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Public tax transparency

The value of participating

3. How to implement public tax transparency

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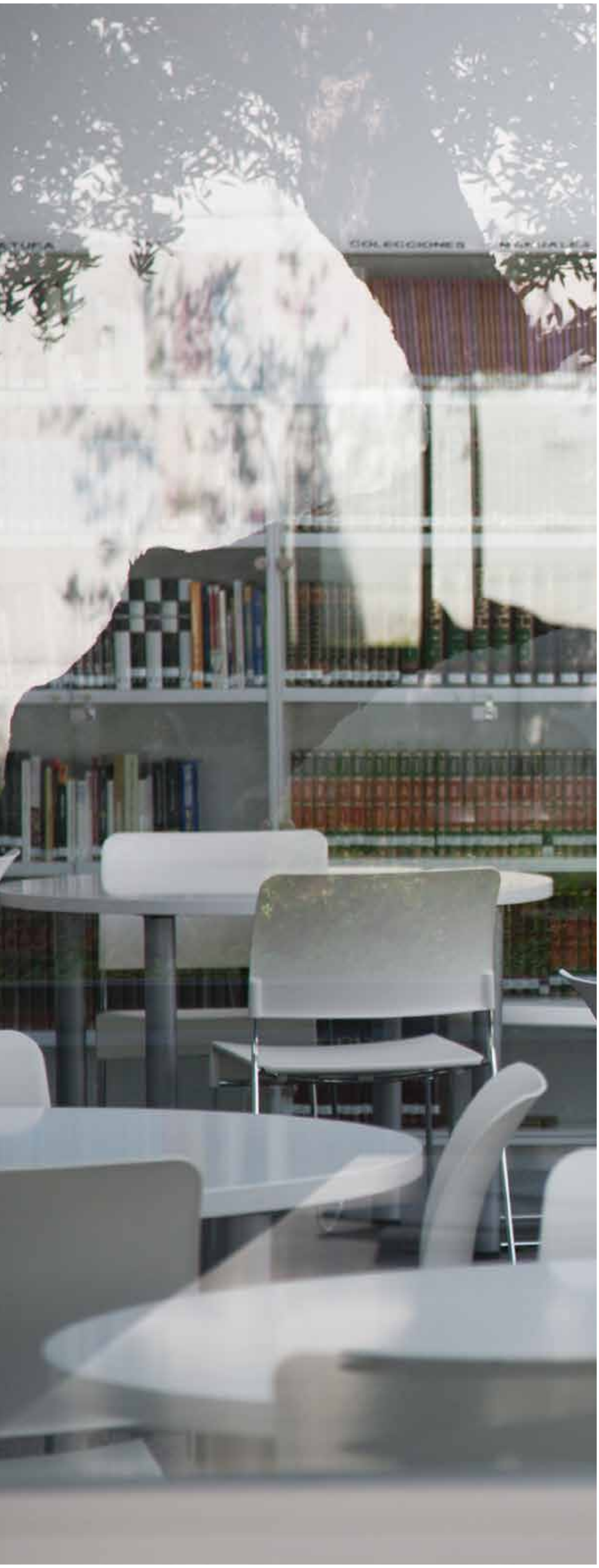

1. Introduction

Strong media and political scrutiny as well as tax administrations in the process of digital transformation have started to shed bright light on the tax affairs of multinational organisations.[1] In the wake of this development towards a more scrutinised world of tax,[2] the role of tax functions will inevitably change. A growing challenge is managing tax-related reputational risks. Public tax transparency could play a significant part in this. In an increasingly transparent tax environment, companies may want to communicate their positive financial impact on the societies they operate in.

That's why we have decided to dedicate a series of four brief papers to public tax transparency. We have defined public tax transparency and described its benefits in the preceding papers in this series. In this third paper, we want to get to the very core of delivering public tax transparency. We will therefore have a close look at the content that could be disclosed and the process of developing a tax transparency report.

[1] For more details, see the first paper in this series 'What is public tax transparency about?'.

[2] For detailed information on this topic, see our other paper regarding the digital transformation of tax administrations and tax functions: 'Tax disruption management', https://www.pwc.ch/en/insights/tax/taxdisruption-management.html [May 2019].

2. What information could be disclosed?

Public tax transparency

- Total Tax Contribution(s) (TTC)
- Country-by-country reporting information
- Tax strategy
- Tax risk and control framework

General remarks

Before getting technical, we want to emphasise that the specific extent of benefits arising from increased public tax transparency depends on the respective profile of an organisation. Some companies are in very different positions than others. Initially, organisations should decide what kind and what amount of disclosures are most appropriate for their circumstances. Tax disclosures should not undermine commercial confidentiality.

Before taking action, every company should assess the value of increased public tax transparency for itself. We suggest that companies decide on their strategic focus by answering questions like the following: Who are my specific stakeholders, and what information do they want to obtain? What am I already obliged to disclose? What additional information can help to tell the whole story, which may not be fully explained by legal disclosure obligations? Where could additional disclosures help to reap the full benefits outlined in the second paper in this series? We acknowledge that, for some companies, this assessment may result in negligible value, making public tax transparency an insufficient business case. For others, however, it may result in public tax transparency becoming an absolute top priority.[3]

We also want to point out that there is a range of different approaches, and one size does not fit all. In the following, we will introduce our view on what options organisations have by starting with quantitative information such as Total Tax Contribution(s) and Country-by-Country Reporting information, followed by qualitative information such as tax strategy as well as tax risk and control framework

Quantitative information

This part of a public tax transparency report focuses mainly on financial, accounting and other tax-related numerical information.

Total Tax Contribution(s)

A good starting point for providing quantitative information is Total Tax Contribution(s). Businesses don't contribute to public finance by way of corporate income taxes alone. Typically, companies make a wide range of payments to the respective governments. For instance, a significant contribution usually comes from social security contributions and payroll taxes borne by the employers (in addition to the taxes withheld by employers, in many countries, on behalf of the employees and paid to the tax authorities).

For over a decade, PwC[4] has been using the Total Tax Contribution (TTC) framework[5] intended to determine the overall amount of taxes paid and collected by an organisation. As a starting point, the framework uses the OECD classification, where tax is defined as compulsory and doesn't result in a return of value for a right or asset used in business payments to federal, state or local government. This includes, for example, amounts paid by an agent and church taxes as well as fines and penalties relating to tax offences. It excludes, for example, payments to non-government bodies such as public enterprises, welfare agencies and trade unions as well as payments for licences and for the right to explore oil, gas or other minerals.[6]

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[3] For detailed information on the potential benefits of public tax transparency, see the second paper in our series, 'Public tax transparency - Is it in your interests to be publicly tax transparent?'.

[4] PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure [May 2019] for further details.

[5] For detailed information, see https://www.pwc.com/gx/en/tax/pdf/the-total-tax-contribution-framework.pdf [May 2019].

[6] For common questions, see 'The Total Tax Contribution Framework – Over a decade of development', p. 13, https://www.pwc.com/gx/en/tax/pdf/the-total-tax-contribution-framework.pdf [May 2019].

Total Tax Contribution(s) details these taxes administered by an organisation during a specific period (e.g. financial year) and splits them in two categories:

- Taxes borne: payments that the company bears itself as a taxable legal entity and that affect its after-tax profit.
- Taxes collected: payments that the company collects from third parties and remits to the government (federal, state or local level). They are pure transit items that do not directly cause financial costs for the company and do not directly affect its results.

Note that some taxes may appear as both (namely, irrecoverable VAT is a tax borne, declared VAT is a tax collected). Total Tax Contribution(s) can be disclosed at a group-wide level. In such cases, we speak of (a single) Total Tax Contribution. Alternatively, it can be split at regional or country level, in which case we speak of (multiple) Total Tax Contributions.

Sometimes, organisations may deviate from the 'average' at first glance by exhibiting unusually low Total Tax Contribution(s). This doesn't need to be harmful per se. However, the company may want to provide additional information to explain the differences that may occur, for example, due to ad-hoc losses in one or more jurisdictions. Additional disclosures should not reveal any important business secrets. Unintentionally disclosing this kind of information bears undesired risks. Accordingly, the Total Tax Contribution framework can be adopted in a way that protects the competitiveness of an organisation.

In the end, disclosing Total Tax Contribution(s) is intended to communicate an organisation's total amount of economic contributions by paying or collecting taxes.

Country-by-Country Reporting information

As an emerging trend, we further observe that companies have started to include additional contextual information. This is often taken from (mandatory) Country-by-Country Reporting (CbCR under OECD BEPS) information submitted to local tax authorities across the globe. This can include financial information by tax jurisdiction such as total revenue, profit before tax, number of employees (headcount or FTE), number of entities or corporate income taxes paid and current-year corporate income tax accrued.

Note that CbCR information, in contrast to Total Tax Contribution(s), is limited to corporate income tax, typically including only payments to national governments and excluding payments to local and state governments in some countries. Therefore, the information content is limited even further.

Additionally, as acknowledged by the OECD in its 'Country-by-Country Reporting: Handbook on effective tax risk assessment'[7], CbCR information is open to a variety of different interpretations. While tax authorities have access to a range of information such as tax returns, master files and local transfer pricing documents, helping them to interpret CbCR disclosures correctly, public readers lack such information.

On the other hand, additional CbCR data can greatly facilitate the understanding of other provided information and help to put it in the right context.

Again, this depends strongly on the profile of the company. One size does not fit all. Organisations need to consider their specific case carefully and evaluate whether additional CbCR information is appropriate and how much further explanation is required to ensure that the data are understood correctly.

Qualitative information

Public tax transparency is not only about disclosing numerical information, but also about explaining an organisation's attitude towards tax strategy and tax risk management.

Tax strategy

Disclosing a tax strategy means describing the guiding principles, objectives and ways in which an organisation manages tax in line with its corporate strategy and business operations. Tax strategies are usually formulated at a global level. They could include topics like the following:

- Description of tax positions taken/function
- Tax governance framework
- Statement of willingness to comply
- Approach to tax planning
- Approach to engagement with tax authorities

Tax functions may want to demonstrate, with evidence, that they follow principles like integrity, consistency and prudence, that they have implemented robust governance and that they operate in an effective and efficient way.

[7] http://www.oecd.org/tax/beps/country-by-country-reporting-handbook-on-effective-tax-risk-assessment.pdf [May 2019].

Tax risk and control framework

This part of the disclosure could cover a more detailed description of a company's approach to tax risks, control frameworks and governance arrangements.

It can state the accepted levels of tax risks and how these levels are defined. It can depict the procedure governing how tax risks are identified, assessed, monitored and mitigated within the company and who is responsible for doing so.

We would propose that it explains how the tax strategy is implemented and demonstrates robust governance by describing particular governance arrangements. Furthermore, it can describe the control frameworks and assurance processes in place, such as internal and external audits, and how these frameworks and processes are evaluated.

Concluding remarks

Keep in mind that tax accounting is a complex area, often very technical and difficult to understand. Typically, disclosures in this field are not intuitively accessible to a non-expert audience. Therefore, it is important to prepare relevant information in such way that it's easily and quickly comprehensible. Complex matters must be presented simply and visually. The targeted readers should be able to understand your statements at first glance. Apparent consistency within a report is also essential. Misunderstanding or misinterpretation of published information is undesirable and must be avoided.

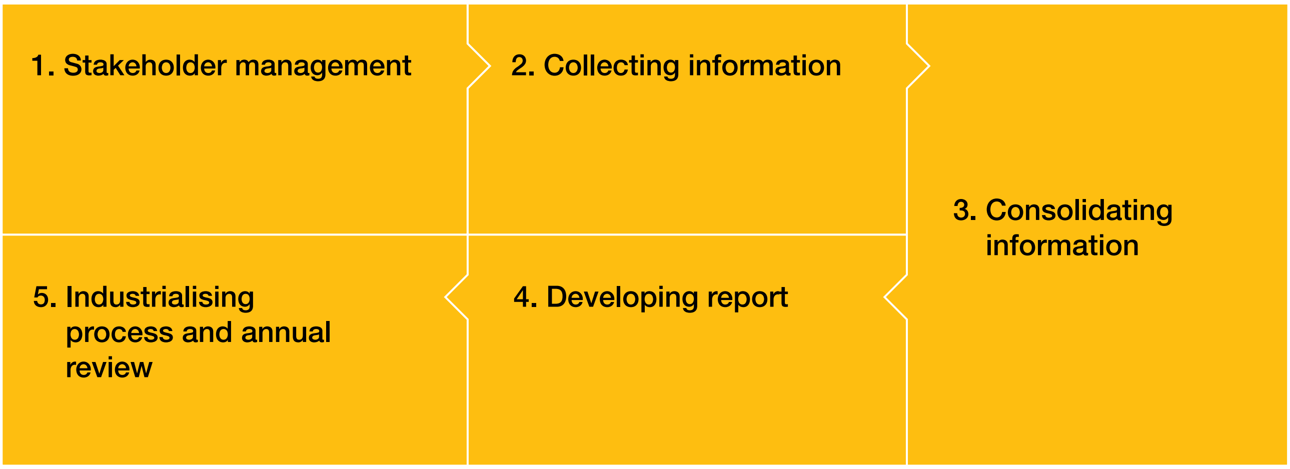
In addition, it may be reasonable to assist readers by providing extra information. For example, organisations may want to illustrate the mechanisms of the tax systems they operate in or comment on specific market conditions which may have had a material effect on the figures presented in the report.

Last but not least, information that links tax to an organisation's environmental, social and governance (ESG) framework or similar sustainability goals could be valuable.

3. How to organise action

Having proposed contents for public tax transparency, we also want to take a deep dive into how to deliver a public tax transparency report.

Compiling such a report is a multi-level task. A systematic approach and thorough planning will help to avoid pitfalls and improve the desired output. We have defined five phases to demonstrate a structured process.



Phase 1: Stakeholder management

As mentioned above, the process starts with the strategic decision as to whether or not to share (more) tax data publicly. This decision strongly depends on how you assess future developments in the realm of tax and the potential benefits of public tax transparency for your organisation's particular profile. Answering questions like 'Who are my specific stakeholders, and what information do they want to obtain? What am I already obliged to disclose? What additional information can help to tell the whole story, which may not be fully explained by legal disclosure obligations?' should support you in taking a decision. Another important factor for this decision may be the attitude of your peers. Comparing yourself against competitors and best-in-class players may help you to position yourself.

If you decide to become publicly tax transparent, communicating with (other) executive team members and (other) board members should be the first thing on your to-do list. Make sure to build a positive attitude and to get widespread support, which helps to dispel potential doubts in this potentially sensitive and important area.

To support these conversations and to have a solid starting point for the next phase, key disclosure messages should already be determined and formulated.

Phase 2: Collecting information

While entering the second phase, you should start to communicate the move towards public tax transparency to local tax teams and get their support. Usually, collecting this kind of information involves a lot of entities and individuals that must deliver the necessary data.

You also want to think about how exactly you will collect the information and how you will categorise it. A well-defined scope and tailored data collection template will help to avoid friction.

Collecting a huge amount of data from many different entities is never completely risk-free. A certain amount of internal, local controls and/or documentation to back up the data can help to mitigate that risk.

Make sure to train local teams on the data requirements and necessary controls in a timely manner.

Phase 3: Consolidating information

Once the data have been collected, it's all about calculations, consistency and getting comfortable with the numbers.

In a first step, the data received from the local tax teams must be cleansed. The figures can then be consolidated and aggregated, and your overall contributions, such as the Total Tax Contribution(s), can be calculated.

Analysing the data for plausibility as well as checking for errors and inconsistencies should ensure the accuracy of the reported data. If available, the data can be compared against prior years to understand significant deviations.

Information consistency is essential, not only within the report. It's crucial to ensure the consistency of information in the published report with the information in non-public (mandatory) disclosures.

Phase 4: Developing report

The main phase of the process should start with reviewing the findings. Define what content elements you want to include in the final report. Agree on an approach to regional/ country level disclosure and CbCR information. Identify or re-evaluate (see Phase 1) the key disclosure messages you want to highlight in the report.

A solid level of consistency in the report through the years is desirable, so some sort of scenario planning should be exercised. This can help in providing executive management with the necessary comfort in different scenarios.

In this phase, we recommend intense interdisciplinary collaboration with other related teams in your organisation, such as Investor Relations, Communications and Sustainability, in order to decide which performance indicators can best meet the objective of the project and confirm alignment with the organisation's other goals, corporate strategy and business operations. It's also necessary to think about packaging (do you want to have an introduction from the CFO, for instance?) and format (number of tables, graphs and diagrams). Good visualisation is critical for breaking down the information and making the report easy to read.

Finally, you should try to detect and avoid potential misunderstandings in the draft report by providing additional explanations and context.

Phase 4 is successfully concluded with the report's publication.

Phase 5: Industrialising process and annual review

As it's common to publish a tax transparency report on an annual basis, it should be good practice to regularly update your reporting approach to take account of emerging market trends and peer performance. Even more importantly, the report should be constantly compared against developments in major guidance and governance frameworks as market practice around the format, content and scope is still evolving.

Ultimately, the goal should be to automate the process of in-house data collection. Standardising and digitalising the reporting format and process will reduce costs, save time, diminish the risk of errors and increase levels of consistency. To make the report a sustainable process, it is important to add as little as possible to the day-to-day work of the local tax teams. Investigating the use of third-party solutions to support digital transformation in this area may be a good idea.

Indeed, initiating digital transformation in this particular field might have a valuable side-effect. It could serve as a door-opener that stimulates the inevitable and soon necessary digital transformation of the whole tax function.[8]

[8] For more information on the 'tax function of the future', see our other paper 'Tax disruption management', https://www.pwc.ch/en/insights/tax/taxdisruption-management.html [May 2019].

4. What should I do now?

Enter phase 1!

Initially, as described above, just decide whether you want to become publicly tax transparent or not by positioning yourself in an increasingly transparent world of tax and assessing the potential benefits of public tax transparency for your organisation's particular profile. As public tax transparency is still very new, being a first mover in this area might give you a competitive edge.

Concluding our series of papers on public tax transparency, we will provide a benchmark study on public tax transparency practices in the fourth paper to give you a better understanding of where the bar is set today and the direction in which business is moving. Stay tuned!

Questions?

If you would like more information on public tax transparency
or wish to discuss the topic, please contact:

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