EY Center for Board Matters

Three important tax developments for boards

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Corporate tax matters are increasingly in the headlines. Today's boards are facing new challenges due to changes in tax policy, and directors need to be familiar with the risks associated with their company's tax strategy.

Driven by budget deficits and economic uncertainties, governments are looking for ways to increase revenue, and many are taking a closer look at the taxes companies pay. The European Commission (EC) is questioning individual EU governments on tax arrangements, and Organisation for Economic Co-operation and Development (OECD) member countries and others have instituted, or will be instituting soon, unprecedented information sharing of tax data across countries. Moreover, tax authorities are turning to digital methods to improve tax compliance and to identify tax compliance risks. This heightened scrutiny brings new challenges and risks to companies and their boards.

To help boards stay informed of emerging tax developments, the EY Center for Board Matters provides an overview of three tax topics in the spotlight.

1. EC "state aid" investigations

What's going on?

Multinationals operating in the EU need to pay close attention to developments in the ongoing EC investigations into "state aid." State aid is aid from an EU Member State that gives the receiving company, industry or regional group of companies a selective advantage that is capable of distorting trade between EU Member States. Restrictions on state aid apply to arrangements such as (1) tax rulings given by EU Member States to companies; (2) transfer pricing agreements between EU Member States and companies; and (3) direct incentives.

In 2014, the EC launched a series of highly publicized investigations into the tax rulings of several EU countries, asserting that those tax rulings were prohibited state aid. As a result of those investigations, the EC determined in recent months that certain countries granted state aid to certain companies by means of those tax rulings. These determinations have created uncertainty about the future of commonly used multinational corporate structures and practices.

What do boards need to know?

The EC's determination may force the affected countries to recover the alleged advantages from the companies involved through the collection of additional tax amounts, and may have implications for financial statement reporting obligations.

Multinationals with a tax ruling with an EU country should assess potential exposure under the principles espoused by the EC, though this assessment is inherently challenging, because the principles have not been fully laid out at this point. The US government has asked the EC to reconsider its rulings, but reconsideration appears unlikely.

Questions for the board to consider

- Does the company have a presence in any of the countries currently under state aid investigation?
- Does the company have a ruling that is the same as or similar to the rulings under investigation?
- If so, has the company considered the financial or reputational impact of an unfavorable decision by the EC?

> Corporate tax strategies are under increasing scrutiny, and boards must understand potential risk areas or risk losing stakeholder trust.

2. Country-by-country (CbC) reporting requirements of the OECD Base Erosion and Profit Shifting (BEPS) project

What's going on?

Under the new CbC reporting requirements, multinationals must provide tax authorities with high-level information regarding the global and local distribution of the multinational's revenue, profits, income taxes paid and employees — and that information may be shared with other jurisdictions[1] in which the company operates.

What do boards need to know?

Reporting requirements may vary by country. Noncompliance could expose a company to penalties and lead to a loss of stakeholder trust. In addition, companies should consider the potential for corporate reputational risk if the information were to become public. The information to be reported may be difficult to assemble and could be misinterpreted by the public if taken out of context, so boards need to consider how their companies will respond to these new disclosure requirements and how they might answer any stakeholder questions.

US CbC regulations are expected to be finalized in 2016. Once the regulations are finalized, affected companies generally will be required to file a CbC report with tax returns covering subsequent tax years. Thus, for calendar-year taxpayers, US CbC reporting would generally apply for the 2017 tax year assuming that the regulations are finalized in 2016.

Some countries have already taken steps to require CbC reporting for the 2016 tax year, and the EC has released a draft directive that would require CbC reporting in certain cases for fiscal years starting on or after January 1, 2016.

US multinationals with subsidiaries in countries where CbC reporting is required for 2016 should be aware that tax authorities in those countries may seek the parent corporation's CbC report from the local country subsidiary, whether or not the parent corporation's home jurisdiction requires reporting for 2016.

In addition, on April 12, 2016, the EC published a draft directive on CbC reporting that, if adopted, would amend existing EU law on disclosure of income tax information. It would require certain large multinational companies to disclose publicly, on the company's website and on an official register in the EU, specific information including a breakdown of profits, revenues, taxes and employees. This initiative is separate from the OECD BEPS action on CbC reporting. It is also different from the EC proposed directive noted above, which would require more detailed

information that would be shared among tax authorities and would not be made public. This latest EC proposal may be adopted with the support of only a qualified majority (in practice, 16 of the 28 member states). After adoption, all EU member states would have to enact conforming legislation. The level of support for this action is unclear, although the recently released UK budget indicates support for public disclosure.

Questions for the board to consider

- Is management addressing the varying timelines and requirements related to the CbC reporting initiatives?
- Is the company's tax function working with the treasury, accounting and IT functions so all key internal stakeholders that will be involved in reporting are aligned?
- If there is no requirement to file in the US for 2016, is there an applicable requirement to file in another jurisdiction for the 2016 tax year?
- Is there a plan in place to handle potential controversies that may arise as a result of the new reporting requirements and the additional transparency involved, including potential public disclosure?

3. Tax digitization

What's going on?

Tax authorities are increasingly relying on digital tax data gathering and analysis to facilitate real-time or near-real-time collection and assessment of taxpayer data, which can bring greater scrutiny and new challenges to companies and boards. In addition, authorities are using data analytics to respond more quickly and in more targeted ways to address perceived compliance risks — and increasingly using data analytics to help focus these efforts.

What do boards need to know?

Digitization is accelerating the timing and frequency of tax reporting. Legacy systems and processes may not be able to support these requirements, exposing businesses to increased risks, costs and compliance challenges. Digitization is also changing filing obligations, and tax authorities are asking companies to disclose information that reaches beyond tax forms and often includes accounting and sales data.

As tax authorities move at varying speeds toward greater digitization of tax information, businesses need to develop a detailed understanding of digital tax requirements in their markets. In the Americas, some countries (particularly Mexico and Brazil) are leading the digital revolution, while other countries, such as the US, are slower to embrace digitization. Elsewhere, countries such as Russia and the UK are leading the charge, working closely with a group of countries that includes Singapore, Australia and South Africa.

Questions for the board to consider

- Is the company's tax function able to meet digital data and filing obligations in its operating jurisdictions?
- Is the company ready to run and review data analytics every time it submits data to ensure accuracy and predict questions for tax authorities? Is the company prepared to defend tax audits in real or near-real time?
- What investment may be needed to respond to the increasing demand for digital tax information?
- How will the company address the risks inherent in the expansion of electronic data submission?

Key takeaway for the board — the bottom line

Corporate tax strategies are under increasing scrutiny from all stakeholders, making it critical that boards understand potential risk areas. Boards that engage frequently with their tax function are better positioned to ask the right questions, make better long-term business decisions, and communicate with investors and the public about the company's tax position.

Endnotes

1 Information-sharing requirements are based on applicable legal agreements such as treaties.

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