Tax Research

Tax Reporting Standards

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1. Summary

This paper argues that:

- There is a growing and unsatisfied demand for data on the tax affairs of companies;
- The International Accounting Standards Board (IASB) does not define its obligations in a way that lets it set standards that might meet this demand;
- Since the IASB says that those requiring data that its standards are not designed to meet must look elsewhere for that information it is suggested that the time to create Tax Reporting Standards (TRS) has arrived;
- Tax Reporting Standards are necessary as to be useful accounting data must be:
    - Consistent;
    - Comparable;
    - Comprehensive;
    - Comprehensible;
- Voluntary disclosures cannot meet these expectations: standards to ensure that these expectations are met are, therefore, essential;
- Tax Reporting Standards should cover:
    - Large companies;
    - Smaller companies;
    - Government reporting on taxation;
- This paper only covers large company disclosures and suggests that TRS be issued to cover required disclosure on:
    - Company ownership;
    - Company location;
    - Company management;
    - What each component of the entity does;

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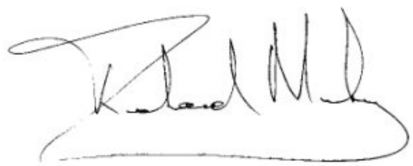
    - The entity's attitude towards tax, risk and lobbying;
    - Country-by-country reporting;
    - Quantifiable tax risk;
- The process by which TRS might be created is suggested.

Comments on the proposals made would be welcome.



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2. Why we need Tax Reporting Standards

a. Background – the rise of the tax justice movement

- Corporate tax risk was on almost no-one's radar in 2002;
- In the decade that followed the work of the Tax Justice Network, and of those who supported their cause, put Google, Amazon and Starbucks (amongst many others) under intense public and political scrutiny;
- The consequence was the OECD Base Erosion and Profit Shifting agenda, which has resulted in the adoption of one of the Tax Justice Network's key ideas and demands - country-by-country reporting - for the purposes of tax reporting from companies to their tax authorities, but not (so far) to the public;
- A momentum for change has been created as a result of civil society pressure and there is no sign that the demand for multinational corporation accountability with regard to tax has been anywhere near sated as yet.

b. The creation of tax risk

- The civil society campaign on corporate tax abuse has emphasised that corporate tax behaviour creates risk for society and investors;
- It has, in part, done so by creating reputational risk for companies;
- This has seemingly encouraged an increasingly aggressive stance from tax authorities keen to play on this issue;

- The result is an increase in tax risk that existing tax reporting does not permit almost anyone to appraise.

c. The asymmetry of data

- Existing tax reporting is widely acknowledged to be too opaque to be of use to those seeking to appraise corporate tax risk;
- Existing tax disclosure is deeply secretive:
    - Tax returns are invariably secret;
    - Accounts are also in many cases secret as well e.g.
        - In the case of tax haven companies;
        - For smaller companies;
- Existing financial reporting standards on tax are weak and produce largely incomprehensible data, especially because reporting of current and deferred taxation is often combined in ways that make meaningful interpretation of current tax liabilities hard to achieve;
- Most of the existing data on tax from multinational companies fails as a result to answer the questions now asked of their affairs;
- Financial markets are as a result of this failure likely to be functioning profoundly inefficiently: the existence of significant asymmetry in the knowledge that exists within and outside companies on the risks that those entities might face might be resulting in material misallocation of capital resources that could impose substantial costs on those engaged in financial markets, on tax revenues and on many aspects of broader society.

d. There is no indication that the IFRS Foundation has any attention of tackling this issue

- The IFRS suggests that[i]:
    - *The primary users of general purpose financial reporting are present and potential investors, lenders and other creditors, who use that information to make decisions about buying, selling or holding equity or debt instruments and providing or settling loans or other forms of credit*
- They say:
    - *The primary users need information about the resources of the entity not only to assess an entity's prospects for future net cash inflows but also how effectively and efficiently management has discharged their responsibilities to use the entity's existing resources (i.e., stewardship).*
- But add:
    - *The IFRS Framework notes that general purpose financial reports cannot provide all the information that users may need to make economic decisions. They will need to consider pertinent information from other sources as well.*
- And then note:

- *The IFRS Framework notes that other parties, including prudential and market regulators, may find general purpose financial reports useful. However, the Board considered that the objectives of general purpose financial reporting and the objectives of financial regulation may not be consistent. Hence, regulators are not considered a primary user and general purpose financial reports are not primarily directed to regulators or other parties.*
- The consequence is that many users of accounts and those seeking to answer questions that do not relate directly to the supply of capital must look elsewhere for the answers they are seeking;
- It is apparent that the IFRS take the view that most of the questions now asked of companies with regard to their tax affairs do fall into the category where answers must be sought elsewhere: they have suggested that the questions raised are political and therefore are beyond the remit of IFRS to answer.

e. On tax there is nowhere else to look for data

- In tat case the time has come to create the data that is now needed to assess the tax risk inherent in companies;
- The only way to do this on a reliable an consistent basis is to create and then enforce Tax Reporting Standards (TRS);
- TRS must be issued by a Tax Reporting Standards Committee that aims to eventually set standards for the world, as have other accounting standard setters.

3. Who has a need to report on tax

a. Tax is at the forefront of political debate for four reasons

- The lack of corporate accountability on tax;
- The lack of government accountability on tax;
- The austerity agenda pursued by many governments that have led people to question whether they are being provided with all the answers they need on the use and abuses of tax;
- Growing awareness of tax gaps[1] in the revenue streams of governments around the world.

[1] A tax gap in this context is the difference between the tax revenues that would be collected by a tax authority if the tax laws of the jurisdiction in which it works operated as it believed its legislature intended and the actual sum recovered from taxpayers by it during a period.

b. The question of accountability is not just a matter of micro-accountability of some taxpayers

- It also embraces government;
- And broader issues of corporate accountability;
- And the tax gap;
- And the need for government to explain what it is doing for the benefit of wider society.

c. As a result Tax Reporting Standards must address:

- Who must report on public record;
- What they must report on public record;
- Why these issues need to be addressed;
- How governments will respond to this demand for accountability by producing data on their budgeting and performance in ways that also impart useful information to those who have need of it.

d. And the need for Tax Reporting Standards falls into two distinct parts:

- The obligations of individuals and entities to report on their tax affairs;
- The obligations of governments to account for taxation;
- Only the first issue is dealt with in this paper. A paper on the obligations of government to account for tax will follow.

4. Why companies and other entities have a duty to report that individuals do not

a. Most individuals create very limited tax risk

- All decisions made with regard to tax, the whole world over, are made by individuals. However whilst some of those decisions are made with regard to their own personal affairs for which they are personally liable for the consequences, the scale of which do, in the vast majority of cases impose relatively limited risk to others such that the case for tax reporting can be dismissed on the grounds of the likely inconsequence of the data to others this is not true when individuals come together to act in concert in certain types of entity whose existence is permitted by law;

b. Some types of entity provide opportunity for tax risk to be leveraged

- The non-governmental entities that provide the opportunity to leverage an individual's actions so that they increase their potential influence over others such that they should be held to account for the consequences of their behaviour are:
    - All limited liability corporations and entities, however they are precisely structured;
    - Trusts, foundations and similar entities that, by definition must be accountable to others because of the separation of ownership and control inherent in them;
    - Charities, for the same reason that trusts and foundations must be accountable;
    - Pension and other mutual investment funds;
    - Large unlimited liability organisations that have intention to influence the action of others or where significant stewardship of funds is involved;
- These entities that have an obligation to report share some or all of these characteristics in common:
    - They are not responsible for their debts in the event that their management fail and as such impose a financial risk on others;
    - There is significance dependence upon them settling their legal obligations, such as paying tax and complying with the requirements of regulatory authorities;
    - They are likely to undertake the stewardship of funds on behalf of others;
    - Their actions are likely to have significant impact on the societies in which they undertake their activities;
    - Their behaviour, as indicated by their compliance with the norms of the societies in which they operate, is likely to influence social change in others whether as individuals or in other organisations;
- As a consequence these entities have a duty to report their behaviour for the benefit of others, whether known or unknown to them, although the scale of the reporting required of them is likely to vary depending upon the impact they are likely to have.

5. What accounts are for

a. An obligation based upon trust

- Accounts recognise the obligation a person or organisation has to others to report on the trust placed in them to act responsibly with regard to the interests of those other people when undertaking their own activities;

b. The duty to supply useful information

- The principle purpose of accounting data is, then, to supply information that others think useful when assessing the activity of the person or organisation undertaking an activity;
- The job of Tax Reporting Standard setters is to work out the range of questions the reasonably anticipatable users of accounts might ask and then seek, as far as possible, to supply the data required to answer those questions.

c. What is useful is decided by the user, not the producer of accounting data

- It is stressed that what is useful or not is an issue that cannot be determined by the reporting entity. That is a decision for users to decide upon. This is why:
    - Users of accounting data must decide what it disclosed i.e. they have the duty to establish what should be included in Tax Reporting Standards;
    - Materiality cannot be determined by reporting entities when it comes to tax. This is because, for example, an entity not paying tax is information of some significance to many users of accounts and yet may be deemed an immaterial issue using conventional accounting logic;
    - Commercial sensitivity cannot be a reason for not reporting tax risk under Tax Reporting Standards: failure to disclose creates unacceptable asymmetric risk for the users of financial statements in such situations;

d. Stewardship

- The process of reporting may, and may not, embrace an account of the stewardship the person or organisation has undertaken for the funds of others entrusted to their use. The duty to act responsibly explicitly extends beyond this stewardship function when it comes to Tax Reporting Standards.

6. Who needs a company's accounts?

a. The IASB has a very clear view on this issue

The IASB says that the principal users of financial statements are:

- Investors;
- Loan creditors;
- Other creditors.

The IASB quite specifically excludes from consideration:

- Other interested parties;
- Including tax authorities and other regulators.

This second opinion may be appropriate given that the IASB has so narrowly defined the users of financial statements. It is believed to be an inappropriate view in the context of Tax Reporting Standards where the range of users is likely to be much broader.

b. Who needs accounts: an alternative view

In 1975, at the very start of the accounting standards era, the UK based Accounting Standards Steering Committee (ASSC) said in its seminal publication, The Corporate Report[ii], that in its opinion the users of accounts were:

- Shareholders;
- Loan creditors;
- Investment advisers;
- Employees;
- Pension funds and their trustees;
- Those trading with the company;
- Government;
- The public.

This paper shares the opinion of the ASSC. Tax Reporting Standards must be designed to meet the needs of these interest groups.

7. What are the questions the users of a company's accounts are likely to ask with regard to tax?

a. Who owns the company?

- This information is needed so that those benefitting from, as well as potentially controlling, the entity can be properly identified;

b. Where is the company and how do we know?

- Incorporation or other details for the controlling entity and all sub-entities disclosing:
    - Place of incorporation;
    - Registered address;

  - Registered number;
  - Main place of trade, or places if in more than one country;
  - Trading names if other than incorporated name;
- This information is need to properly identify the entity so that it might be held to account;

c. Who manages the company

- As whole;
- By sub-entity;
- By jurisdiction;
- This information is needed to properly identify those responsible for both managing the entity and reporting on its behalf: they are the people responsible for complying with Tax Reporting Standards;

d. What the entity and each sub-entity does

- A description of the trade or activities of the entity and each of its sub-entities is required to ensure that the organisation can be sufficiently well understood that the consequences that flow from the operations undertaken can be properly appraised;
- Brevity is unlikely to enhance this understanding: sufficiency of information to ensure comprehension is the goal;

e. What the organisation's attitude to tax is

- Overview:
  - How does the entity interpret its tax obligations e.g.
    - Does it seek minimal compliance with the letter of the law and minimal disclosure to support that aim?
    - Or does it seek to determine the spirit of the law and comply with it, using that understanding to guide its behaviour even when there is no apparent law it must comply with e.g. when acting inter-jurisdictionally?
    - Or find some compromise between these positions?
  - Does the organisation set its managers targets with regard to Expected Tax Rates (ETR) payable?
  - How does the organisation view the use of tax havens?
  - Does the organisation use marketed tax avoidance schemes and arrangements, and not just with regard to taxes due on corporate profits?
- Attitude to risk
  - What is the organisation's attitude to tax risk both generally and within each jurisdiction in which it works?

    - How is that risk appraised?
    - Who is responsible for the appraisal?
    - What is the planned relationship with tax authorities?
- Tax lobbying
    - Does the organisation directly, or indirectly through other organisations of which it is a member, partake in tax lobbying?
    - What sums are allocated to this activity?
    - What outcomes have been sought?
    - What outcomes have been achieved?
    - How have conflicts of interest been managed?
- How are decisions to be made with regard to these issues, how are outcomes appraised and reported, and who is responsible for ensuring that reporting actually happens?

f. The scale of the organisation's activities as a whole and on a country-by-country basis

Country-by-country reporting might fairly be considered to be the subject of the first TRS, although it was not understood to be one when published in 2003[iii]. The following reflect the information expectations it has given rise to:

- A income statement for the entity as a whole and for each jurisdiction in which it trades, with jurisdictional accounts revealing the impact of intra-group activities on the reported result in that place in a way that permits reconciliation with the reported result for the entity as a whole;
- Statements on the destination of sales from a jurisdiction if they differ by more than 10% from the data provided on a source basis in the income statement;
- The tax provided on both a current and deferred basis for the organisation as a whole and by jurisdiction together with tax reconciliations explaining the difference between anticipated tax due at the local tax rate and that actually payable for the period, with the reconciliation being to the current tax charge in the first instance and to the deferred tax provision for the period thereafter;
- The tax on corporate profits actually paid in each jurisdiction during a period;
- The Actual Tax Rate (ATR) payable for a jurisdiction for a period compared to the ETR and an explanation for the difference;
- A cash tax reconciliation for the period demonstrating that the opening tax liability for the period can be reconciled with the closing tax liability, with cross reference to and explanation for all reconciling items being required to an appropriate disclosure in the financial statements;
- The deferred tax position of the organisation as a whole and by jurisdiction with an explanation as to why such positions arise and a statement as to when and in what amounts they might result in cash assets or liabilities;
- Data on employees engaged by jurisdiction and remuneration paid;

- Data on assets employed in a jurisdiction split, between tangible and intangible assets.

g. The tax risks that the organisation faces as a result of the activities it undertakes

- What are the actual major tax risks that the organisation faces?
  - To be split between risk arising on taxes due in corporate profits
  - And other taxes
- What are the financial uncertainties that arise as a result of these risks?
- What are the sums involved and the degree of uncertainty attaching to them?
- Over how many years are the risks outstanding?
- What proportion of the potential risk has been provided for in the financial statements?

h. In summary

- Is the right amount of tax paid in the right place, at the right rate and at the right time where 'right' means that the form in which the transactions are reported for tax purposes matches the substance that they have in the jurisdictions in which their economic impact arises?
- If not, why not?
- With the overall logic of 'pay or explain'.

8. The obligation of smaller companies

- The tax risk created by smaller companies is likely to be less than that of larger entities and reduced disclosure may be permitted as a consequence;
- The control environment of smaller companies is usually simpler than that of larger companies and the policy disclosures required would be simpler as a consequence;
- When full disclosure of profit and loss accounts is not required of SMEs it may be possible to permit data on tax disclosure to fulfill Tax Reporting Standard obligations to be made on a percentage basis rather than in absolute financial terms;
- Detailed consideration of these issues is not offered in this document and will be addressed later.

9. The nature of accounting standards and why Tax Reporting Standards are necessary

a. To be useful accounting data has to be

- Consistent;
- Comparable;

- Comprehensive;
- Comprehensible;

b. To be useful these qualities must exist:

- Over time within one organisation;
- Between organisations;

c. To provide useful accounting disclosure with regard to tax standards are, therefore, required.

If such standards are not set these consequences follow:

- Reported data may be incomplete
- Reported data may not meet user expectations
- Those reporting may themselves being asked for additional data that may impose unanticipated burdens or costs upon them, with risk of adverse assessment if not complied with.

10. Who might set Tax Reporting Standards

a. A new body is required

- The IFRS Foundation clearly do not wish to undertake the task;
- The tax profession has a low standing with regard to public trust and cannot be solely responsible for the task;
- The standards cannot be set by the producers of information since they are required to meet the needs of the users of financial statements;
- A new multi-disciplinary body is, therefore, required to create and promise the use of Tax Reporting Standards;

b. The likely composition of the membership of the Tax Reporting Standards Committee

- A minority from amongst:
  - The companies producing financial statements;
  - The professional bodies of accountants, lawyers and others responsible for taxation related issues;
- A majority from amongst:
  - Investors;
  - Asset managers;
  - Employee representatives and trade unions;

    - Consumer organisations;
    - The smaller business community;
    - NGOs, CSOs and others with a track record of using financial data or with an interest in taxation issues;
    - Pension trustees;
- With observers from:
    - Governments;
    - The EU;
    - Tax authorities.

11.How the process might work

- The process for setting accounting standards is well established;
- Proposed standards are issued as exposure drafts for discussion with an invitation to comment;
- Final standards are then promulgated after consultation is complete.

12.What the standards might cover

a. Tax Reporting Standards will be of two types:

- Disclosure standards;
- Data standards;

b. Disclosure standards will address:

- Basic company data;
- Taxation policies;
- Governance issues;

c. Data standards:

- Cover the financial and other variable data requiring disclosure to meet users need for information on an annual basis;

d. The standards would:

- Seek to meet the information needs of the users of company financial statements already identified in this paper;
- Be issued so that each proposed standard covered elements of the disclosure required to meet user need. This:

- will assist the process of their production;
- permit partial adoption by those reporting using the standards as compliance with their requirements develops.

13. How the standards might be enforced

- In the first instance compliance with Tax Reporting Standards might be voluntary and those making disclosure would be encouraged to disclose which Standards they have complied with;
- As familiarity with the standards becomes more commonplace it would be expected that those companies making use of them would:
  - Adopt them as a whole;
  - Incorporate the disclosure into their annual financial statements;
  - Have the disclosure audited.

14. Next steps

- If this matter is to progress then:
  - Those interested in participating in the development of Tax Reporting Standards need to volunteer to take part to establish a provisional committee to start the project;
  - Funding will be required;
  - Publicity surrounding the project will need to be attracted to secure national and international support;
  - A Tax Reporting Standards Committee will need to be appointed;
  - The Standard setting process would need to commence.

15. Tax Reporting Standards for Governments

- This issue is not addressed here but is of at least as much significance as the issues noted above. A separate paper will follow.

16. About the author

Richard Murphy is a UK chartered accountant and political economist. He was senior partner of a practicing firm and director of a number of entrepreneurial companies before becoming one of the founders of the Tax Justice Network in 2002. He now directs Tax Research UK and writes, broadcasts and blogs extensively, the latter at http://www.taxresearch.org.uk/Blog/

Richard was appointed as Professor of Practice in International Political Economy at City University in September 2015.

During the summer of 2015 he was widely credited with creating 'Corbynomics' and is the creator of the idea now known as People's Quantitative Easing.

Richard's latest book is 'The Joy of Tax' (Bantam, October 2015).

Richard created the country-by-country reporting concept and has been credited with creating much of the debate on tax gaps in the UK and Europe. He also defined the term 'secrecy jurisdictions', now widely used in debates on offshore. He has been involved in many of the stories on corporate tax abuse that have made headlines in recent years.

Richard developed the idea of the Fair Tax Mark and is technical director of that accreditation scheme.

Richard is joint author of 'Tax Havens, The True Story of Globalisation', Cornell University Press 2010 and sole author of 'The Courageous State', Searching Finance, 2011.

In 2012 the Association of International Accountants gave Richard their award for an outstanding contribution to the accountancy profession. He was named the seventh most influential person in international tax by the International Tax Review in 2013. In 2015 the Sheila McKechnie Foundation named him as their Economic Justice Campaigner of the Year.

17.Endnotes

[i] http://www.iasplus.com/en/standards/other/framework

[ii] http://www.ion.icaew.com/ClientFiles/6f45ef7e-1eff-41ff-909e-24eeb6e9ed15//The%20Corporate%20Report2.pdf

[iii] http://visar.csustan.edu/aaba/ProposedAccstd.pdf