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WALK THE LINE

Tax planning is undoubtedly a treasury issue. Taxes can have a significant impact on cash flow, firm value and reputation. For this reason, tax is an essential part of the ACT's qualifications and assessments. Doug Williamson explains

In a global business it can be easy to pay full tax to several governments on the same income. In order to maximise shareholder wealth, companies, and particularly groups of companies, need to use legitimate tax-planning strategies to avoid paying more tax than they need to pay, or than anyone would expect them to pay.

However, increased criticism of some tax-planning practices underscores the importance of all treasurers knowing enough about tax, in order to find balanced solutions and safeguard the company's reputation.

Reputation is part of value

Commercial firms have a duty to maximise firm value. The firm's reputation contributes to the value. Today, corporate social responsibility (CSR), including paying what is seen to be a fair share of taxes in relevant jurisdictions, is part of that.

Balancing act

In the short term, there may be a perceived divergence of value and CSR considerations. This can lead to conflict between a business and government. There may be a tax reputational risk that ultimately translates into a loss of value for the shareholders.

Come and work here

At the same time, host governments compete with each other to attract inward investment through their national tax policies.

Fair play

It is a well-established principle in tax law that taxpayers are not required to pay the maximum amount of tax possible, and indeed they may legitimately organise their affairs to reduce tax leakage. However, the techniques employed to achieve such tax mitigation are being increasingly closely scrutinised and, particularly if too complex, criticised.

> The hearings we held showed that international companies are able to exploit national and international tax structures to minimise corporation tax on the economic activity they conduct in the UK. The outcome is that they do not pay their fair share.
>
> *UK Public Accounts Committee 2012*

The treasurer must be familiar with the developing concepts and arguments around tax planning, and needs technical knowledge, integrity and business acumen to identify an appropriately balanced response.

Commercial rationale

Good tax planning at its basic level means ensuring that all tax reliefs and claims to which an organisation is entitled are properly made. It can also include structuring commercial transactions so that the tax burden is minimised.

Financially sustainable businesses aim to manage their tax affairs legitimately, with appropriate commercial substance and alignment with their operational objectives. In all cases, the treasurer must be fully aware of the underlying commercial rationale.

Tax residence in the spotlight

Tax is an important part of the ACT's qualifications. For example, a recent assessment question asked about tax residence and tax-planning strategies.

Double fault?

A number of international companies have come under the public spotlight for their taxation strategies that exploit gaps between the tax rules in the different countries in which they operate. These strategies in part focus on the residency rules set out in double tax treaties.

Required:

Briefly state the tax residency rules set out by the OECD and explain how some companies have used these rules to reduce their overall tax liabilities.

CertFin, Corporate Tax, October 2014, Q6 (extracts)

The Examiner reported that this topical tax question was poorly answered: "The results from this question suggest that the majority of candidates chose not to study this part of the course."

The rest of this article sets out a framework for answering these elements of the question. The detail of the response you need to write will of course vary, depending on the level of the qualification you're studying for.

Answer framework

Tax residence

Residence (or non-residence) in a country is important, because local tax authorities typically levy much heavier tax burdens on taxpayers resident within their own jurisdiction.

Multinational businesses can often take advantage of variations in the tax rules in the different countries in which they operate. Companies with operations in a number of countries may therefore be resident in more than one tax jurisdiction, under the respective laws of each country.

OECD tie-breaker

The Organisation for Economic Co-operation and Development (OECD) Model Tax Convention contains a 'tie-breaker' clause that determines a company's residence for tax purposes. This is where effective management and control of the company takes place.

Encouraging trade

Many countries have entered into international tax agreements, based on the OECD Convention, known as 'double tax treaties'. These treaties aim to eliminate double taxation and thereby help to encourage cross-border trade.

Over the line?

International companies have been criticised for exploiting tax residency rules to reduce their overall tax bills, by following the double tax treaty rules to become resident in low-tax countries, and then artificially shifting profits to these low-tax jurisdictions. The Group of Twenty (G20) countries have proposed international action to eliminate this practice.

Intervention

International proposals to eliminate artificial profit shifting are set out in the *Action Plan on Base Erosion and Profit Shifting* 2013, published by the OECD and endorsed by the G20.

The OECD reported:

(1) Fundamental changes are needed to effectively prevent double non-taxation, as well as cases of no or low taxation, associated with practices that artificially segregate taxable income from the activities that generate it.

(2) A realignment of taxation and relevant substance is needed to restore the intended effects and benefits of international standards, which may not have kept pace with changing business models and technological developments.

(3) Multinational enterprises may face significant reputational risk if their effective tax rate is viewed as being too low.

In simple terms, the OECD and the G20 are seeking to neutralise the perceived adverse effects of over-aggressive tax planning.

A game of doubles

Tax and treasury professionals share the challenges and opportunities resulting from very rapid changes in technology, regulation and markets and, in the case of tax, political pressures and related legislation.

...it seems likely that many countries will continue to pursue a domestic agenda of increasing tax revenues from the financial transactions of multinational companies. Treasurers should monitor developments, and be prepared to restructure their operations, in a way that can still support the business, where this is made necessary by the changes afoot.

The Treasurer, *October 2014, page 33*

As you step up to senior treasury roles, you will have tax responsibilities and tax specialists reporting to you. Excellent tax awareness is essential for you to serve in these high-level roles.

With many thanks to John Grout for his valued input and advice on this article.

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