 on the Review of Links with Large Business.

\(^11\) Craig Jackson, Fiona Moore and Timothy Dalton (Ernst and Young) “Managing dealings within the Corporate Tax Group and with the ATO – An External View” Annual Corporate Tax Intensive, Taxation Institute of Australia 26-27 October 2006

Without a doubt the worldwide trend has been towards increased risk management, greater transparency in financial reporting and accountability of corporate decision makers, and these trends have had significant impact on the tax function within a corporation.

**Changing nature of the Tax Management Function**

The tax management function within a large corporation has changed markedly since the 1980’s when the tax function focused on the costs of doing business, specifically cost efficiency and cost minimization. The tax function’s success was based on its ability to reduce costs and to ensure that the company met its tax compliance obligations with the relevant revenue authority.

In the 1990’s the tax function was not only seen as a cost centre but also as a means by which the returns to investors could be improved through effective tax planning. Increasingly performance of tax directors was being measured by their ability to contribute to the bottom line.

Into the 21st century the tax function has a responsibility for cost minimization and efficiency, value added performance and most recently tax risk management. Recent worldwide surveys of large corporations demonstrate that today the tax function must ensure that tax risks are addressed through structured and documented corporate policy.

As highlighted by Ernst and Young in a report detailing results of its worldwide survey of tax directors “2004 Tax Risk Management” …

“The shift in emphasis to tax risk management has become more pronounced such that tax directors are now being measured on it-they are expected to deliver in this area more than in some of the traditional measures such as effective tax rates. This perhaps, more than any other finding in our survey, emphasizes the profound change and expectations companies have for tax directors and the global tax function.”

Evidence suggests that information concerning, a corporation’s taxes is being used by a wide range of stakeholders and as a result there is a need for more information about the taxes a corporation pays. PricewaterhouseCoopers recently carried out a review of the tax reporting of the FTSE 350 as well as meeting with companies and stakeholder groups to discuss their views. The results concerning tax reporting were published in a discussion paper “Tax Transparency Framework- a suggested framework for communicating your

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13 Ernst and Young “Tax Risk Management. The evolving role of tax directors” 2004
12 KPMG Tax Department Survey 2005
12 KPMG Tax Department Survey 2006
13 KPMG “The Rising Tide-Regulation and Stakeholder pressure on tax departments worldwide” 2006
13 Ernst and Young “Tax Risk Management. The evolving role of tax directors”2004 page 6
What is Tax Risk?

The decisions, activities and operations of a corporation give rise to uncertainties or business risks. In a recent global survey by Ernst and Young “Strategic Business Risk: 2008 – The Top 10 Risks for Global Business”, regulatory and compliance risk was ranked first in the list of strategic challenges facing leading global businesses. Tax uncertainties give rise to regulatory and compliance risk and dealing with those risks pose a significant challenge for corporations. Until recently tax risk management and tax internal controls were rarely discussed or written about and the tax department within a corporation tended to operate in isolation from the board of directors. Perhaps this was due to the fact that tax is a specialist area and it was felt that those with tax expertise were most appropriate to make the decisions in relation to taxation. Times have changed and a tax risk management system is required. The board of directors must be involved in establishing a tax risk profile and must also be informed in relation to the tax implications of corporate decisions.

Tax uncertainties create tax risks and managing tax risk is about managing those uncertainties. A narrow view of tax risk would include “uncertain tax positions and vulnerabilities in tax financial controls and reporting”.\(^\text{15}\) In comparison a broader definition and one that reflects the current view on risks includes “any event, action, or inaction in tax strategy, operations, financial reporting, or compliance that adversely affects either the company’s tax or business operations or results in an unanticipated or unacceptable level of monetary, financial statement or reputational exposure”\(^\text{16}\)

PricewaterhouseCoopers in their publication ”Tax Risk Management” outline seven broad categories of risk associated with taxes\(^\text{17}\), of those four are associated with specific risk areas and three are generic risk areas.

**Transactional Risk**

This category includes the risks associated with specific transactions that the company enters into. Any uncertainty in relation to how the income tax legislation will apply to a specific transaction is a transaction risk. Those transactions that a company enters into that are outside the ordinary course of business are likely to have greater tax risks than

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15 Ernst and Young “Tax Risk Management. The evolving role of tax directors” 2004 page 5  
16 ibid 15  
17 PricewaterhouseCoopers “Tax risk management” 2004 -This analysis is not by type of tax and they include all types of tax under tax risk management
the more usual transaction. As highlighted by PricewaterhouseCoopers “the highest risk transactions are often those that are happening specifically for tax purposes”\(^\text{18}\).

Transaction risk would also include the risk of failure to obtain appropriate tax advice with respect to a transaction, the failure to evaluate a transaction against acceptable risk criteria and the failure to properly record, document and implement a transaction.

**Operational Risk**

Operational risk concerns the risks that arise in the application of the tax laws, regulations and determinations to the routine day to day business operations of a company. Different operations will give rise to different levels of tax risk. By way of example it is expected that greater operational risk would exist in relation to purchases and sales in related party transactions compared to third party transactions. PricewaterhouseCoopers view is that the closer the tax function is to the business operations within a company the better these types of risks are managed.

**Compliance Risk**

The risks associated with a company’s ability to meet its tax compliance obligations constitute compliance risks. Tax compliance risk includes the risks arising in the preparation, completion and review of a company’s income tax returns. Any failure in the systems, processes and procedures used by a company in the preparation and submission of its income tax return and in correspondence with the ATO gives rise to compliance risks. The types of systems, processes and procedures that will impact on compliance risk include,

- The integrity of the underlying accounting systems and information
- The procedure whereby tax information is extracted from the accounting system
- Ensuring tax compliance decisions are based on up to date information
- Appropriate use of technology in the process

The level of compliance risk will undoubtedly have cost implications as the more complete and comprehensive the systems, processes and procedures the greater the cost to the business.

**Financial Accounting Risk**

Financial accounting risk relates to the risk that the figures in the accounts may not be correct. An evaluation of this type of risk looks at the processes in place that contribute to the accounts figures and the internal controls around these processes. The figures in the accounts that relate to tax are estimates of the tax payable for the reporting period and deferred tax accounting requires the estimation of taxes to be paid in the future on income included in the accounts in the current year. SOX focuses on the risks in the financial accounting area and Section 404 requires documented and tested internal controls over

\(^{18}\) PricewaterhouseCoopers “Tax Risk Management” 2004 pg 4
financial reporting including the tax figures in the accounts. It is envisaged that SOX will have an impact on the level of acceptable financial accounting risk with respect to tax in the accounts and that tax directors will be more conservative as a result. Arguably as result of SOX a change in the tax governance culture has occurred and is demonstrated in the results of surveys conducted by the accounting profession referred to in this paper.

**Generic Risk Areas**

PricewaterhouseCoopers suggest that in addition to transaction risk, operational risk, compliance risk and financial accounting risk there are also a number of generic risks. Generic risks, PricewaterhouseCoopers suggests includes portfolio risk concerning the overall aggregate level of each type of risk and their interaction. Management risk is included in generic risks and relates to the risk of not properly managing the various risks. Lastly reputational risk concerns the wider impact on the company that may arise from its actions if the general public was to be become aware. For example what would be the impact on a company of being seen to be particularly aggressive in relation to tax planning?

**Australian Taxation Office Targets Tax Risk Management**

The ATO has since March 2003 identified the importance of tax risk management by large corporations and the requirement that directors of a corporation be informed about tax matters particularly the risk approach taken by the company. The ATO has noted that they do not expect all directors to be tax experts but that they must have in place good governance systems to ensure that they are aware and have some input into the risk stance that the corporation takes.

The focus on good governance and tax risk management by the ATO has been on large corporations, that is, those with an annual turnover of around $100 million or more. As at April 2007, according to ATO figures, there are about 36,200 entities that constitute a large corporation, totalling 1,900 corporate groups. Approximately 55% of the large corporate profits are from foreign-owned multi-national enterprises. Further the top 100 corporations contributed 67% of corporate income tax collection, the next 100 companies contributed 9% and the next 400 largest companies contributed 11%.  

In a leaders’ luncheon address on 10 June 2003 the then Australian Commissioner of Taxation, Michael Carmody raised tax compliance as a corporate governance issue. In that speech the Commissioner stated that material tax issues require the attention of the Chief Executive Officers and board of directors and that there is a clear link between tax compliance and good corporate governance. In that speech the Commissioner identified a checklist of what the ATO believed were the questions that a Chief Executive Officer or Company Director should be asking in ensuring that their corporate governance responsibilities are met (see Appendix One for a copy of the checklist). Interestingly a survey of the FTSE350 carried out by Henderson Global Investors in 2005, after

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19 Speech by Michael D’Ascenzo Commissioner of Taxation “Increasing certainty in uncertain times” Deloitte Academy, Melbourne 16 April 2007
discussions with survey participants, suggest a series of questions that all companies should ask themselves as a ‘good practice self-assessment’ on responsible tax. The series of questions identified by Henderson Global Investors, based in the UK are of a similar vein to those suggested by the ATO in 2003.20

At the Leader’s Luncheon on 10 June 2003 the ATO also released a new publication “Large Business and Tax Compliance” and the Commissioner noted that it “marks a further step in the process of exploring the benefits to companies, shareholders, the community and the Tax Office from a more overt link between tax compliance and good governance”21 An updated version of the “Large Business and Tax Compliance: Governance guide for boards and directors” was released in 2006.

In January 2004 the Commissioner sent letters to the chairs of the board of directors of Australian listed companies to provide practical guidance for boards in the management of the tax risks associated with major transactions or arrangements. Attached to the letter was a list of 10 questions that boards and their tax advisors should consider in identifying and managing relevant tax risks. The questions came from the checklist identified in the Commissioner’s speech of 10 June 2003.

The Deputy Commissioner of Taxation Jim Killaly also addressed the importance of good corporate governance practices with respect to taxation in large companies and the requirement that directors be informed about the tax position that the company takes in a speech at the 2nd Australian Taxation Summit in Sydney February 200422. Killaly notes that ….

“In cases that I have recently had cause to review I have been amazed at the extent to which some boards rely on specialist tax advice, whether internal or external, without any independent scrutiny on their part. Directors need to be demonstrating that they are considering what is being put to them in a way that shows that the company took reasonable care and did not act recklessly”23

Killaly went on to state that it was the ATO view that the board of directors are the persons within a corporation who should manage major tax risks and the review of governance practices will be part of ATO risk assessment work in respect of large business.

In December 2004 the ATO released PSLA 2004/14 “Access to corporate board documents on tax compliance risk” in which the ATO policy on accessing the relevant board documents was set out. Although the PSLA highlights the ATO has the legislative power to access most documents the ATO states that access to corporate board documents on tax compliance risk will not be sought during a compliance risk review or

20 “Tax, risk and corporate governance” Henderson Global Investors Findings from a survey of the FTSE350 February 2005
21 Michael Carmody Commissioner of Taxation “Large Business and Tax Compliance a Corporate Governance Issue” Leader’s Luncheon 10 June 2003 Sydney NSW page 10
22 Jim Killaly Deputy Commissioner of Taxation “Recent Developments in Tax Administration” Australian Taxation Summit 9-10 February 2004
23 ibid 22 page 16
an audit except in exceptional circumstances. The ATO then goes on to list what would constitute exceptional circumstances.

The focus on tax risk management is raised by Steve Chapman, Deputy Inspector-General of Taxation at the 3rd Australian Taxation Summit in February 2005 in a speech titled “Regulatory Perspectives on the Tax Compliance Program”. Chapman notes that from his observations that corporation’s attitude to managing tax risks has evolved and the quest for certainty as companies try to minimise risk puts pressure on the ATO resources to respond to taxpayer requests in a timely manner. As Chapman states…

“We are told that corporations are now approaching the Tax Office and highlighting areas of concern and doubt on aspects of their particular activities. These corporations ask the Tax Office to review these areas of concern. Is this taking tax risk management too far? In my view it is not.”

Chapman believes the current more open and less adversarial approach is a good thing and is very much a reflection of the requirement of corporate taxpayers to manage risk and as a consequence large corporate taxpayers have become more risk averse.

In March 2005 the Commissioner of Taxation Michael Carmody again spoke of the role of corporate governance in tax at the Taxation Institute National Convention.

“Since raising the issue I have sought to reinforce and support more conscious tax risk management by writing directly to the Chairmen of Boards of Australian listed companies; by giving boards confidence that tax risk analysis papers prepared for them will remain confidential; and more recently by developing cooperative and time sensitive arrangements for private rulings on issues of concern to boards.”

As an indicator that the focus on tax risk management is having an impact on corporate tax compliance the Commissioner refers to the fact that the growth in company tax collections has outstripped the growth in GDP and “audit results, particularly for large corporates have been healthy.”

The Commissioner also outlined in the speech to the Taxation Institute a Part IVA checklist (see Appendix Two for a copy of the Part IVA checklist) for boards “in assessing the tax risk associated with particular proposals”.

26 ibid 25 page 1
27 See also chart at page 1 in the address by Micheal Carmody, Commissioner of Taxation to the CFO Forum, Sydney Australia, 13 October 2005
28 ibid 25 page 1
29 ibid 25 page 9
The ATO has made it clear that corporate taxpayers who adopt a high-risk profile will be targeted for further investigation…

“The governance issue for large businesses that take an aggressive stance in relation to tax avoidance is that they have to recognise that they are thereby adopting a high risk profile that may have significant financial consequences and adversely impact their reputation. On our side there is a risk to revenue and community confidence if we do not tackle such behaviour”\(^{30}\)

The evidence collected by the ATO on corporate approaches to tax risk management was revealed in a speech by the Commissioner of Taxation, Michael D’Ascenzo to the PricewaterhouseCoopers boardroom dinner in Brisbane 28 June 2006. In that speech Michael D’Ascenzo refers to a KPMG survey that identified 80% of executives from 120 multinationals said that they were “finding it of great or increasing importance to communicate with investors and shareholders about tax matters”\(^{31}\).

The ATO have witnessed a variety of tax risk profiles adopted by large corporate taxpayers. The Commissioner notes that some taxpayers have had open and frank discussions with the ATO concerning their risks and risk profile and two groups (ANZ Bank and BP Australia) have entered into discussions and concluded forward compliance arrangements to manage their tax risks in the future.

Of interest to the ATO is the number of large corporate taxpayers who are seeking private tax rulings to gain clarity on the ATO position in relation to major transactions and there is some concern that this may indicate a need for the ATO to do more to minimise risks for those kinds of taxpayers eg issue more public rulings on common but significant transactions.

The ATO continue to see some groups who are prepared to accept moderate to high levels of risk and in relation to those groups who prefer to adopt the highest level of risk the Commissioner advises… “they can expect a higher degree of scrutiny from the Tax Office”\(^{32}\).

During 2006 the ATO issued information packs (2006 Large Business and Tax Compliance Booklet) to the chairmen of large corporations regarding good governance, tax risk management and compliance and included in that pack was 10 copies of a new one page Tax Governance Guide (a copy of the Key Governance questions is attached at Appendix Three). The Tax Governance Guide contains two checklists very much taken from earlier checklists issued by the ATO concerning tax risk management. The ATO argues that they are designed to assist board members to identify the issues and characteristics that attract the ATO’s attention and potential tax risks.

\(^{30}\) Speech by Jim Killaly, Deputy Commissioner, Large Business and International(Case Leadership) given at the Australian Taxation Summit, 15-17 February 2006, The Grace Hotel Sydney page 4

\(^{31}\) Commissioner of Taxation, Michael D’Ascenzo to the PricewaterhouseCoopers boardroom dinner in Brisbane 28 June 2006 page 1

\(^{32}\) ibid 31 page 2
The ATO held a Large Business Symposium in Sydney in August 2006. The Symposium reflects ATO efforts to foster a more open working relationship with large corporate taxpayers and according to the ATO significant positive feedback was received with respect to the Symposium.

Drawing on the Symposium’s outcomes, in January 2007 the Commissioner of Taxation wrote to the top ASX 200 enclosing a summary of the Large Business and Tax Compliance Booklet. The intention of the letter and summary sent by the Commissioner was “to provide the company board members and directors with some suggested common sense questions which they could use for governance purposes.”

The common sense questions for directors of a large corporation to address as determined by the ATO are as follows:

Is there,

- a sound framework in place to manage its tax risks and comply with its tax obligations?
- a well resourced in-house tax governance capability?
- reporting requirements to ensure that significant tax risks could be elevated to the board level?
- appropriate review and sign off procedures for material transactions?
- an effective tax risk mitigation capability including the company’s relationship with the Tax Office, and
- a capacity to regularly audit tax governance systems?

The Commissioner advised that the feedback from this initiative was generally positive.

Evidence of Tax Risk Management practices in Large Companies Worldwide

As mentioned previously in this paper a sign of the significance of tax risk management is the number of surveys conducted by the large international chartered accounting firms looking at tax risk management practices. Also those same firms who see a market in advising on tax risk management have published a significant amount of material on the topic.

KPMG and Ernst and Young have led the way in collecting information from tax executives concerning the functioning of tax departments within large listed companies.

33 Michael D’Ascenzo, Commissioner of Taxation “Tax risk governance: the corporate and personal dimensions” Australian Institute of Company Directors 18 July 2007 Page 1
34 ibid 33 page 2
35 PricewaterhouseCoopers “Tax Risk Management” 2004
PricewaterhouseCoopers “The ATO and Large Business – the way forward” 2006
Ernst and Young “Tax Risk Management” LexisNexis Butterworths 2007
Ernst and Young “Tax Risk Management. The evolving role of tax directors” 2004
The two KPMG reports “KPMG Tax Department Survey 2005 and 2006” look at major US companies whilst KPMG “The Rising Tide-Regulation and Stakeholder pressure on tax departments worldwide” 2006 surveyed 203 senior tax professionals in the US then in a second stage of the survey used a slightly revised set of questions to survey 550 similar executives in an additional 18 countries across five continents.

The surveys by KPMG indicate that there is increasing pressure on tax departments to manage tax risks within a corporate governance framework. Whilst globally the majority of tax department time is still spent on tax return compliance, respondents indicate that this was not where tax executives believed tax departments could offer most value to the company.37 Worldwide surveys do note differences in activities and focus of tax departments in different countries yet consistently the importance placed on tax risk management by respondents was not reflected in the existence of documented procedures or in the amount of time tax departments devoted to the activity.38

**Ernst and Young’s Global Tax Risk Survey - Australian responses**

During 2006 Ernst and Young conducted a global tax risk survey (the survey) of 474 tax directors and senior financial executives from large corporations from 14 countries including the United States, the United Kingdom, Canada, Germany, Australia and New Zealand. The survey asked tax executives about the tax function within the corporation and was the second of its type carried out by Ernst and Young.39 The first global tax risk survey was conducted in 2004 and indicated significant changes in the tax function of large corporations, particularly the emerging role of tax risk management which was again highlighted in the 2006 survey.

An analysis of Ernst and Young’s Global Tax Risk Survey 2006 was carried out by the Australian arm of Ernst and Young in which they compare and contrast Australian responses to the survey questions with global and US responses and provides a number of insights into the tax function in Australia and around the world.40

This paper focuses on the Australian responses to the survey to obtain a picture of the tax functions in large Australian companies and the impact of recent measures in Australia that have put tax risk on the board of directors agenda.

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37 KPMG “The Rising Tide-Regulation and Stakeholder pressure on tax departments worldwide’ 2006 page 2  
38 ibid 37 page 8  
Survey Methodology

The Ernst and Young Global Tax Risk Survey was carried out in May through July 2006 and independent researchers conducted telephone interviews with tax directors and senior tax decision makers in 474 companies in 14 countries. Ernst and Young’s Quantitative and Economic Statistics Practice analysed the data. Of the 474 respondent executives 26 were from large Australian corporations.

The tax function in large Australian corporations

The Australian survey results in relation to the percentage of time the tax function spent on a variety of activities were as follows:
Routine Compliance 31%
Tax Planning 28%
Tax Financial Reporting 19%
Tax Audits 15%
Other 7%

Based on the survey responses the tax function in a large Australian corporation spends the highest amount, as it did in 2004, of its time (31%) on routine compliance activities. This is consistent with global results.

Interestingly the Australian results show an increase in the percentage of the tax function’s time spent on tax planning being 21.9% in 2004 up to 28.5% in 2006. Globally the percentage of time spent on tax planning fell from 28% in 2004 to 20% in 2006. Ernst and Young suggest that the reduction in the percentage of time spent on tax planning globally (28% to 20%) reflects a shift from tax planning to tax financial reporting (9% to 23%) largely as a consequence of greater reporting obligations on tax department’s worldwide stemming from previous failures in relation to tax financial reporting and the introduction of SOX reporting requirements. The fact that Australian results are inconsistent here may be due to the fact that only a small number of companies in Australia are subject to SOX and ASX reporting requirements are not compulsory.

Despite the fact that tax financial reporting obligations on Australian companies have increased the survey indicates that the tax functions in Australia have been able to continue to address tax planning as part of day-to-day activities. Ernst and Young suggest that the inconsistency of Australian results in this area with global results may be due to the complex and continually changing nature of Australian Federal and State tax legislation…

“This environment requires tax functions to be alert and focused on tax planning and tax technical matters. Furthermore, increased activity within global markets by Australian companies is generating transactions that require greater technical understanding and planning”.

41 ibid 40 page 2
The survey results also reveal a difference in activities and responsibilities of Australian tax departments compared to global tax departments. In Australia 77% of internal tax functions are responsible for national and international tax advice compared to 55% globally (66% in the US). Australian tax functions are responsible for a broader range of tax matters including GST, transfer pricing and foreign corporate income tax returns. Australian results also highlighted significant involvement in tax return preparation and in the supply of taxation data by persons within the corporation but outside the control of the corporation’s tax department.

The identification of greater range of activities and responsibilities in Australian tax departments is significant as it suggests that the tax function in Australia faces greater risks because of this diversity.

**Tax Risk Management Systems**

A majority of respondents said that they would describe their coverage of tax risks as comprehensive. Of Australian tax directors 69% felt that their tax risk coverage was comprehensive which is comparable to the global positive response of 65%. Interestingly the figure was 82% for US tax directors. This may again highlight the impact of the legislative requirements in SOX on a corporation to address and identify risks whilst in Australia the requirement to address tax risk, as part of the financial reporting function, does not receive legislative backing.

Interestingly when respondents were asked whether they had a documented procedure in place for managing tax risk only 46% of companies in the US and Australia reported that that had a documented procedure in place (44% globally). As noted by Ernst and Young in their report on the Australian results…

“The results tend to suggest a divergence between perception and reality. Tax directors perceive that their organisation’s tax risk coverage is comprehensive, but are unable to demonstrate this through a formally defined and documented approach.”

Also of interest is the fact that almost half of respondents in Australia and the US said that they spend less than 5% of their time on identifying, managing, tracking and reporting tax risks to senior management and the board compared to the global response of 32%. There appears a mismatch between the importance placed on tax risk management and the formal systems in place to manage those risks.

Ernst and Young suggest a couple of reasons for the divergence. They argue that perhaps tax directors have a narrow view of what tax risk incorporates. Also that the mismatch between what tax directors believe to be their coverage of tax risk and what is actually documented procedure reflects a culture that does not require tax directors to evidence their work in this area. The impact of such a culture is even greater where the tax director has been with the organisation for a long time and is the only person with a comprehensive knowledge of the organisation’s practices in relation to tax risk.

42 ibid 40 page 5
management. The isolation of knowledge in one individual, without comprehensive written documentation concerning the tax position a corporation takes, creates a risk exposure in itself in the event that person leaves the organization.

Management Evaluation

The measure of performance by management within a corporation has an important role to play in ensuring the managers’ decisions in relation to taxation align with the corporate tax policy.

There has been a shift in the role of tax within a company away from its treatment as business cost to a possible source of increased value to the firm and that shift was reflected in the criteria for tax management performance measurement such as tax rate, cash flow impact, compliance, risk management and success in negotiations with the tax authorities.43

There is evidence that the emphasis on taxation as an important risk area within a corporation in most recent times will have an impact on performance measurement in tax departments within a company as they become more risk averse and greater emphasis is placed on accuracy of compliance as apposed to tax reduction as a contributor to shareholder returns.

The survey asked tax executives what performance measure was most important to their tax department and the results for Australian tax executives were as follows:

Tax risk management in general 22%  
Ensuring tax accounts and disclosures in financial statements are correct 17%  
Success in dealing with tax authorities 13%  
Timeliness of compliance 13%  
Effective tax rate planning 13%  
Effective tax internal controls 8%  
Cash flow impact 5%

The most important measure globally (32%) and in the US (50%) of tax department performance was the extent to which tax accounts and disclosures in financial statements are correct. Australia ranked tax risk management in general (22%) as the most important measure above the extent to which tax accounts and disclosures are correct (17%).

43 Ernst and Young “Tax Risk Management. The evolving role of tax directors” 2004  
Slemrod, J “The Economics of Corporate Tax Selfishness” National Tax Journal 57 No 4 2004 (December): 877-899
Perhaps the reason for the relatively greater importance placed on tax risk management as a measure of performance in Australia derives from the pressure placed on corporate management by the ATO to address this issue as part of a good tax compliance program. This is also reinforced by the importance placed in Australia (13%) on success in dealing with tax authorities compared to 8% globally as a performance measure.

The survey by Ernst and Young highlights a mismatch between the time tax departments in Australia and overseas are spending on tax risk management compared to its importance as a measure of performance. In Australia management of tax risks was the most important measure of tax department performance yet almost 50% (32% globally) of the survey participants spent less than 5% of their time on identifying, managing, tracking and reporting tax risks to senior management and the board of directors. Arguably to be an effective measure of performance it needs to evaluate what tax directors are doing within the tax department. Perhaps it highlights a lack of resources within the tax department so that all the responsibilities can be addressed.

All survey responses in Australia and globally indicate that the importance of tax risk as a measure of performance has increased since 2004. It suggests that the ATO efforts to get large corporations to consider their tax risk profile and ASX reporting requirements have resulted in a change in culture so that a tax departments effectiveness requires the minimisation of tax costs, compliance with the law and it would appear most importantly that tax risk management is addressed.

**Factors that impact on tax risk in a large corporation**

The Ernst and Young survey also gives an insight into the factors that impact on the level of tax risk within a corporation. In both the 2004 and 2006 respondents to the survey highlight external and internal factors having the greatest impact on the tax risks within the corporation.

Key external factors impacting tax risk reported in survey responses include changes in the tax laws, interpretations of the tax law by tax authorities and also interpretations of the corporate governance requirements. Interestingly the impact on tax risk of any change in the interests of stakeholders in a company was “not of great significance but requiring some consideration”\(^{44}\).

The most important internal factor that respondents felt contributed to tax risk was the lack of staff with appropriate knowledge and qualifications within the tax department. The Australian results were generally in line with the global results with the exception that Australian respondents felt that insufficient internal communication was a greater challenge relative to other internal factors.

**Increasingly risk-averse**

\(^{44}\) Ibid 40 page 4
A comparison of the global responses in 2004 to 2006 indicates that tax decision makers are becoming more risk-averse. In 2004 44% of global respondents said their company had become more risk-averse since 2002 then in 2006 54% indicated that they had become more risk-averse since 2004. Interestingly in 2006 only 46% of Australian tax directors said that they had become more risk-averse in the last two years which was lower than the global figure.

Perhaps the trend by tax decision makers in large corporations to become more risk-averse reached its peak in 2006 as 62% in Australia and globally said that they envisaged the organisations attitude to tax planning would stay the same over the next two years. Only 27% in Australia and 34% globally said that they felt the organisation would be more cautious in the next two years. This may indicate that many large companies have addressed tax risk management practices and a smaller number of companies are yet to complete the process.

*Increasing tax function budgets*

The responses in relation to expected tax function budgets indicated that tax directors in both Australia (39%) and globally (40%) expect their budgets to increase. Of Australian respondents 39% expected the tax budget to stay the same compared to 48% globally. Certainly it would be expected that workloads would increase as a result of the requirement to evaluate tax risk and this is reflected in the tax budget expectations of 39% of Australian respondents.

*Review of tax departments within an organisation*

Of the survey participants 26% of Australian respondents reported that internal audit has carried out testing and review of the tax department compared to 37% globally and 48% in the US. Only 17% of Australian respondents have an internal audit program in relation to their tax department that goes beyond specific statutory requirements such as SOX Section 404. It appears that in Australia and globally tax risks are not being comprehensively dealt with as part of the organisation wide risk assessment and this may be due to the lack of tax expertise within internal audit.

Also of note is the fact that 60% of Australian respondents reported that persons within the tax department are involved in the testing and reviewing of tax financial processes and controls. In addition 50% of Australian respondents (67% globally) use third parties and external advisors for the testing and review of tax processes and controls.

Of significance 35% of respondents in Australia and globally did plan to increase the involvement of internal audit in the review of tax processes and controls over the next 12 months

*Communication between the tax department and the board*
Survey responses indicate that on the whole tax directors believe their corporation to have well-established communication channels between the tax department, senior management and the board of directors.

Considering the management, monitoring and communication of tax risk, 88% of Australian respondents felt the communication channels with senior management were effective compared to 90% globally and 95% in the US.

Of Australian survey participants 77% felt that communication between the corporation's tax department and the board of directors was well established compared to 70% globally and 62% in the US. The Australian results may be due to the ATO’s focus in presentations to the business community since 2003 that identify the need for directors to be informed and participate in decision making that affect tax risk. The ATO has been quite prescriptive in setting out a series of tax risk matters that directors should concern themselves with.

Australia and all regions excluding the US reported that the highest level of guidance on how to manage tax risk came from external advisors 27%. Australian responses also demonstrate guidance from senior executives (25%), the audit committee (20%), the board of directors (14%), business units (7%) and other executives (7%). US companies responses indicated that the most guidance came from senior executives at 30% followed by external advisors (27%), other executives (22%), the audit committee (11%), the board of directors (6%) and business units (4%).

All Australian tax directors surveyed stated that they regularly brief and advise C-suite executives on how tax risks are being managed, 78% provide briefings to the audit committee and 52% to the board of directors. These results are consistent with the US and percentages are higher than global responses. In terms of the regularity of briefings 61% of Australian and global respondents stated that these briefings occurred quarterly or less often.

Responsibility for final approval of tax risk policy and procedures

A corporation is a separate legal entity that can sue and be sued yet the business decisions cannot be made by the corporation itself but by its managers. To ensure accountability for the decisions of management in relation to tax risk policy arguably there is a need to identify an individual or group of individuals who are responsible for the final approval of tax risk policy. The survey provides some insight concerning who are the key tax risk policy decision makers within a large corporation. The Chief Financial Officer was identified as the person responsible for final approval by 50% of Australian respondents, the board of directors by 23% and the Director of tax by 12%. The Australian results are consistent with global and US results in which almost half identified the CFO of the organisation as ultimately responsible for final approval of tax risk policy and procedures. The fact that the final approval is generally not made by the Director of tax suggest that management understand that the implications of tax decisions will be felt
across the corporation and the effect on a corporation's reputation of any tax adjustment or aggressive tax policy.

**Barriers to raising the tax risk management profile**

The tax directors were asked to identify any barriers they felt prevented them from raising the profile of tax risk management within the organisation and 61% of Australian and global respondents (48% US) felt that they faced some barriers. Key barriers identified were:

- Time constraints 34% Aus, 34% Global
- Budget constraints 35% Aus, 22% Global
- Lack of visibility at the board or parent entity level 35% Aus, 17% Global
- Corporate culture 26% Aus, 24% Global

The identification of budget constraints and lack of visibility by a larger number of Australian respondents than the global respondents may indicate that the current methods in Australia are too time consuming and perhaps less effective than those used in other jurisdictions. Ernst and Young also suggest that it may be a consequence of a lack of “appropriate formal systems in place to allow for efficient and timely reporting of tax risk management issues”. 45

The fact that only 48% of US respondents felt that there were barriers, may be a consequence of the increased profile of tax risk management in the US as a result of the introduction of SOX.

The Ernst and Young Global Tax Risk Survey 2006 does provide an insight into the role of tax risk management within a large corporation and the results highlight that tax risk management is a fundamental part of a large corporation's risk management program. The survey also highlights the impact on the tax department within a corporation as its resources are stretched.

**Tax Governance practice of a large Australian corporation - Commonwealth Bank of Australia (CBA)**

At the Taxation Institute of Australia Annual Corporate Tax Intensive October 2006 a paper titled “Managing communications and tax risk in a corporate tax group – an internal view” was presented by Chris Millet (Head of Group Tax) and Caroline McKenna from the CBA. The paper gives some insight into how a large Australian corporation such as the CBA addresses tax risk management.

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45 ibid 40 pg 7
Head of Group Tax at CBA believes that the smooth running of tax risk management in a large corporate is the “establishment and maintenance of open channels of communication between the tax function and all stakeholders”.  

Millett and McKenna list the stakeholders relevant to tax risk management as:
- the board
- audit committee
- internal auditors
- the business units your own tax team
- ATO/Treasury
- external auditors
- industry groups

Accordingly Millett and McKenna argue that tax risk management is about the right level of communication with all the stakeholders.

The CBA does have a Group tax policy that is approved by the Managing Director and that policy sets out the “broad fundamental requirements for tax activities conducted within the bank and is centrally managed”.

The CBA has a formal policy as to when group tax approvals are required for certain transactions and all “significant transactions, external acquisitions and new products require Group Taxation sign off”. When CBA purchase a new business, Group Tax is usually involved from the start and a “Tax Due Diligence Manual” is used to ensure all tax issues are addressed.

Millett and McKenna highlight that quite often it is important to clarify what Group Tax and each business unit is responsible for to ensure no misunderstanding and the CBA has created a Transactions Manual documenting each of these responsibilities. Documentation of specific policies is an important part of CBA’s tax governance profile.

**Concluding Remarks**

The global survey results highlight that tax risk management is an important part of the tax department function of a large corporation and that tax risk management is more than the ‘flavour of the month’. The importance of tax risk management is not just as a result of specific legislative obligations such as SOX in the US but as the survey demonstrates large corporations around the world have taken on tax risk management as part of their corporate governance program.

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46 Chris Millett and Caroline McKenna “Managing Communications and tax risk in a corporate tax group – An Internal View Commonwealth Bank of Australia” Annual Corporate Tax Intensive, Taxation Institute of Australia 26-27 October 2006 page 4
47 ibid 46 page 15
48 ibid 46 page 15
There have been pressures on large corporations in Australia to manage tax risk, such as the ATO’s focus on tax risk management and ASX Good Governance Principles yet it could be argued that the survey results demonstrate a change in culture within large corporations with respect to taxation, perhaps corporate social responsibility has a part to play here. Certainly this an area that could be the subject of further research.

The ATO and revenue authorities around the world argue that the management of tax risk by large corporations is part of a good corporate governance program with the expectation that a focus on managing tax risk would improve tax compliance by large corporations. Participants in a recent symposium held by KPMG’s Tax Business School on 6 June 2007 doubted whether improved tax governance would automatically lead to an increase in tax receipts. Attending the symposium were tax professionals from major international companies, the Treasury, the UK HM Revenue and Customs, major universities and personnel from KPMG.49

Arguably the board of directors have a responsibility in the current environment to be informed, with respect to tax matters and have some say in the tax stance that the corporation takes. As a result there is an increased accountability for the tax profile that a large corporation takes. The survey results suggest that large corporations have taken this on board and management performance measures reflect the increased importance of tax risk management. Further it may be that improved tax governance could result in tax savings where procedures introduced as part of a tax risk management strategy result in improved business decision-making.

In addition the pressure on large corporations to put in place a tax risk management system is in some sense transferring back to the corporate taxpayer much of the audit role that the ATO traditionally carried out. The ATO is reducing its workload by focusing on a review of tax risk management systems of corporate taxpayers and the better those systems the less likely the ATO will need to have a closer look.

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49 KPMG “Tax governance and its impact on risk assessment” A report of a symposium held by KPMG’s Tax Business School” 6 June 2007
Appendix One

From Commissioner’s Speech of 10 June 2003

Tax and Corporate Governance

As part of your corporate governance responsibilities as a Chief Executive Officer or Company Director I encourage you to consider the following checklist.

• Are you confident that your records and control systems enable your group to?
  - keep your tax registrations up to date;
  - pay the correct amount of tax without incurring any general interest charge or underpayment penalty; and
  - meet your obligations to supply accurate returns and information when required?

• Are the amounts of tax you are paying and your pattern of tax payments in line with your current and previous business results? If not, can the inconsistency be explained in terms of tax concessions that arise in the ordinary course of your operations? Or are there additional steps that cannot be explained in terms of what is needed to conduct those operations that reduce your tax and produce this inconsistency?

• Is there anything to indicate that your group's business results and tax payments are lower than would be suggested by economic conditions and the performance of others in your sector? If so, are you confident that the processes you have in place to handle transfer pricing are producing a proper allocation of income and expenses in relation to your dealings with offshore associates? Or, if there are other reasons why your group is underperforming, is there a convincing business case?

• If your group is consistently reporting losses, are these real economic losses and can they be satisfactorily explained in terms of the group's overall performance?

• Where your group is undertaking a major transaction, are you confident that the advice you have been given on the tax issues is objective and soundly based? Are the tax outcomes in line with the business outcomes? Has the transaction been properly valued and adequately recorded?

• If the structure for your group's business or a major transaction is complicated, is this because the business issues are complex? Or are there additional steps designed to reduce the taxes that would ordinarily be payable?

• Are you comfortable that your group is making the necessary changes to its processes and giving proper consideration to major transactions in the context of implementing tax reform?

• Your answers to these questions will help you determine whether there are some governance issues associated with your group's tax responsibilities that may require your attention. They will also indicate whether there are potential tax problems within your group that will attract our attention, or that we can be expected to challenge.
Part IVA risk checklist for Boards

In offering this checklist I am assuming that Boards would only be considering arrangements that have some underlying commercial purpose, that is, that we are not dealing with paper schemes.

In this context Boards might like to consider the following questions. They are not designed to determine the application of Part IVA. Rather, consistent with Board roles, they are intended to provoke enquiries that assist Boards in assessing the tax risk associated with particular proposals.

Does the arrangement accord with your view of the sort of arrangements ordinarily used to achieve the particular commercial objective?

Does the arrangement seem more complex than is necessary to achieve the commercial objective?

Are there steps or a series of steps involved in the arrangement that appear to serve no real purpose other than to gain a tax advantage?

Does the tax result appear at odds with the commercial or economic result?

Do you have little or no risk in circumstances where significant commercial risks would normally be expected? Alternatively do you need to eliminate substantial risks that arise because of the steps introduced to secure the tax advantage?

Are the parties to the arrangement operating on non-commercial terms or in a non-arm’s length manner?

Is there a gap between the substance of what is being achieved under the arrangement (or a part of it) and the legal form it is being presented in?

If having weighed up the answers to these questions you feel uneasy you might like to consider getting further advice or applying for a ruling from the Tax Office.
Appendix Three

Tax Governance Guide

Key governance questions - overall tax performance

The following questions are proposed as a means by which directors and senior management may be able to better understand the nature and extent of the tax risks in relation to the overall tax performance of the group and major transactions and strategies.

As chief executive officer, company director or chief financial officer:

1. Are you confident that your records and control systems enable your group to:
   - keep your tax registrations up to date
   - pay the correct amount of tax without overpaying tax
   - or incurring any general interest charge or underpayment penalty
   - meet your obligations to supply accurate returns and information when required, and
   - identify and manage tax risks to your satisfaction?

2. Are the amounts of tax you are paying and your pattern of tax payments in line with your current and previous business results? If not, can the inconsistency be explained in terms of business decisions or the ordinary course of your operations? Or is the tax result associated with a major transaction, and if so, is the shape of the transaction explicable on commercial grounds?

3. Is there anything to indicate that your group’s business results and tax payments are lower than would be suggested by economic conditions and the performance of others in your sector? If so, what are the reasons? For example, are you confident that the processes you have in place to handle transfer pricing are producing a proper allocation of income and expenses in relation to your dealings with offshore associates? Or, if there are other reasons why your group is underperforming, is there a convincing business case?

4. If your group is consistently reporting losses, are these real economic losses and can they be satisfactorily explained in terms of the group’s overall performance? Is there a material difference between the losses reported for accounting purposes and the losses claimed for tax purposes? If so, can the difference be satisfactorily explained?

5. Are you comfortable that your group is making the necessary changes to its processes and giving proper consideration to major transactions and strategies to take account of changes in the tax laws and any tax compliance problem previously identified?
6. Are you aware of any material timing or permanent differences in the group’s tax effect accounting and, if so, are you comfortable with the reasons for those differences?

7. Are there any areas of major disagreement between your group and the Tax Office? If so, are you satisfied with the way they are being handled? Have any additional tax liabilities been adequately provided for?

Key governance questions - major transactions and strategies

In the course of considering a major transaction or strategy in your role as chief executive officer, company director or chief financial officer, ask yourself:

1. What commercial objectives are being sought by the proposed strategy or the ownership and financial structure being proposed for a major transaction? Is there a genuine and material financial benefit for your group apart from any effect on the group’s tax position? Are the tax results at odds with the commercial results?

2. If the structure and financing for your group’s business or a major transaction is complicated, is this because the business issues are complex? Is it more complex than necessary to achieve the commercial objectives? Are there additional steps designed primarily to reduce the taxes that would ordinarily be payable? Is the form of the transaction or strategy consistent with the substance of the arrangement?

3. What level of confidence do you have in the correctness of your advice? For example, is the advice provided on the basis that it is as likely as not to be correct? Is the person giving the tax advice fully acquainted with your group’s business and the purposes of the major transaction or strategy on which the advice was given, or were they asked a more limited set of questions?

4. How likely is it that the Tax Office will take a different view of the application of the law and assess the company accordingly?

It is reasonable to expect that senior decision makers are aware of Tax Office advice that is out in the marketplace through for example public rulings, taxpayer alerts, and compliance programs, even if a different view is adopted. If the contentious issue has wider impact in the market, has it been discussed at consultative forums with the Tax Office? Should the issue be prioritised by these representative bodies as sufficiently important to require a public ruling from the Tax Office?

5. If the Tax Office takes a different view and the matter proceeds to litigation, what is the risk of the Federal Court or the High Court deciding the matter in favour of the Tax Office?
The reality is that not all judges will necessarily come to the same conclusion on a disputed issue. Neither the Tax Office nor taxpayers have a 100% track record in the courts. Matters of evidence may also be critical.

6. What is the potential downside if the company is unsuccessful in litigation with the Tax Office?

Any response to this question would have to take into account interest charges, possible culpability penalties (which will depend generally on whether there is a reasonably arguable case) and the potential application of the anti-avoidance provisions of the tax law (breaches of which generally attract a minimum culpability penalty of 25% of the primary tax and 50% if the group does not have a reasonably arguable case). Clearly, also, unsuccessful litigation almost invariably involves substantial litigation costs and senior management attention.

7. If there is a dispute with the Tax Office, what is the likelihood of the Tax Office being prepared to settle the dispute and, if so, on what terms?

The Tax Office has published guidelines on settlements. If the disputed issue involves a matter of principle which could be of precedent value, we could be expected to take the matter through the courts rather than entering into a settlement.

8. How likely is it that the Tax Office will identify the tax issues arising from the proposed course of action? Allied with that, to what extent will embarking on the proposed course of action increase the tax risk profile of the company and the possibility of audit scrutiny?

Nowadays, in the case of major corporates it is unlikely that many material issues go undetected. This publication details the comprehensive approach the Tax Office has to analysing tax risk profiles and to identifying cases for possible audit.

9. Depending on the potential risk, and your need for certainty, would it be desirable to approach the Tax Office for guidance in the form of a private binding ruling?

How likely is it that a positive private binding ruling could be secured? If it is unlikely, why? If there are time pressures is it possible to arrange with the Tax Office for a ruling to issue within the applicable time constraint? The Tax Office can provide advice on major transactions within tight deadlines. We have publicly stated that we will work with taxpayers to meet commercial deadlines where they are prepared to work cooperatively with us and involve us at the earliest practical time.

On the other hand, you may be comfortable with the level of risk, particularly where you have good grounds to believe that there will not be a tax problem. In these situations, even if you prove to be mistaken, you will generally not be
subject to penalties if you have a reasonably arguable position. In addition the new shortfall and general interest charge remission policy reduces the interest that is applicable to your shortfall.

10. Where a position has been taken on a tax issue, would it be desirable to be upfront with the Tax Office in identifying the issues before or when lodging the tax return or business activity statement and endeavouring to constructively handle any disagreements that may ensue?

The advantage of this approach is that the culpability penalty and interest charge may be avoided if the Tax Office view prevails.

11. Is the advice based on the actual transaction or on an expectation of how the transaction will be implemented?

Tax liabilities will arise from the actual transaction implemented and not any proposed or intended transaction on which taxation advice may have been sought at an earlier point. In such cases consideration will need to be given to the implications of any material changes that occur, or have occurred, in implementing the transaction.

12. Are you satisfied that the factual basis for the tax advice has been properly checked?

The factual basis of a transaction or strategy critically influences the tax consequence. Senior decision makers may feel it prudent in assessing the tax risk to seek assurances on the accuracy of the facts. For example, were they independently verified or were statements of intention or other people’s understanding of the relevant facts relied on? Does the factual basis stated for the transaction or strategy accord with your understanding of the matter? If the advice is based on any assumptions, are they reasonable, and what would happen if they did not eventuate?
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